

Impacts of The Production of Private Labels on The Food Retailing and Its Suppliers

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The share of private label (PL) sales in the retail trade is increasing worldwide. In this paper we analysed the situation in Hungary and how this phenomenon influences the relationship between the suppliers and retailers in the food market. Owing to lack of statistical data we used in-depth interviews conducted with experts of five retail and 24 supplier companies. The most important result of our research was that the Hungarian food suppliers have already developed their PL production strategies. We could distinguish a defensive, an offensive and an innovative strategy which depended on the characteristics and possibilities of the related firms. It was also an important result that the increase in PL products brought not only disadvantages but also benefits for the suppliers. Although it increased their vulnerability and reduced their profitability, it also improved their capacity utilisation, covered their fixed costs and in some cases opened new markets for the suppliers.

Keywords: Private label, food retail, food suppliers.

JEL classification: D21.

Introduction

The share of private label (PL) sales in the food retail trade has increased remarkably during the past five years, amounting to a considerable proportion throughout Europe, taking 10 to 45% of the total market from the manufacturer brands. In Hungary, the share of the store brand products already approaches one quarter of the sales volume of the domestic market. Store brands are not spreading in a uniform manner in all product groups; they have the highest penetration in the so-called 'utilitarian' product category, where customers have no emotional attachment and therefore these products are less suitable for branding by manufacturers. These product groups include pet food, frozen food, breakfast products, basic milk and meat types, where already almost half of the market is dominated by private labels, including in Hungary. But even the category of 'hedonic' products, such as sweets

and alcoholic drinks, previously considered a secure stronghold of the manufacturers, is no longer exempt from the competition of private labels.

Distinction constitutes the primary purpose of brands, thus evidencing a product's individual and irreproducible character. Brands have therefore become a condensed symbol of the benefits granted by the goods to customers. They constitute one of the most important marketing tools and, if sufficiently strong, an embodiment of independent market value.

The evolution of private labels has already passed through several stages, and this also meant that the value of these products has increased (Maurer, 2006). The so-called first generation PL products were of low quality and their price was 30-50% lower than the price of branded products. The further development from the generation of 'economic' cheap mass products to the high standard, innovative 'individual' category resulted in the third and fourth generation PL products providing real alternatives for any possible customer demands and segments, thus becoming an efficient instrument available for the retail trade in bringing down the bargaining positions of suppliers with strong manufacturer brands.

We have identified four factors that have encouraged the spread of store brand products. These include: concentration of the food retail trade through establishment of scale efficiency conditions; spreading of the heavy discount stores, owing to large volume sales of own-brand products; commercial pricing advantageously influencing the consumer price that has become a significant benefit due to the effects of the economic crisis; and finally the increasing level of acceptance by customers thanks to the constantly improving quality of PL products.

The main driving force of spreading of PL products is the demand of consumers. Though it is impossible to

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characterise the typical consumers of PL products by socio-demographic criteria, it is widely accepted in the literature that the consumers of PL products are well informed, rational, price-sensitive persons who do not listen to advertisements. According to Quelch and Hardling (1996) the spreading of PL products and the economic situation follow opposite directions. Nandan and Dickinson (1994) showed that consumption of PL products increases in an economic recession. Lamey *et al.* (2007) go further, stating that the consumption level never re-establishes after a crisis.

International and also Hungarian researchers have tried to describe the typical suppliers of PL products. Citygroup Smith Barney (2005) found three main categories:

- Big producers, which produce both PL and branded products;
- middle-sized or small producers which are specialised in producing PL products;
- Retailers and wholesalers which within their own plants or in vertical integration produce PL products for themselves.

Dobos (2007) and Bunte *et al.* (2010) confirmed that the retailers preferred the bigger companies as suppliers of PL products. Nevertheless it is important to underline that all three studies found that the role of middle-sized and small companies has increased in the production of PL products.

The effect of PL products on innovation was one of the most important questions in our research. The international literature underlines the negative effects:

- the lower income of the suppliers owing to lower price of PL products impedes effective innovation (Olbrich *et al.*, 2005);
- the new products are copied so fast by the PL products that the branded goods do not have enough time to earn the cost of innovation and this restrains innovation (Olbrich *et al.*, 2005; Bernitz, 2009).

Both Hungarian and international researchers found positive effects as well:

- The source and motivation of the innovation is the demand, so the increasing demand for PL products creates innovation on the production side (Czibik-Mako, 2008; Dobos, 2007);
- The new generations of PL products are not just copies of branded products, some of them are real new products created by the retailers and suppliers in cooperation, as the retailers know very well the consumers' desires from their vast databases (scanned data, retail cards etc.) (Chunling *et al.*; 2008, Maurer, 2006);
- In the case of large producers innovation may speed up as their PL products compete with their own manufacturer brands (Competition Commission, 2007).

The aim of this paper is to explore the theoretical background of the history and development of private la-

bel products within Hungary and across Europe, analyse the aspects and strategy of both the suppliers and retailers with special regard to food innovation, and investigating the opinion of consumers. We tried to judge this phenomenon objectively as we have encountered many false opinion and information about PL products.

Methodology

The starting point of the research was the exact definition of PL, exploring the sub-categories within this term, and how the meaning and quality of PL products have changed during recent decades. In order to explore the strategy of Hungarian suppliers and retailers regarding PL products we used three main methods during the research:

- reviewing of Hungarian and international literature in the field of food retail;
- in-depth interviews conducted with experts of five retail and 24 supplier companies; and
- data collection of prices and other information available from retail leaflets and web pages in order to analyse the pricing policy of PL products.

Data collection covered the first half of 2010. In some product groups, we have also tried to assess the share of the private label and manufacturer brands, allowing conclusions to be drawn concerning the probable intensity of price competition as well as the share of store brands within the total sales. The interviews were also conducted in 2010; in the first half of the year we interviewed the retailers and small food industrial enterprises, in the second half we concentrated on larger supplier companies.

Results

Consumers' Estimation of Private Label Products

The analyses of retail experts indicate that, although it is hard to establish on the basis of socio-demographic criteria the identity of the consumers inclined to purchase store brand products, sales of private label products are principally increasing among well-informed rational and price-sensitive consumers, less impressionable by promotions. Both experience and the international trade literature allow the conclusion that the demand for store brands increases during an economic crisis and this increased demand does not return to the previous level even after the crisis period.

Although we did not carry out our own consumer market research, we asked the opinion and experiences of the interviewed experts about consumption trends. It is clear from their answers that in Hungary the consumption of PL products has increased significantly. It was also widely accepted that this trend will probably continue as the consumers nowadays encounter the third and fourth generations of PL products which give offer favourable

price/value ratios, so they do not have any reason to switch back to branded products.

The interviewed experts from both the retail trade and supplier side mentioned the price sensitivity of the Hungarian consumers as an important factor, although this factor was more stressed by the retail trade side. Both sides agreed that the quality of private label products is improving and this strongly depends on the consumers' requirements. Also domestic customers show a growing demand for Hungarian products; as a result, an increasing number of commercial chains indicate in a distinct manner the domestic origin of their private label products.

Retailers' Strategy on Private Label Products

With the spreading of PL products the importance of category management has increased in the retailers' strategy. But there are great differences among the rates of store brand product distribution by the different commercial chains operating in Hungary, as this is strongly connected with their product range and price policies. Tesco (a British retail company) had a leading role in selling private label products for nearly five years, until 2007. Even although the rate of private label products during this period doubled, by the end of the decade Tesco had lost its leading position, which was assumed by Lidl (the quickly expanding German hard discounter) which sells mainly store brand products.

In response to the spreading of discount stores and private labels, all major domestic retailers reacted through expansion, deepening and diversification of their store brand portfolio. The 'economic', 'mid-price' and 'premium' brand lines appeared, but more companies mentioned that the lowest category PL products caused a bad image for the retailer, so nowadays they try to quit these and advertise their more valuable PL products.

The good image of PL products is important for the advertisement of the retailer, for increasing the sales volume and for gaining bigger market share. This is why that the retailers are very rigorous about the quality and safety of their PL products. Their suppliers must meet high level food safety requirements, must invest in adaptation of food safety systems etc.

According to the interviewed experts of the retailers, it is a very important strategic question as to which products are sold as PL products, as a successful product group can bring in many new consumers. (For example the good quality but cheap baby care products of Tesco increased the sales volume of the firm). In the case of international retailers the decision on the assortment policy of PL products is also international. The centre finds the products and tests the market, and if the product is successful it will be placed on the market of other regions.

In the case of regional PL products the suppliers are usually chosen in (electronic) tenders. This can increase the level of imports but also provides opportunities for Hungarian firms. Unfortunately most of the Hungarian

food industry firms are too small to supply a regional market so they are rarely successful in these tenders.

In the case of foods where the national taste and tradition are more important, it is more common that the retailer develops PL products especially for the domestic market, in many cases in co-operation with a national supplier who is a leader in the domestic market or has a strong national brand. This are gives more opportunities for the Hungarian food industry companies.

Suppliers' Strategies

The rate of spreading of PL products is so high that it is impossible to stay out from their production. Nevertheless the rate of PL products within the food industry firms' production structure ranges widely. All of the firms in our sample produced PL products; the average rate of their production was 43%. The larger companies produced fewer PL products, the smaller firms more, but the spreading was extremely high in the case of small firms (Figure 1).

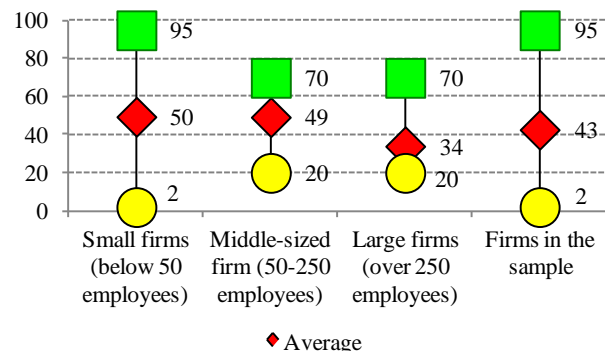


Figure 1. The Rate of Private Label Products from the Sales Volume in the Interviewed Firms (percents)
 Source: own survey

The food industry companies apply different strategies in this context. The first strategy we have called 'joining in order to save my market share', meaning a defence solution. The second strategy was the opposite of this: it was typical in the case of smaller, follower firms which tried to gain market by winning the production rights of PL products, imitating the products of a big food industrial firm. This is a typical offensive strategy which we called 'joining in order expanding my possibilities'. We have found some examples of innovative small firms which still resist the production of PL products, but these companies valued their strategy hardly sustainable.

According to the Hungarian food industry firms the most important benefit of the production of PL products is capacity utilisation: the continuous, predictable production volumes, which is important for the companies both technologically and for financial reasons (liquidity, predictable selling and income). It is also an advantage that in the case of those companies which produce PL products in large proportion or exclusively there is no need for marketing activity or merchandising and this means lower

costs for the company. Lower back conditions, closer cooperation with the retailers and advantageous in-listing of other products were also mentioned as positive effects of PL products (Figure 2).

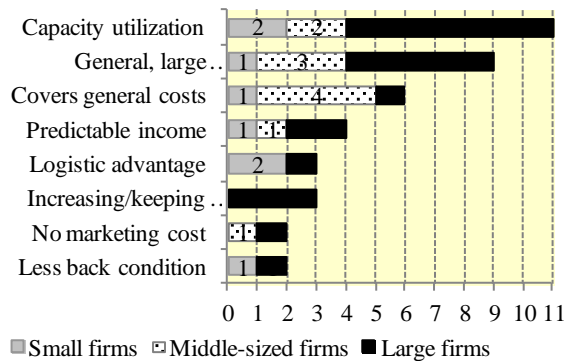


Figure 2. Benefits of the Production of Private Label Products According to the Suppliers (Scores)
Source: own survey

Defencelessness and uncertainty have been cited as the most important and overall disadvantage by the suppliers interviewed, caused by the full replacability of the product and of the manufacturer. The danger of replacing supplier and of de-listing the product exists in the case of private labels without customers' reaction, if there is no quality change. At the same time, losing a large volume order of store brand products may cause serious difficulties for a supplier, especially if packaging material or even private label products that have already been manufactured and are therefore not marketable elsewhere remain in stock. In the case of online tenders generally used for procuring store brand products, several objective problems have emerged at the domestic companies, including for example their insufficient capacity. However they often mentioned that even in the case of having sufficient capacity and proper quality they were not invited to submit tenders in the Central-European countries, while manufacturers of the neighbouring countries may participate in the domestic tenders as competitors (Figure 3).

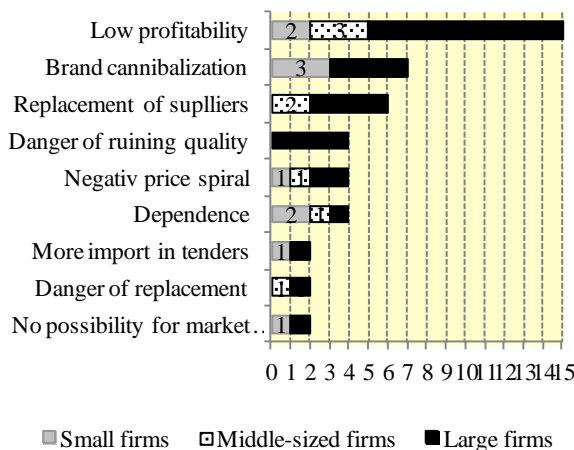


Figure 3. Disadvantages of the Production of Private Label Products According to the Suppliers (Scores)

Source: own survey

In the case of manufacturer brands of insufficient brand value, it emerged several times that the store brand produced by the supplier raised competition against the supplier's own manufacturer brand. As several people noted, the commercial chain's private label production 'cannibalised' the market potential of their manufacturer brand. This danger is also increased by the fact that the composition and quality of the private label brand is often very similar to that of the manufacturer brand and customers quickly get to know this through the rational-minded (non brand-dependent) and 'curious' consumer groups.

From among the commercial practices mentioned in the domestic and international trade literature, the enterprises interviewed confirmed the importance of the different pricing, the less extensive background conditions and the more advantageous shelf positioning. At the same time, they did not consider typical the comparative marketing.

Effects of Private Label Products on Innovation

Neither the trade literature nor our own research confirmed that the innovation in the European or the domestic food industry was at a very low level. However, there are already some warning signs – the low proportion of real innovations or the falling innovation rate in Spain – that forecast possible negative effects of the further expansion of the private label brands to the introduction of new products under a certain combination of market conditions.

Many food industry firms had the opinion that PL products increase innovation. They gave two main reasons for this: firstly, the classical imitating of other firms' brands is a kind of innovation. Secondly, that innovation can be one of the most important defence strategies against the rapid spread of PL products: if the food industry develops new products with better quality and new functions this can save their own brands for a while. But it is an important fact that just innovation is not enough! Good marketing and market research policy are also essential factors in the pre-flight, offensive strategy.

It is also true that the strong competition and the new desires of retailers for creating PL products bound the sources of the food industry firms and no sources and energy remain for 'real' innovation (Figure 4).

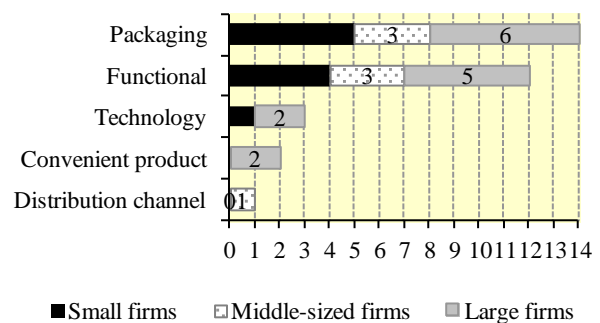


Figure 4. Innovation Types of the Suppliers (Scores)
Source: own survey

It also discourages the innovation that the smaller profit from due to lower prices of PL products reducing the financial resources of the firms.

Probably the picture is not only black or white. The innovation strategy and how it is affected by PL products depends on the characteristic of the firms. Large companies with enough capital and/or with strong brands try to continue their innovation policy, while the smaller firms may concentrate on 'staying alive' by copying other brands or winning tenders for the production of PL products. In these cases we cannot speak about real innovation.

Limitations of the Research

One of the main limitations of our research is the low number of the interviewed experts, especially among the retailers. On the other hand the chosen method (in-depth interviews with many open questions where we wanted to learn their opinions and experiences about the PL products as a phenomenon) did not allow us to meet many more experts. In the case of food industry firms we were successful in covering all of the sub-sectors, every type of firm were represented in our sample, except the producers of pet foods who were not willing to give their opinion.

In the case of retailers the sample is not only small but some types of retailers are not represented at all, though their role in PL sales is important (for example foreign discount chains, foreign supermarket chains). Unfortunately the policy of these companies usually does not allow them to give out information even for scientific research.

We also aimed to investigate and analyse the price policy of the retailers regarding PL products (compared to 'normal' product prices and 'sales' prices of branded products), but this turned out to be impossible as in Hungary the available public databases (HCSO and AKI PAIR consumer price collections) do not differentiate between prices of retail and manufacturer brands. Therefore we have used the promotional leaflets of the commercial chains for comparing prices.

Evaluation of Results and Conclusions

One of our purposes was to evaluate the PL products as a phenomenon from the point of view of consumers, retailers and suppliers. We wanted to judge it: if it is a 'good', 'useful' thing or 'bad' for the different actors of the food supply chain. By the end of our research we learnt that it is impossible to give a simple evaluation for PL products: it depends on several aspects (the strategy, the characteristics of the actors); for some of them it is disadvantageous, for others it is a success story, again others can live with it.

At first sight, from the point of view of the retailers the benefits of the spreading of PL products is clear, as the retailers created them and push them but, investigat-

ing the details, we have found the disadvantages, too. The retailers receive less margin and refunds on PL products.

There are also a lot of disadvantages and advantages associated with PL products for the suppliers. The most important is that most of the Hungarian food suppliers have already developed their PL production strategies and thus they cannot adapt to this new challenge. We could distinguish a defensive, an offensive and an innovative strategy which depended on the characteristics and possibilities of the related firms.

It was also very hard to give any advice for the policy makers regarding PL products, but even so we tried to compose suggestions for improving the positions of suppliers in market situations dominated by store brands.

The first package of suggestions consists of two parts and has been entitled 'raising consumers' awareness'. On the one hand, we suggest elaborating an information programme calling the attention of consumers to the production and origin of food in general. During this campaign, the benefits of locally produced food could be emphasised, together with the importance of knowing the identity of producer and the origin of the ingredients. The second package includes a scheme elaborated after the pattern of the 'Fair Trade' trade-mark. This would provide a guarantee that on the one hand the trademarked products provide 'fair' revenues for suppliers and on the other hand the consumers can be sure about buying from fair suppliers as the trademark guarantees the strict and regular self- and independent control of suppliers regarding their compliance with all legal obligations (tax, labour and quality-related regulations).

Support policies providing assistance to the supplier side could be an efficient instrument in the medium term. Maintenance or even expansion of the already existing R+D competitions (for example within the framework of the Szechenyi Scheme or from European Union funds) is considered of outstanding importance: The same applies to restarting basic food industry research, perhaps through encouraging active co-operation between the existing research centres and universities and enterprises. In addition, based on the failures of launching innovative products, we emphasise the importance of having available funds under the R+D competitions for supporting not only the development but also market introduction and marketing activities related to the product. Under the current conditions of abundance of goods neither the retail trade nor the consumers would accept new products without effective advertising campaigns!

Our purpose is to continue the research by interviewing more companies, especially in the field of retail. In 2008/2009 we analysed the pricing policy of retailers, in 2009/2010 we investigated the food safety systems as another important aspect of the connection of suppliers and retailer. Next year we will research the logistic of foods in Hungary and our long-term aim is to connect these re-

searches into one mega-study which could give a good and correct picture about the food chain in Hungary.

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