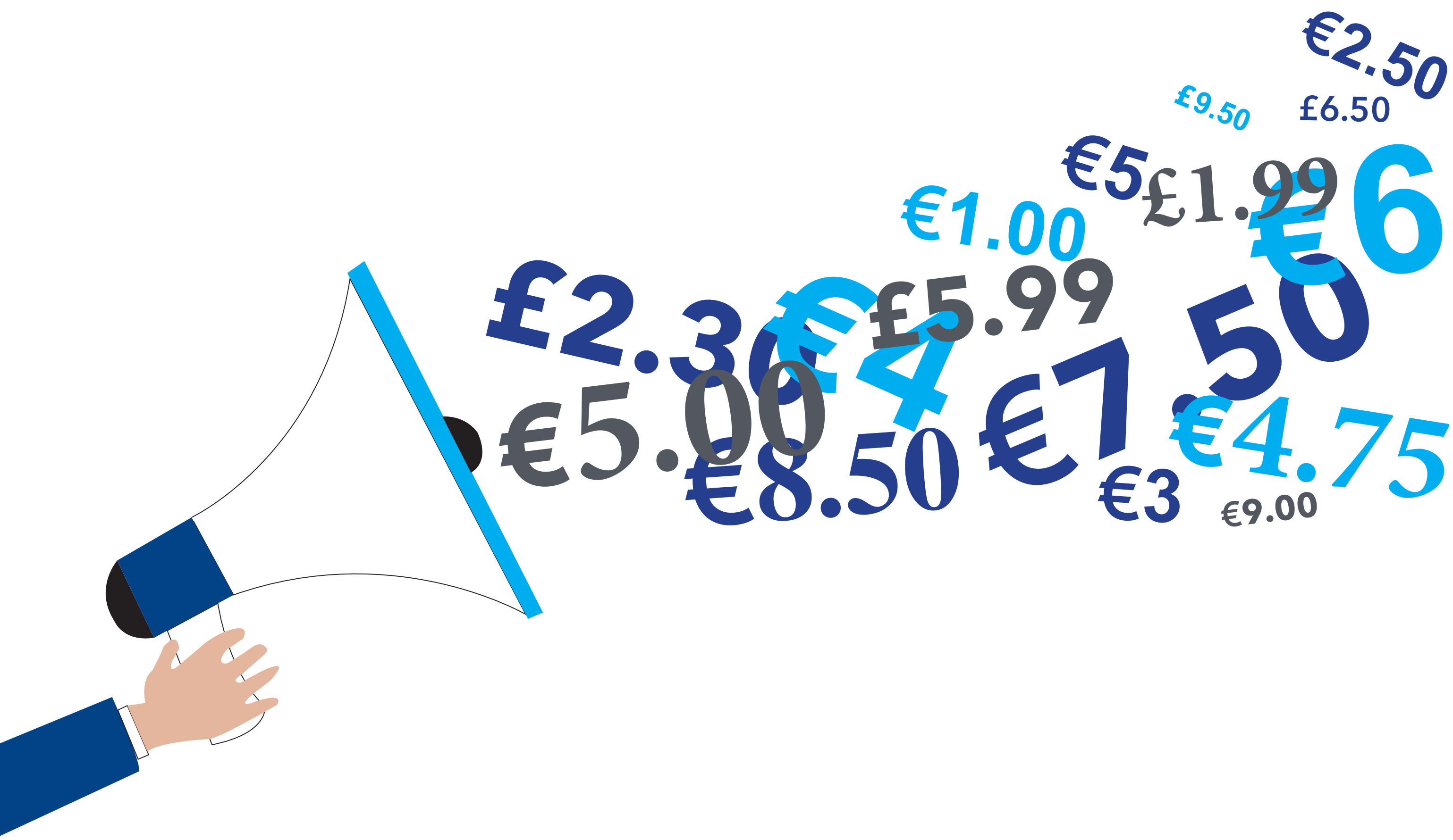
FMCG Price War in France

An Overview and Lessons for other European countries



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Agenda

Introduction

A price war has been raging between retailers in France for almost two years and is now impacting other European countries. In these countries (particularly Spain, Italy and the United Kingdom), we have seen the beginnings of deflation over the last few quarters, vary in intensity from one country to another.

Even in the countries most affected by the economic crisis (southern Europe), price has not been the main lever used by mass retail chains and manufacturers. Promotion was the tool of choice to maintain activity levels for mass-market products, so this trend is rather new, supported partiallly by raw material price decrease.

This IRI Point of View examines the long running case of the French price war and the lessons that have been learned from it. It also outlines the findings that we can apply to other countries facing the same challenge, despite specific local factors in each country. There is no magical remedy: it's about employing the best strategies for growth in a very challenging situation, for retailers and for manufacturers.

The short-term reasons for the beginning of this price war differ from one region to another.

In the United Kingdom, the main cause is the rise of the hard discount sector, which gained more than two points in market share between 2012 and 2014 and is threatening the traditional retail chains.

The growth of the hard discount sector is all the more worrying as the sales volumes in the United Kingdom grocery sector (excluding hard discount) dropped by more than 2.5% in 2014, having previously only just remained stable.

The major retailers are vulnerable as private labels play a very powerful (or even dominant) structural role in their business. In the United Kingdom, the price war is affecting private labels, more than national brands!

In Spain, fast moving consumer goods (FMCG) have until now withstood the economic and financial crisis affecting the country rather well.

The crisis even boosted domestic consumption, at least initially between 2009 and 2012, to the detriment of out-of-home-consumption.

But the increase in sales only benefited private label products, the soft discount sector (with the explosion of Mercadona's market share) and to a lesser degree the hard discount sector. Moreover, the level of activity by volume has been fairly stable for two years now.

At a time when the economy is regaining strength, both national brands and the majority of retailers need to recover some of the ground lost during the last four years.

Inflation in food products and non-alcoholic beverages in Europe (in %)

	Average 2009 to 2012	2013	2014
Germany	1.6	3.8	0.9
Spain	0.6	2.8	-0.3
France	1.4	1.2	-0.8
Italy	1.7	2.1	0.0
Netherlands	1.3	2.4	0.0
United Kingdom	4.4	3.7	-0.2

Source: Eurostat

In Italy, the crisis has ultimately had little effect on volumes.
Unlike Spain, the purchasing structure has not been fundamentally altered: the importance of private labels has not increased significantly in most countries, and hard discounters have only nibbled away at retailers' market share.

The resilience of the supermarkets and national brands is largely due to promotional activitiy rather than pricing however.

Could the beginning of a price war revive a rather stagnant situation?

In the Netherlands, we are not detecting any early warning signs of a price war, even though consumption is fairly stable or even slightly in decline.

The last price war of 2003 may well have left indelible marks on Dutch distribution which limits the use of this lever!

In Germany, where prices are low, the price war is no longer news in itself.

Deflation has been spreading for several months

Even though the situation is very specific to each country, an analysis of the consequences and impact of a price war on FMCG products in France provides lessons and avenues for reflection.

In fact, despite different local market situations, there is one thing that is almost the same across all mature markets, there is a general stability in the volume of mass-market product consumption, pretty much regardless of the general economic context (crisis or growth).

After two years, has the price war in France altered the overall balance of the market?

And what lessons can we learn from it moving forward?

I. The triggers and extent of the price war phenomenon in France

1. The start of the battle

The price war in France became evident at the beginning of 2013.

It had been preceded by a period of very moderate inflation, with France having been for several years one of the countries with the lowest inflation in Europe, due to legislative changes (Law on the Modernisation of the Economy) and the first price skirmishes provoked by certain retail chains.

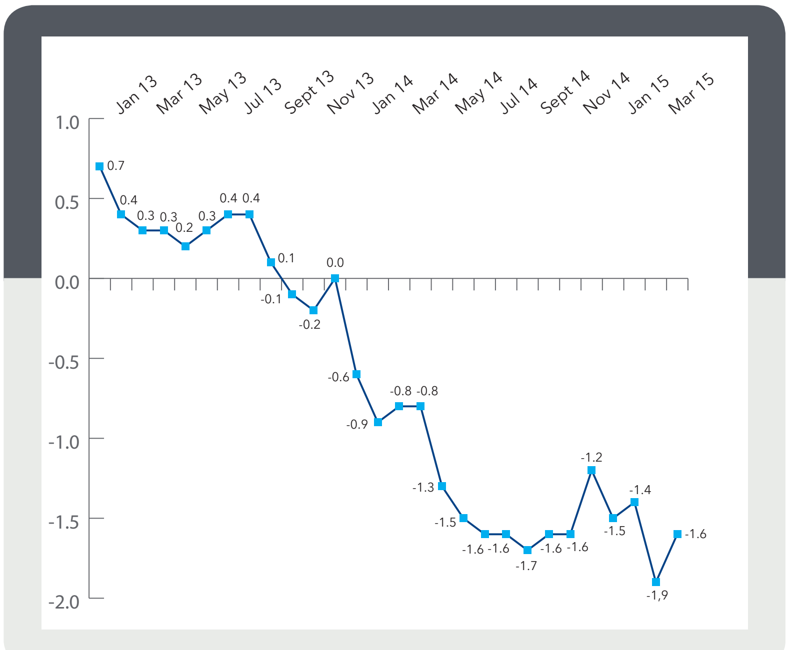
The war was unleashed by the Casino Group's hypermarket chain, Géant. For several years this retailer had completely abandoned its position on price compared with other hypermarkets (HMs). Moreover, the chain was doing rather badly, registering significant losses in market share. The group's management decided to reposition themselves with a very aggressive pricing strategy, to the point of rivalling the chain that was traditionally so, both in terms of price index and price image, namely Leclerc.

From being the most expensive hypermarket chain, Géant fell virtually into line with its principal competitors in the space of a few months. Continuing the momentum, it gradually got closer to Leclerc in terms of price levels.

This offensive by Géant could have had a limited impact on the retailer's market share, particularly because, rather curiously, this repositioning had been backed by barely any communication.

French FMCG retail chains have historically always paid particular attention to price and their level of price-competitiveness, so all hypermarket chains were forced to react in order not to be caught out.

Year on year inflation in FMCG products in France (in %)



Source: IRI, GPS Solution

Between January and June 2013, prices had already dropped by almost 0.6% in hypermarkets; for national brands alone, deflation reached 0.9% over that period. In supermarkets (SMs), prices continued to increase (+0.3%). In September, the price war spread to all store formats. Just one year after the offensive (February 2014), prices had dropped by almost 1% year on year. The trend has continued ever since.

2. The situation after two years

a) Price trends

We estimate that, since the beginning of the price war, deflation has reached around 2.6% in hypermarkets and supermarkets (HMSMs), just over 3% in HMs and 2% in SMs.

Ultimately, only the prices of national brands have been affected (dropping more than 4%) while the prices of private label have been practically stable and even rising in supermarkets.

The price war has affected practically all FMCG sectors, though it has not had the same intensity in all products or brand types, as the below table illustrates.

Inflation between April 2013 and April 2015 per sector and brand type in HMSMs, in France (en %)

	Total	National Brands	Private Labels	Low Price
TOTAL FMCG INFOSCAN	-2.7	-4.4	0.3	1.9
NON-FOOD	-4.1	-6.0	0.1	0.4
CLEANING PRODUCTS	-4.1	-6.4	0.5	1.8
HYGIENE - BEAUTY	-4.0	-5.8	-0.2	-0.5
GROCERIES	-3.9	-5.8	0.0	3.0
SAVOURY GROCERY PRODUCTS	-3.3	-5.5	0.2	4.1
SWEET GROCERY PRODUCTS	-4.4	-5.9	-0.1	1.4
DRINKS	-2.0	-3.1	2.0	0.8
SOFT DRINKS AND WATER	-3.6	-5.9	1.4	-0.5
BEERS AND CIDERS	-4.0	-4.8	4.3	1.0
SPIRITS	0.4	0.0	2.6	1.8
FIXED WEIGHT SELF-SERVICE PRODUCTS	-1.5	-3.1	0.1	1.9
FROZEN FOODS AND ICE CREAMS	-2.0	-5.4	1.1	0.3
DAIRY PRODUCTS	-2.0	-3.4	-0.7	4.6
FRESH NON-DAIRY SELF-SERVICE	-0.9	-2.3	0.6	0.0

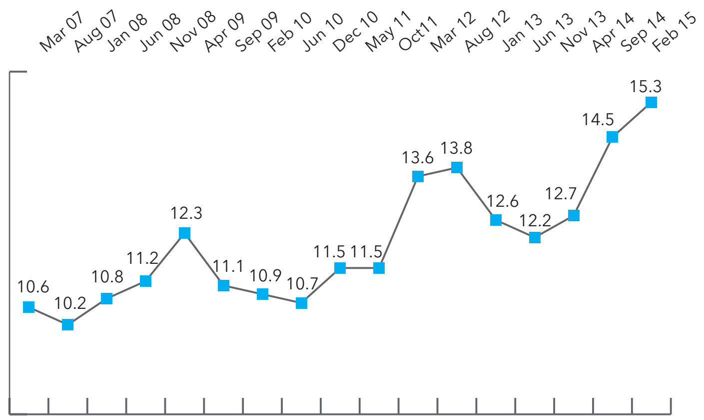
Source: IRI, Infoscan solution

Price slides were particularly acute for cleaning products and hygiene/beauty products, as well as groceries and non-alcoholic beverages. It was more moderate for fresh, non-dairy products and spirits (which were affected by an increase in taxes).

b) Price differences between retailers

The price war has led to a sharp widening of price differences between retailers.

Retailers' price corridor since 2007, in France
National brands (in points)



For almost 10 years IRI has monitored price differences between the main retailers in national brand products (which are the only ones impacted by this war in France). The price corridor is the difference between the price index of the two most expensive retailers and the two least expensive retailers.

Source : IRI

Today the corridor has reached a record level: the two most expensive retail chains apply pricing that is 15% higher than the two most aggressive retailers in terms of pricing. This sharp widening of the corridor is essentially mechanical (the effect of a strong decrease by one operator) and the pricing level for each retailer has remained fairly stable, with each one trying to maintain its distance from the leader.

II. The impact on FMCG general activity and on retailers' performance in France

What consequences has the price war had on FMCG markets?

1. Has the deflation caused by this price war boosted volume consumption?

Clearly, and rather unsurprisingly, ***not really.***

In fact, price elasticity for FMCG is rather low, around -0.3/-0.4.

During 2014, consumption in France rose (+0.5%), whereas it was only stable in 2012 and even in decline in 2013 but this growth in volume only corresponds to demographic growth.

While France has succeeded in maintaining the growth rate of previous years, this rate has tended to drop in other countries, either because of the economic crisis (Spain and Italy for example) or due to the development of the hard discount sector (in the UK).

For non-food (cleaning and hygiene/beauty), sharp deflation (and promotion) seems to have helped re-energise a sector that was on a declining path.

A slight consumption recovery, in volume, in France in 2014 (+0.5%) at the expense of hard discounters

2. Has it altered the balance of power between types of retailers or between banners?

a) Channels other than HMSMs: hard discount and click and collect

In France, the impact of the price war between the so-called traditional retail chains has had a negative impact on the performances of the hard discount sector which has been in difficulty since 2010, even before the price war.

Already weakened, hard discounters loss of influence in France has greatly accelerated in recent years, despite the ongoing economic crisis, while its market share has continued to increase in other European countries.

Click and collect, has continued to advance steadily. Due to the flexibility it offers and in terms of transparency (making prices per store more accessible), its contribution to making this price war public has been even greater than that of price comparison websites.

b) Within retailers

The performances of the different retail chains have not, for the moment, been fundamentally altered by their level of involvement in the price war. The most recent results published by our partner KantarWorldpanel confirms this; the landscape of French distribution remains fairly static as regards to the traditional retail chains. This was confirmed in Casino Group's latest results: turnover for the Géant chain is likely to remain negative this year despite an encouraging upturn in activity levels (traffic).

3. How to explain this inertia? The role and power of other levers

a) The simultaneous use of other levers

Even though price remains one of the fundamental levers and is often essential in terms of appealing to consumers, it is far from being the only one. In the hierarchy of choice criteria, according to the latest IRI shopper surveys, price in France is almost equally important as choice, ease of purchase and promotions.

The majority of retailers, while monitoring and controlling their price levels mainly for national brands and leading products, have put in place additional or alternative strategies such as expanding their promotional activity or broadening their in-store offering, sometimes with the aim of avoiding the price war.

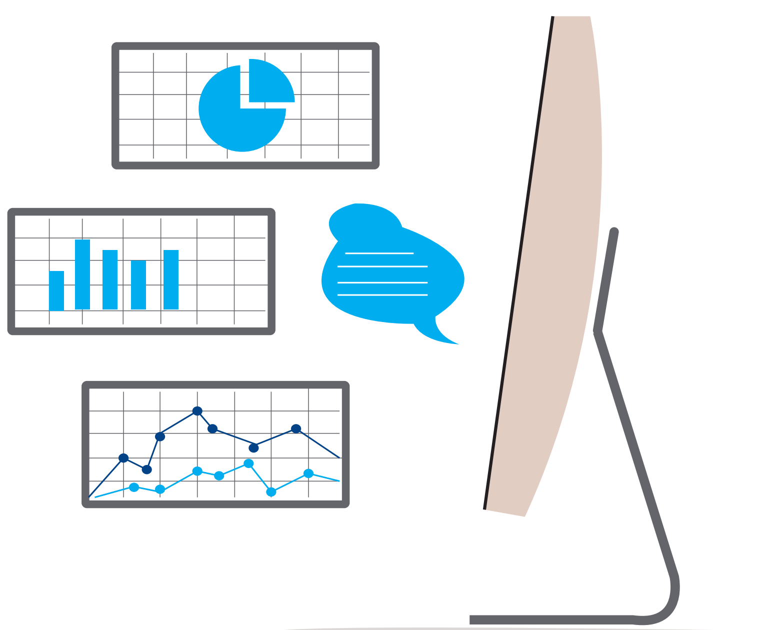
As a result, in 2014, we recorded an increase in promotional pressure in supermarkets as well as a 3% expansion in the range of national brands offered, particularly in hypermarkets, between 2013 and 2014. Although assortment of the large groups (primarily affected by the price war) only increased by 1.6%, that of SMEs (less than €100 million euros) increased by 4.5%.

b) The impact of different levers on the performance of retailers and stores

Since the beginning of the price war, IRI has conducted and regularly updated a number of studies on the role of the various levers in the performance of retail chains.

These compared trends in the performances of the 10 main retailers in each of the 200 main FMCG categories, against the backdrop of their price changes, their promotional activity and their range.

The results of these investigations are consistent over time and there is real clarity across all banners. The short-term performance of all categories are linked first to product range, then to promotion and finally to price.



III. The main impacts in France: the balance of power between national brands and private labels, upgrading and organisational changes

The price war may have no major consequences on either the pace of growth in consumption overall or for the balance of power between retailers but it has had significant effects in three different areas:

- The balance of power between national brands and private label products
- The phenomenon of moving upmarket, of upgrading
- Consequences in procurement organisations of retailers

Price war has changed the balance of power between national brands and private labels and has generated upgrading

1. The relationship between national brands and private labels

Even before the beginning of the price war, and contrary to what we have observed in most European countries, sales of private label products in France have seemed to level off in the last two or three years (see IRI Private Label Special Report).

The large price reductions that applied to national brands, principally on core products with a high turnover, have led to a loss of price-competitiveness for private labels, which was also the case in Italy in 2014.

Promotional pressure has also increased for brands, while the level of promotional activity on store brands continues to drop.

After several years of growth in the private label offering, things started to change at the end of 2012.

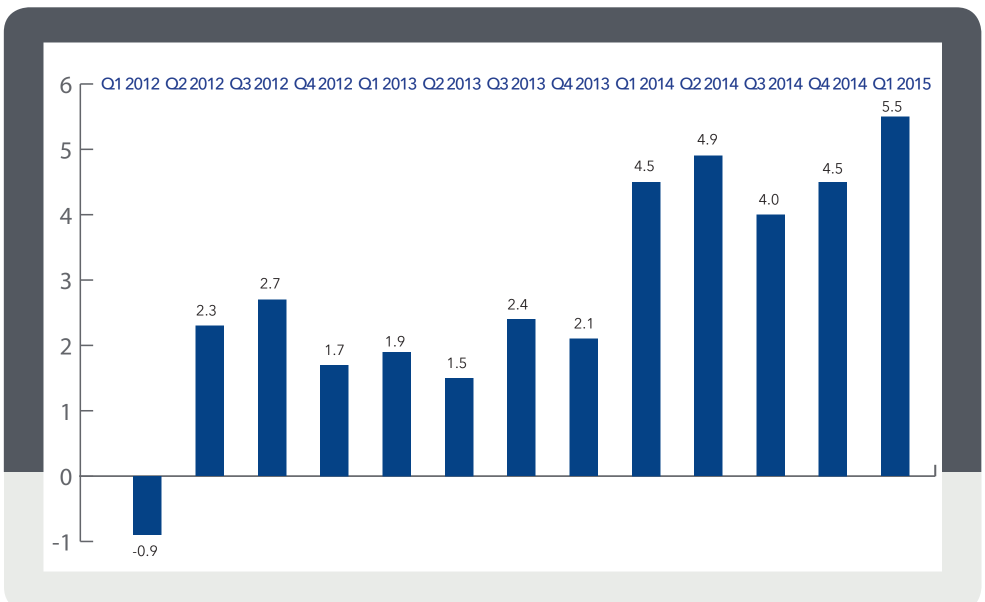
In 2014, as mentioned previously, many retailers decided to expand their assortment of small brands. At the same time, the number of private label products on the shelves only increased by 0.6%, in particular due to the development (very much more moderate than previously) of themed private labels.

As a result, there was a negative trend in all indicators linked to offering. Demand was hardly any better, with a clear deterioration in the appreciation of private label products among consumers.

In 2014, in hypermarkets and supermarkets, sales volumes of private label products dropped by 2.3% while national brands recorded growth of +2.1%, a growth difference of 4.4 points.

This decline in private labels has affected all mass-market products (almost eight categories out of 10), pretty much regardless of the level of brand deflation. The trend even grew during the first months of 2015, as demonstrated by the following graph.

Volume growth differential between national brands and private labels quarter on quarter since 2012 in HMSMs (in points)



Source : IRI

2. Strengthening of the phenomenon of upgrading

Deflation reached 1.3% in 2014 in the FMCG universe, in France. Yet, despite this practically unprecedented drop in prices, the price of a shopping basket increased during the same period by 0.3%.

The difference between these two price indicators is linked to a rather fundamental change in the content of the basket: more national brands and fewer private label products, more expensive products amongst national brands and a high awareness of innovation, and all this despite a rather gloomy economic situation.

If we translate these figures into raw data, the price drop of 1.3% over the whole of 2014 amounts to returning about €1 billion to the pockets of French households.

This billion was immediately re-invested by households in their everyday purchasing, not to consume more, but to buy more expensive products. This seemingly enormous windfall only represents an amount of less than €3 per month per household.

The big short-term winner of France's war is obviously the end consumer. The war has given them room to manoeuvre and to have fun… despite economic difficulties.

> A price decrease valued at €1 billion, which is the equivalent of €3 per month per household

More fundamentally and perhaps more lastingly, this price war (and the communication which accompanied it) has tended to reassure shoppers, giving them more confidence in their purchasing process. While they remain distrustful of retailers' promotional jargon and hype and have difficulty believing that each retailer is 'the cheapest', they do note that the store they go to is taking part in this price war and therefore at least offers reasonable prices.

The price war also seems to be encouraging consumers to reconsider national brands (and even adopt them). Brand prices had been rising considerably in France for almost 10 years (1996 to 2005) when legislative changes (law on the Modernisation of the Economy) and the price war finally made national brands to become more affordable.

If this price war has really provided a benefit, it is doubtless of a psychological nature in the form of reassurance for the consumers, and a return to a climate of trust in their store and the products they purchase there.

3. The impact on retailers' organisations and questions about the continuation of this price war

This review of France's price war over the last two years is somewhat mixed from a macro-economic point of view, both for retailers and manufacturers. However prices were continuing to fall at the beginning of 2015.

Since the end of 2014 it has even been driving tie-ups between purchasing organisations looking to present a stronger front in 2015's commercial negotiations including:

- An alliance between Système U and the Auchan Group to achieve a critical threshold of around 20%.
- A collaboration between Casino and Intermarché in order to achieve an even higher market share.
- Carrefour Group joining with Cora to hold on to its place as the largest player.
- Only Leclerc, previously the largest purchasing organisation with Carrefour, has remained totally independent. Leclerc has lost its leadership position.

Negotiations therefore proceeded with just four groups of operators at the beginning of 2015, instead of the previous seven. Together, these four represent almost 90% of French distribution. It is likely that this record level of concentration made negotiations more complicated, as well as more difficult and tense. We cannot yet measure the effects on prices.

Four purchasing organisations instead of seven

At the beginning of April the Competition Authority, at the request of the public authorities published its opinion, stressing the risks to the entire production chain (farmers and processors) on account of this concentration of purchasing.

The Competition Authority highlighted the dangers of a reduction in supplier margins, which could lead to a reduction in their investments, restricting their capacity for innovation, streamlining their offering and, perhaps, even lowering the quality of their products.

This was incidentally what happened in the Netherlands after the very fierce price war initiated by Albert Heijn a little more than 10 years ago.

Even though the deflationary trend in France has not reached the same level on 'the Richter scale' of prices, manufacturers are afraid that the same causes will produce the same effects in the medium/long-term, as well as posing a threat to jobs.

No one can predict whether this price war will last or intensify in the coming months, and we can only hypothesize. Some think that reason should prevail among retailers whose margins have been naturally eroded, and that prices could stabilise at this low level.

Others believe that the trend will only come to a halt when the fleet of stores (which has grown much more quickly than the general population) has been cleansed by the disappearance of the weakest.

Throughout May and June, results on price evolution seem to confirm those last thoughts. Indeed, between April and May prices still decreased by 0.15% and by 0.27% from May to June.

IV. What are the lessons learned for other countries?

A summary of the impact of the price war in France after two years:

- A recovery, though marginal, in the volume of activity.
- Strong growth in national brands to the detriment of private labels, supported at the same time by an increase in the in-store offering (often a factor in differentiation).
- A strong propensity among consumers, reassured as to price levels being applied, to upgrade their purchasing and in their own words (via IRI shopper surveys) to leave room in their purchasing for impulse buys and products for pleasure.

It would be audacious or even presumptuous to anticipate the consequences of a price war in countries where it is just beginning to appear today. Nevertheless, there are some interesting key learnings we can draw from what has happened in France:

- Whilst the price war in the United Kingdom today began with brands increasing promotional pressure, more recently it seems that private labels have been reducing base prices more quickly than brands. Overall, average prices for 12 weeks ending April 2015 for brands are -1.5% versus a year ago whereas private labels stand at -3.3%.

  Is this price war focused on private label products 'necessary and sufficient' to counter the hard discount stores in the long term? Whatever the case, it will reduce margins considerably, unless of course it affects product quality at a later stage.

  The price differential between private labels and national brands is in danger of being affected by this, making national brands less attractive despite the fact that they remain retailers' main point of differentiation from hard discount stores.

  While exercising the necessary caution, it should be remembered that in France, the advance of the hard discount sector has been stopped twice by the supermarkets*, both times using the same approach: the temporary development (and even promotion) of the low price offering to maintain loyalty to the retail chain.

*The first time shortly after they became widespread on the French market, when they were at current UK levels; then 10 years later when they exceeded the 10% market share threshold.

- In countries that are gradually emerging from crisis, such as Spain or Italy, a moderate price drop (although perceptible and publicised through advertising) can trigger an earlier and quicker return to the normal pre-crisis situation, after several years of frustration and restricted consumption.

  While it remains to be confirmed in the long term, in Italy as in France, price reductions and more intense promotions have already been encouraging consumers to upgrade for several months now.

  For this phenomenon to have its full effect, deflation must be accompanied by a thorough overhaul of the in-store offering, in particular with the development of an assortment structure which meets this desire to consume (again). A shared 'manufacturer/retailer' approach should be employed for this review of ranges, as well as for price positioning of products and innovation.

Price decrease and high promotion activity in France has contributed towards an upgrading of the shopping basket

IV. What levers can be activated for growth in such a context?

The worst case scenario for both retailers and manufactuers is obviously to remain passive in a price war context.

For manufacturers it is therefore appropriate to:

- Anticipate the effects of the price war on the performance (traffic, sales and profitability) of different brands and products in their portfolios but not globally, banner by banner. A manufacturer could rely on the situation in each banner and upon analysis on the elasticity of various products.
- Define alternatives to this situation using the other levers: promotion, assortment, new product or size launches and advertising.
- Measure, step by step the importance of movement in prices and those of competitors and the impact on brand or category performance.

For retailers there is a real need to distinguish between offensive and defensive strategies.

In an offensive strategy, retailers must remember to:

- Share the effort across the various categories, perhaps unequally, but work with most categories.
- Identify the categories, brands and products that the retailer must focus the efforts on in terms of price-investment, paying attention to the consistency of the offer, including the price level of private labels.
- Monitor the impact of the pricing policy on performance taking into account the offensives against its competitors.
- Measure the impact of new prices upon its aggressive-price image, in relation to its communication campaigns.

In a more defensive strategy, it will be critical to:

- Identify the gaps that are created by the most damaging in terms of competitor category performance but also competitors' price image and the overall attractiveness of the stores.
- Do not limit yourself to a simple political alignment (frontal fight) but search for avoidance strategies or limit the effects of the battle caused by competitors' promotions and consider the introduction of new standards (cheaper and / or proprietary) .
- Use other levers such as the comfort of purchase or the service provided to customers (for example, home delivery, click and collect...).

Conclusion

An indiscriminate and widespread price war does not really make sense. An intelligently targeted war will prove to be more judicious and less destructive in terms of value.

It is no small matter for a manufacturer to overcome a price war upon all of its brands, all of its products and in all of its stores.

It's not a simple step for a retailer to seek aggressive price strategy on all categories, all products and in all of its stores unless he or she wishes to waste energy and drastically reduce profitability.

The price war, like a military war should be the last resort when all other means of action have been exhausted or have proved to be ineffective.

It is essential that players select the correct tools which are now available.

IRI solutions to assist you

IRI Assortment Optimization provides precise solutions for all requirements in order to optimise assortment efficiency. Thanks to advanced modelling technologies, IRI Assortment Optimization is the only solution which allows manufacturers and retailers to estimate the real value of each product in their department, by quantifying the contribution of every aspect of the product (flavour, format…). IRI Assortment Optimization can produce exceptional results in just one year; it can generate up to €4.6 million growth in revenue for a product in one category sold through a single retailer.

IRI Price & Trade Advantage measures the price sensitivity of each product reference of a brand or market, as well as the net impact of promotional activities. It allows decisions to be made based on the results of modelling carried out per store on a weekly basis. This solution, enhnaced by a simulation tool, diagnoses price elasticity, price thresholds for a reference, the competitors with the greatest price differential impact and price differentials not to be exceeded with them… with the aim of preparing the pricing strategy as effectively as possible, for a product or a category. It also allows in depth analysis of the response of a product to promotions by endeavouring to measure contributions at the desired level: the brand, the portfolio and the category.

IRI Holistic Retail Solution (HRS) combines all data sources from the retailer such as point of sale, loyalty and shopper data, into a single unified platform. The database, reporting interface and data analysis tools are organised into a structure that matches the retailer's own business workflows to facilitate internal strategic decision making. Manufacturers can also subscribe to the HRS service to monitor their own brand and category performance using exactly the same data structure, reporting and analysis tools as the retailer.

The ability for retailers and manufacturers to work on a single unified platform enables unprecedented levels of collaboration to deliver effective strategies around key activities such as category management and promotional strategy to increase revenue while at the same time delivering an enhanced experience for the shopper.

For further information

Contact your IRI Consultant or send an email **EU.Marketing@IRIworldwide.com**

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