

# Why Aren't Private Label Goods Catching On in Russia?

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Several years ago, experts heralded the triumphant march of private label items into the retail sector. Unfortunately, the development of this area did not live up to experts' optimistic expectations. Why?

- Private label goods make up 3 percent of the Russian retail market.
- A retail chain must have a minimum of 50 stores to make the release of private label goods economically feasible.
- Private label products can save manufacturers 10 to 35 percent. Everything produced is sold through stores or wholesale traders, meaning that manufacturers do not need to invest in brand promotion, distribution or logistics.
- 30 percent of Russian consumers believe that private label goods are cheaper than the branded equivalents.

Private label goods and services are a growing source of income for retail chains and have resulted in the emergence of specialized producers. Private label goods make up 10 to 15 percent of the total sales of retail chains depending on the type of store. Sales of these products are on the up, thanks to the range of benefits they offer. According to research conducted by the FMCG retail chain, the profit margin of private label products is at least twice that of the branded equivalents.

The elimination of promotion and distribution costs normally associated with branded products allows manufacturers to save an additional 20 to 40 percent on expenses. Despite the desire of retailers to increase the amount of private label goods sold, there is a range of constraints associated with placing orders with manufacturers. As a general rule, retail chains order private label goods from manufacturers that produce their own brand goods. Therefore, producers only tend to accept orders from national chains (Magnit, X5, etc.). This creates a barrier to entry for regional retail chains because manufacturers are less prepared

to accept smaller-scale orders. If they do accept such orders, the production cost tends to be higher than for national chains.

Sales of private label goods can constitute 35 percent of the total revenue of retail chains in the United States and Europe, and these chains are intent on increasing their range of own brand products to improve overall profitability. The creation of a number of specialized manufacturers focused on producing orders for retail chains stimulated the growth of private label sales in developed countries. These specialized production facilities help both national and regional chains fulfill their orders. At the same time, long-term contracts with retailers guarantee the future of these specialized manufacturers. Private label manufacturers compete by investing in improving the quality of their products while saving money on marketing expenses.

There are currently no manufacturers in Russia dedicated to the production of private label goods. Meanwhile, industrial heavyweights producing branded goods remain skeptical about producing private label goods, regarding them simply as a means for retailers to boost their profit margins at the expense of manufacturers. Own-brand products are significantly cheaper than their branded equivalents and end up being in direct competition. But manufacturers are often obliged to accept such orders in the interests of maintaining good relations with national chains. Private label goods provide a much-needed lifeline for regional chains to stay afloat, whereas large retailers can be wary about the quality of such goods, and may be reluctant to sell them, which leads to a vicious circle.

The lack of manufacturers dedicated to producing high-quality private label goods has been a longstanding problem in Russia, but there has been recent progress in this area. We have been asked to develop business plans for the production of FMCG products on a number of occasions. These enterprises intend to launch production of private label goods in both regional and national chains. Investments in such projects would help private label items take root in Russia.

According to FCG estimates, the private label production industry is still in its infancy in Russia, but the development of this sphere would offer a range of benefits to both retail chains and manufacturers alike. It's also worth mentioning, that own-brand products are an effective means of attracting investors during an initial public offering. Retail monopolies understand this and have started investing in private label development.

It's not unreasonable that retail chains may want to start production of specialized goods to sell under their own brand, in the interests of increasing profitability at each stage of production. Retail chains are only likely to be prepared to invest in production following successful cooperation with several own-brand manufacturers. Small regional retailers are not capable of competing with national retailers, but they do have the opportunity to up their profitability by releasing their own private label goods with the help of specialized manufacturers.

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