BCG OPPORTUNITIES *for* ACTION

CONSUMER

- *To increase sales of their value brands, some companies add features without increasing price, tempting premium-brand consumers to trade down; others eliminate features and lower prices, putting their value brands in competition with generic or private-label products*
- *Using a two-step process, companies can avoid cannibalization, break the compromise between price and volume, and realize higher prices—even for high-volume value brands*
- *First, identify the features that consumers of value brands care about the most, and shed the ones that they care about the least but that add to costs and price; second, enhance one or more of the features that these consumers value, and charge slightly more for the redesigned product*
- *The result: a higher price point and extraordinary profitability for high-volume value brands*

Premium Margins from Value Brands

As middle-class consumers drift to both ends of the market—trading down to best-value products and trading up to affordable luxuries—consumer goods companies are following suit with a variety of brands all along the price range. In doing so, they are leveraging their assets, avoiding channel conflicts, and serving a full complement of consumer segments (in terms of demographics, usage, occasion, and benefits). But it's not easy to manage a range of brands that have a variety of attributes and multiple price points. Most companies have found that succeeding with brands in both the value and premium segments without inviting cannibalization can be a tricky balancing act and, too often, a seemingly impossible one.

To increase sales of their value brands, for example, some companies add features without increasing price. But that only tempts consumers of the premium brand to trade down to the value brand. The lower-priced, lower-margin brand ends up cannibalizing the higher-priced, higher-margin product, and profits go out the window.

Other companies take the opposite approach, eliminating features from their value brands in order to attract consumers with a lower price. But such a strategy can put these products in competition with generic or private-label products, which often have advantageous cost structures. The result is a loss of profitability for the value brand. There has to be a better way—and there is.

Primary Versus Secondary Features

It might seem counterintuitive, but price is not the only thing that consumers looking for value care about. Rather, they seek a particular combination of price and features—and every consumer segment has its own preferred tradeoffs. Although most companies grasp this principle, very few multibrand players also realize that their value-brand customers are interested in and willing to pay for only a very limited set of product features ("primary features"). Benefits that fall outside this category ("secondary features") aren't, to the value-seeking consumer, worth the price, no matter how desirable they may be to other consumers. In some cases, secondary features can even destroy value by eliminating the benefits of one of the primary features.

Say a value-seeking consumer shopping for a DVD player is most interested in a product that is easy to use and provides a good picture. Company A's value brand offers multiformat capability and timing options, which the company added to stimulate sales. However, these features have made the product more difficult to operate and slightly more expensive than it was before. Naturally, the consumer refuses to pay even a small premium for these unwanted features, especially now that the product is harder to use. In this instance, the company loses not only a sale but also the larger profit margin that the same product without the added features would have generated.

Yet those secondary features, as well as several others, are very important to premium-brand consumers, who *are* willing to pay for them. For these consumers, a DVD player must not only provide a good picture but also offer multiformat capability, various options for plug-ins, and timing and recording features.

A New Approach to Value Brands

At The Boston Consulting Group, we have developed a two-step process for redesigning value brands. The first step is to identify the features that consumers of value brands care about the most and to shed the ones that they care about the least and that add to both costs and price without providing a substantial benefit. But simply ridding the product of unwanted features isn't always sufficient, because that could result in an inexpensive but rather ho-hum product.

To make the offer more appealing, the company needs to add an "extra portion" of the qualities provided by the primary features. By taking this second step, companies can set a higher price point, even for price-conscious value-brand consumers, thus achieving extraordinary price levels—and profitability—for a high-volume segment.

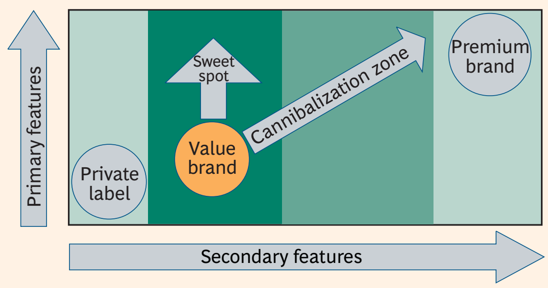
Consider a value-seeking consumer of laundry detergent who most desires a minimum level of cleaning power and a pleasant scent. Other benefits, such as the ability to clean fabrics of various colors and textures or an attractive package with an "easy to pour" spout, hold no interest. This consumer will not pay more for those features, but he or she will pay (a little) more for an especially appealing scent. By taking out the costly cleaning enzymes (while still preserving the minimum threshold for cleaning power), adding a scent that was previously available only with the premium brand (but that costs considerably less than the enzymes), and charging slightly more, the company can increase its sales and its profit margin. It also reduces the risk of cannibalization, because consumers seeking the premium brand won't be tempted by the stripped-down offering, which lacks the secondary features that they desire.

The exhibit below shows a way for companies to find the sweet spot—the relative number of primary versus secondary features—for various brands in their portfolios. The vertical axis represents the primary features that value-seeking consumers care about, and the horizontal axis indicates the secondary features that only premium-brand consumers will pay for. Premium brands should be high in both primary and secondary features. Value brands should have many primary features but few secondary features. The more a value brand moves up and to the right in the graph—which is the path many product managers assume a brand must take—the more it risks cannibalizing the company's premium brand.

Some Companies Are Getting It

A manufacturer of electrical appliances used our strategy to redress some serious problems in the value-brand segment of its portfolio, which suffered from low profitability. In addition, the company's feature-laden value-brand products seemed to be cannibalizing its premium

Value Brands Should Be High in Primary Features and Low in Secondary Features



Source: BCG analysis.

products. Our research revealed that the most important primary features for this company's value-brand customers were compactness, low energy consumption, and simplicity of use. These customers weren't interested in noise-reduction technology or electronic controls, and they certainly didn't want to pay a premium for them. So the product designers refocused their efforts and removed the secondary features that had crept into the value brands and were responsible for cannibalizing the premium products. They took out the noise-reduction feature (a high-cost item) and reduced the size of the appliance to create a streamlined version. As a result, the category increased both its market share and profitability but not at the expense of the company's premium brands.

Companies in both the airline and the automotive industries are experimenting with similar strategies. Rather than cut features and costs across the board to create a low-priced offering, they seek out consumers in the value segment to learn what features they are most and least interested in. That has encouraged some players to eliminate expensive frills and to "overdeliver" on key items. In air travel, for example, value-conscious consumers care more about on-time arrival, with their luggage, than they do about catered meals and special seats. When it comes to their personal vehicles, they prefer extra safety features and good mileage to many of the bells and whistles that come with most cars and drive up the cost.

We should note that marketing plays as important a role as product design in the success of this approach. In order to achieve an increase in sales volume, especially when prices rise, marketers must communicate information about primary and secondary features so that consumers can understand what they are and are not paying for. For example, marketers in the airline and automotive industries might publicize the companies' crash-test results, mileage data, and records of on-time arrival and lost luggage.

Making It Work

To implement our approach, product designers must first rethink their assumptions about product features. More is not necessarily better, and sometimes it can be worse. It is the quality of the primary features that attracts the value seeker, not the total number of features. Moreover, although our approach is ideally suited to products that are rich in features, it can also be applied to the services surrounding products that have limited potential for enhanced features. For example, a company might be able to attract consumers to one of its value brands by offering expert sales assistance, fast after-sales service, or flexible delivery schedules.

Second, both retailers and consumers must understand the significance of the value brand's enhanced primary features. That calls for the education of both retailers and sales associates, along with effective advertising and signage. Consumers must realize that the often-watered-down secondary features offered by the competition are worth less than the improved primary features of the redesigned value brand.

Third, and perhaps most important, the whole strategy will fail if the primary features that a company chooses to enhance are the wrong ones. Therefore, market research and an organization-wide commitment to understanding the changing dynamics of consumer behavior must be ongoing. It's not simply a matter of following a demographic segment up market or down, because consumers at all income levels are moving in both directions. In fact, the value that shoppers assign to various technical, functional, and emotional benefits can shift depending on product category or occasion. Rather than focus on what an item costs, consumers ask: What is it worth to me? How much can I spend? What tradeoffs will I have to make in my budget? Do I need it at all?

Best Practices

Giving value-seeking consumers the features they want and allowing them to avoid paying for features they don't want are constant challenges. They require a thorough knowledge of your industry and an ability to anticipate consumers' complex views on your products and services. The following are some best practices that companies succeeding with value brands have instituted:

- Establish a new pricing mantra: Higher price points don't require more features, they require more relevant features
- If value brands are cannibalizing premium products, determine which secondary features are responsible
- Invest in rigorous and continuous qualitative and quantitative research to discover the features that are most and least important to your value-seeking customers

- Determine whether your value brands have sufficient primary features to distinguish them from private-label offerings

- Determine whether any secondary features are diluting the value of the primary features of your value brand

- Enhance the primary features that consumers value most, eliminate any costly or value-reducing secondary features, and align the price with the improved features

By identifying precisely what various segments of value-seeking consumers want most in a product or service, you can break the compromise between price and volume and realize higher prices, even for high-volume value brands. It's a win-win proposition, whereby suppliers and retailers generate higher margins and profits, and their customers take home more value for the price.

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