Textile Consumer™

Published by Cotton Incorporated *Volume Thirty-One* *Winter 2003*

Measuring the Brand Premium

Most brands and retailers know all too well the pressures of apparel price deflation. Since 1994, the consumer price index has declined in the U.S. market by an annual average of 1.3%. This deflation has many causes, but can generally be attributed to four factors: (1) increased share of clothing sales through the mass-merchant channel, (2) the trend toward casual wardrobes, (3) excess retail floor space, leading to increased competition among retailers, and (4) conditioning of consumers to expect and wait for sale prices.

Data from STS Market Research's AccuPanel Survey provide compelling evidence that the effects of price deflation are widespread in the retail apparel market. All of the major apparel categories tracked showed price declines over the last two years. And prices fell not only across key product groups, but across all retail channels.

Decline in Average Apparel Prices, 2001–03

By Product Category and Retail Channel

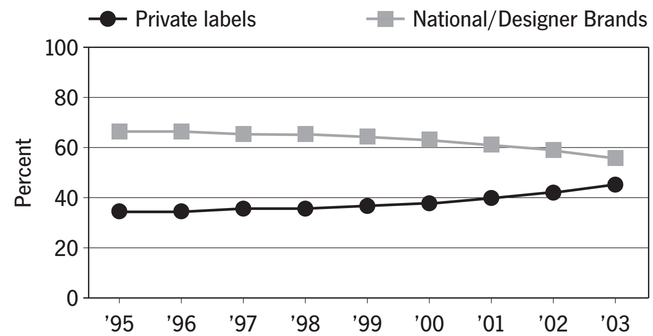
Product	% Change	Retail Channel	% Change
Total	–8.9	Total	–8.9
Jeans	–5.5	Department	–13.7
Slacks	–11.7	National chain	–9.0
Shorts	–4.9	Specialty	–5.8
Sweat apparel	–12.6	Mass merchant	–7.5
Shirts	–8.1	Off-price	–4.2
Sweaters	–16.3	Other	–11.2
Shirts/dresses	–6.1		

Source: STS Market Research.

Against the backdrop of falling prices, brands and retailers have sought ways to counteract the effects of lower retail prices on profit margins. One strategy employed by retailers has been to develop and market private-label brands. These "store brands" now account for 45% of total U.S. apparel unit sales, up from 39% just two years ago and 35% five years ago. In some adult apparel categories, such as skirts, private-label sales account for an estimated 76% of unit sales. In the children's clothing market, research conducted by Cotton Incorporated estimates that 65% of products offered are private label.

Share of Apparel Unit Sales by Brand Type

First Nine Months, 1995–2003



Source: STS Market Research.

How Strong Is Brand Loyalty?

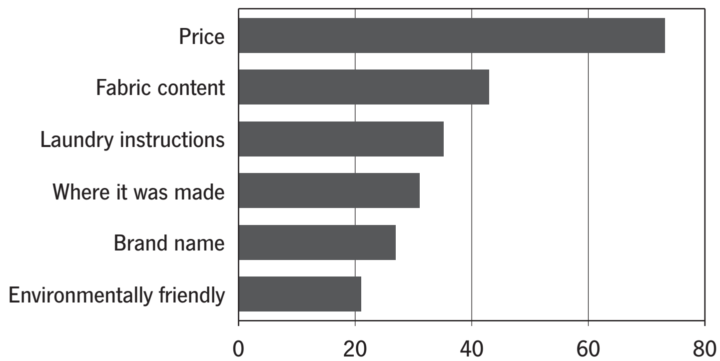
Despite the growth of private-label brands, research by Cotton Incorporated (the Lifestyle Monitor™ and additional proprietary research) points to relatively low brand loyalty on the part of U.S. shoppers. In general, individual consumers own many different brands of clothing and show a proclivity to consider style, fiber, and price over brand name. One exception to this general finding is in men's bottomswear, which appears to enjoy greater brand loyalty than other men's and women's apparel categories.

Nonetheless, men do seek out different brands even in products such as denim jeans, of which they own an average of four brands. As men age, they tend to own fewer brands of denim jeans: men aged 16 to 19 own 5.7 brands on average, while men aged 56 to 70 own 2.6 brands. The tendency of both men and women to buy fewer brands as they age is directly related to the decline in their apparel purchases.

U.S. consumers embrace a diversity of brands, not just individually, but collectively. In the Lifestyle

Information Important to Know Before Buying Apparel

Percent of Consumers Responding



Source: Cotton Incorporated's Lifestyle Monitor™.

Monitor survey, consumers were asked to indicate their favorite brand of clothing. The brand named most frequently was mentioned by only 16% of consumers.

The relatively low brand loyalty in many apparel categories suggests one possible explanation for the recent growth of private-label brands—it is driven less by success in cultivating and maintaining consumer loyalty than by the need to manage supply-chain costs. Another explanation for the growth is more familiar—private labels have been more likely than their national-brand competitors to be sold at markdown. The share of private-label products sold at discounted prices in the first 10 months of 2003 was 68%, compared with 64% for national brands. Among the major retail channels, the percentages of both national-brand and private-label apparel sold at discounted prices were largest at department and specialty stores and smallest at mass merchants. Nonetheless, even though mass merchants are known for low regular prices, they marked down more than half of all the apparel they sold.

Percent of Apparel Sold at Discounted Prices

First 9 months 2003, by Brand Type and Retail Channel

Channel	National Brands	Private Labels
Department	76.7	85.5
National chain	57.8	66.5
Specialty	82.3	84.7
Mass merchant	56.0	60.1
Off-price	65.4	70.1
Other	56.3	57.2

Source: STS Market Research.

Does Branding Combat Price Deflation?

So how has branding, both private-label and national, fared as a marketing strategy to beat the climate of price deflation? Not so well. Recent research conducted by Cotton Incorporated examined the performance of the top brands in selected apparel categories by measuring changes in the "brand premium" over time. The brand premium is defined as the difference between the average retail price of a branded apparel product and the overall average retail price for that apparel category. The brand premium is positive for a branded product with an average price above the market average, and it is negative for a brand with an average price below the market average. In our study, we looked at unit prices and brand premiums for 1995, 2000, and 2002, using an index scale where the average retail price for a product equals 100.

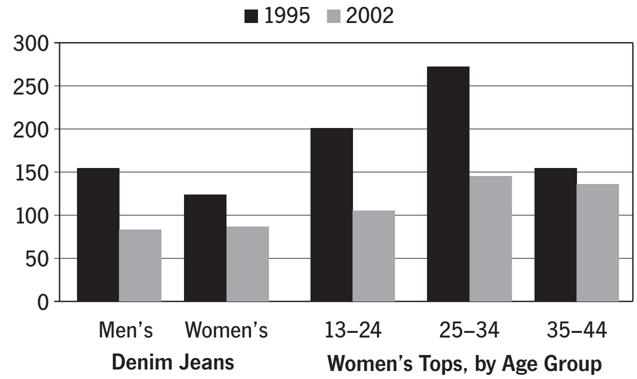
Measurement of brand premiums over this eight-year period gave some startling results. In the category of women's tops, only 6 of the 30 leading brands increased their brand premium, and 10 lost premium, with the largest declines among the higher-priced brands. The remaining 14 brands experienced no net change in brand premium. An analysis of the men's and women's denim jeans market revealed a similar pattern. None of the top 19 brands of men's jeans increased their brand premium, and the premium for 11 brands declined. In women's denim jeans, none of the top 19 brands increased their premium, and 14 lost premium.

The failure of brand premiums to increase was accompanied by another interesting phenomenon: the "premium range"—the spread between the highest positive premium and the lowest negative premium—narrowed from 1995 to 2002. In women's tops, the premium range narrowed by 48% for women aged 25 to 34 and by 14% for women aged 35 to 44. In denim jeans, the premium range narrowed by 45% for men and by 30% for women.

Can a Brand Premium be Preserved?

These research findings not only validate the price pressures at retail, but also raise the question of whether—and how—a brand can maintain a positive price premium. If a brand is forced to compete

Brand Premium Ranges* for Selected Products



*The spread between the highest positive brand premium and the lowest negative brand premium, where 100 = the average retail price.

Source: Cotton Incorporated Strategic Planning.

simply on the basis of price, its price will decline towards the "market center," or average retail price. In other words, brands that engage in price competition to gain market share will almost inevitably lose their brand premium advantage over time. Once lost, a premium appears to be difficult, if not impossible, to regain—a pattern we refer to as the "black hole theory of brands." Like a black hole in space, brands that collapse into the market center will find it difficult to escape the mass of brands competing on the basis of price.

How can brands avoid losing premium and falling victim to the black hole? One obvious answer is for a brand to resist diluting its premium through discounting or marketing in too many different retail channels. Once consumers see a brand offered simultaneously at different channels, such as department stores and mass merchants, the ability to maintain a positive brand premium may be fatally compromised. A better strategy is to introduce a different brand name, perhaps affiliated with the original brand, but with enough independent brand identity so that consumers and retailers can differentiate products. Without differentiation, apparel products will compete largely on the basis of price.

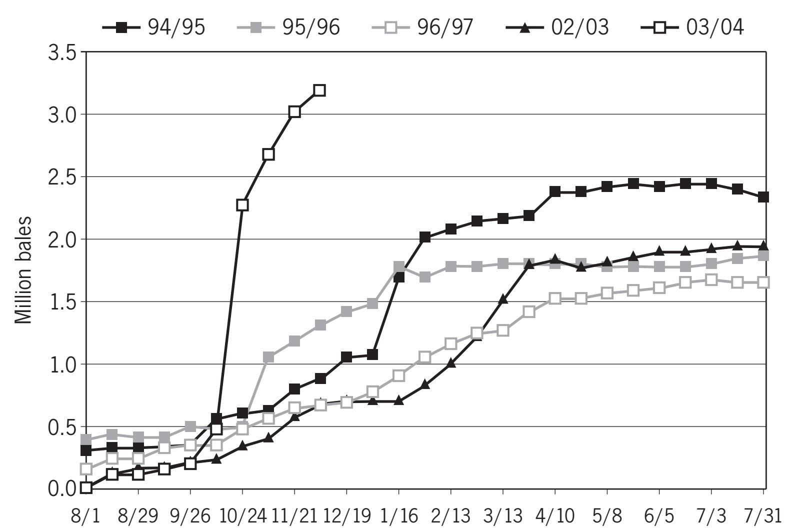
Another strategy for preserving brand premium focuses on emphasizing the non-price attributes of the brand. Attributes such as packaging, labeling, and customer service can enhance a brand image without compromising the brand's retail price. Retailers and brands need to look for ways to enhance the perceived value of apparel products to consumers through product improvements or by emphasizing products' attributes that consumer research demonstrates are important to the purchase decision—such as style and fiber content.

China's Raw Cotton Imports Propel Fiber Prices

As the world's largest producer and consumer of raw cotton, China can have an immense impact on the world market for cotton. In years like this, when Chinese consumption outpaces production, China must import cotton to close the gap between supply and demand. With that gap now the largest on record, Chinese imports are forecast to reach a record high. Import forecasts for the 2003/04 marketing year have been continually revised upward, and the anticipated record level of imports has been a primary factor underlying the strength of cotton prices over the last few months.

Current USDA estimates peg Chinese production and consumption at 22.0 and 30.2 million bales, respectively. China must cover this deficit of over 10 million bales by either drawing down its domestic inventories of raw cotton or importing cotton from the rest of the world. Many analysts believe China's cotton reserves to be less than

U.S. Cotton Sales & Shipments to China



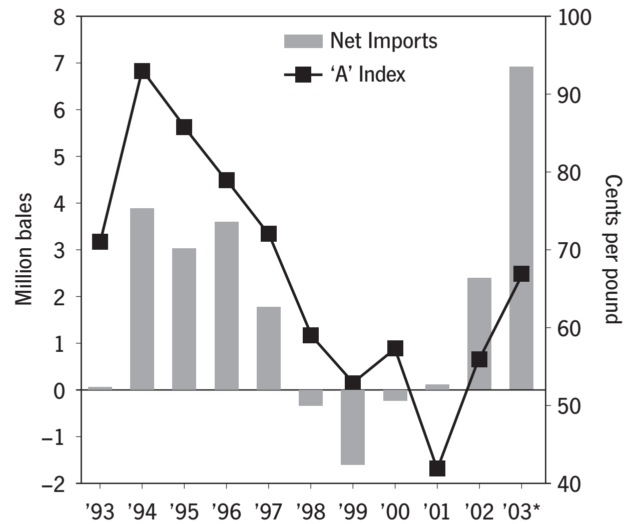
Source: USDA.

6.8 million bales, the lowest level in a decade—and that China must again be a large net importer of cotton this marketing year.

In years when China has been a large net importer of cotton — 1979/80, 1994/95–1996/97, and last year—the United States has been its largest supplier, accounting for approximately 55% of total Chinese purchases. In the current marketing year, U.S. sales and shipments to China had by early December climbed to a record year-to-date level — in excess of 3.2 million bales — already exceeding China's imports of U.S. cotton for any entire marketing year since 1979/80. The unprecedented shortage of cotton in China and China's rapid rate of purchases since the end of September caught the market largely by surprise. In August, the USDA projected Chinese cotton imports from the United States to reach 3 million bales, comparable to last year's purchases. Now, on the strength of robust early-season sales, projected Chinese imports stand at a record 7 million bales.

When China is a large net importer of cotton, the world price (measured by the 'A' Index) tends to rise. Accordingly, as estimates of Chinese net imports have steadily risen over the last two marketing years, price also has risen. Between August 1 and December 1, 2003, as Chinese purchases of raw cotton in the world market soared, cotton prices rose sharply, by 20.1% in the world market and 29.7% in the U.S. market (New York nearby futures contract price). The average year-to-date price is already higher than in the last several years and is poised to remain firm should forecasts for Chinese net imports rise even further in the months ahead.

China's Net Cotton Imports & the 'A' Index



Sources: USDA and Cotlook Ltd. *Forecast imports and YTD price.

Cotton Incorporated

World Headquarters
6399 Weston Parkway
Cary, NC 27513
Tel. (919) 678-2220
Fax (919) 678-2231

New York
488 Madison Avenue
New York, NY 10022-5702
Tel. (212) 413-8300
Fax (212) 413-8377

Los Angeles
110 East 9th Street, Suite A-792
Los Angeles, CA 90079
Tel. (213) 627-3561
Fax (213) 627-3270

Mexico City
Av. Insurgentes Sur 1605, Piso 9
Col. San José Insurgentes 03900
México D.F.
Tel. 52-55-5663-4020
Fax 52-55-5663-4023

Osaka
Osaka Kokusai Building
27th Floor
3-13, Azuchi-Machi 2-chome
Chuo-ku, Osaka, 541, Japan
Tel. 81-6-266-0707
Fax 81-6-266-0710

Singapore
250 North Bridge Road
36-02 Raffles City Tower
Singapore 0617
Tel. 65-6337-2265
Fax 65-6337-3572

Shanghai
Unit 2309 & 2310, Plaza 66
1266 Nanjing Rd (W)
Shanghai, 200040 China
Tel. 86-21-6288-1666
Fax 86-21-6288-3666

www.cottoninc.com

Textile Consumer™ is published quarterly by Cotton Incorporated as a service to the textile and retailing industries.