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Private Label – Retailers' Competitive Strategy

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Abstract - In today's market conditions there has been an increase in the power of retailers in the distribution channels for consumer goods; at the same time the competition between them has been intensified. Retail chains permanently explore and identify the sources of competitive advantage in order to benefit from them. This article focuses on retailers' private labels as a competitive strategy of the present day. The relationship between the degree of concentration of retailing and the share of private label goods is investigated based on empirical data. The factors facilitating private label goods to penetrate the market are outlined, and the benefits for retailers, manufacturers and consumers in developing such labels are discussed. The theoretical considerations are corroborated by examples from retailers' business practices.

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GJMBR-E Classification : JEL Code: L81, M31

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I. Introduction

The development and consolidation of retail chains worldwide have made them the largest popular channel for communication with customers. The creation of private labels is one of the promising directions of communication of retailers with customers in today's market conditions. Besides, large retailers transform the power of the market position of the participants in the distribution channels in their favour, as it is retailers that can manage the entire distribution system to the highest degree in the consumer goods markets.

The above said implies the successful implementation of the private label strategy and the interest shown by powerful retailers. This strategy is one of the possible ways to differentiate retailers, as well as an important source of competitive advantage.

The aim of this article is to investigate on the basis of empirical data the retailers' policy regarding private labels as an important source of competitive advantage and to reveal the benefits of developing private labels for retailers, manufacturers and consumers.

a) *Nature and development of a retailer's private label strategy*

The competitive positioning of retailers in a rapidly changing market environment is implemented via a wide range of tools, among which private labels occupy an important place.

Private label strategy can be implemented only by large retailers; hence, there is a clear relationship between the degree of concentration of retailing and the share of private label goods. Therefore, a private label strategy is typical for countries of strong competition and significant concentration of retailers (See Fig. 1).

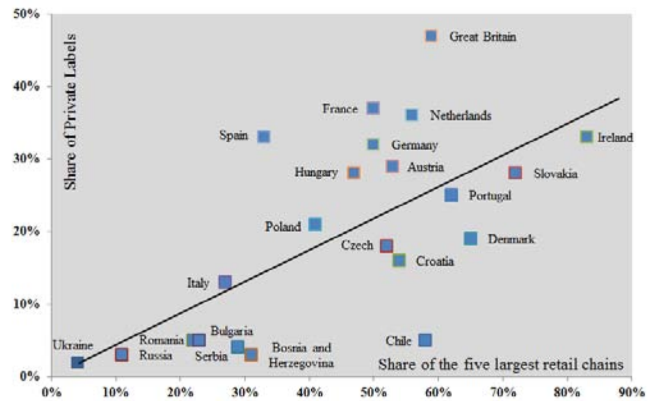

Figure 1 : Relationship between concentration of retailing and private label share, 2010.

Source: Regal, № 10, 2011, p. 31

The data shows that in West European countries, where concentration of retailing is traditionally high and the competition between retailers is being intensified, the share of private label products in retailers' commodity portfolios is large. This mainly refers to discount stores as private label goods are usually offered at the lowest prices. In Southeastern European countries, including Bulgaria, the concentration of retailing is still low and the private label share is small.

Private Label is a strategy of offering products, specially manufactured for a private label retailer and under its specification [1].

A cardinal change in the relationships between market players is being carried out in today's modern society. The role of consumers in the system of market relations is intensified and the impact of retailers' private labels is increased. The globalization of the world economic system enables the development of global competition in international markets, whose main features are: homogenization of consumption, global expansion of mega brands and development of global retailers. Over the last decade, in the market for consumer goods retailers, organized mainly as retail chains, have taken the initiative from manufacturers. One reason for this is the more pronounced competitive orientation of retailers. Most retailers, if not all, beginning with Wal-Mart and Carrefour, and ending with IKEA and Aldi, thoroughly and regularly study price, advertising, assortment, location, characteristics of buyers and all

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other aspects of a competitive situation. In this regard, retailers' private label strategy is identified as suitable under the conditions of growing market competition. Since the 1970s private labels have become an effective tool for increasing the profitability of business. The pioneer in the sphere of creation of a large commercial private label network in 1976 is the French retail company Carrefour. The use of a well-known and developed brand provides significant cost savings in marketing and advertising, allowing, eventually, a significant reduction in retail prices. Naturally, this important advantage is quickly evaluated by buyers. Due to the increased demand, the sales volume and profit of the retail chain are increased. The successful private label strategy is widely spread in many countries. According to the survey conducted by AC Nielsen in 2004, the volume of sales of private label goods in the total sales volume of retail chains in Europe is: in the UK – 41 %, in Belgium – 38%, in Germany – 35%, in Spain – 29%, in France – 25%, in Finland – 25%, in Denmark – 25%, in Sweden – 22%, in the Netherlands – 21%, in Norway – 18% and in Italy – 14%.

Author's own research found the following relationship: the quantity of public label goods in the retail chain is directly proportional to the development of the retail chain itself. In some retailers, e.g. Marks and Spencer (Britain), almost 100% of the goods are sold under a private label. The Swedish IKEA, which is the largest furniture retailer worldwide, is a similar case.

Another relationship that can be outlined is that discount stores offer a greater variety of private label goods compared to the other retailers. For example, the share of private label goods in the German discounter Aldi is approximately 90%. Customers willingly replace established brands with private label goods as they are of similar quality but the prices are 30-40% lower. Therefore, at the height of the global recession the turnover of these goods increased rapidly. The data from the Private Label Manufacturers Association shows that in 2008 the sales of branded fast moving consumer goods rose by 2% and those of similar private label goods in the USA rose by 10% compared to 2007 [2]. In order to meet the increased demand retailers are intensively expanding their assortment of private label goods, introducing new categories and experimenting with innovative products.

There are a number of factors facilitating private label products' penetration in the retail market.

First, the prices of private label products, which are generally cheaper and affordable, and at the same time the risk of poor quality products is virtually eliminated.

Second, the provision of private label products. They are generally available to consumers for a long time, and their distribution is well organized, as retail chains are interested in this more than in the movement of famous competing brands.

Third, profitability of private label products, which as a rule is relatively high for retailers and their pricing policy, is more flexible than that of the national and transnational brands.

Fourth, the features of retail chains which often represent stable oligopolies due to which they sell products of national and transnational brands at relatively high prices. At the same time, retail chains have enough resources to invest in the system of movement and to impose their private labels.

Ultimately, retail chains are more competitive, ensure a higher image, achieve a greater turnover, make cost savings, achieve higher revenue and profits and increase their intangible assets through their private labels.

Expanding their positions and accumulating reputation, retailers realize that they are essentially brands and can build a brand identity and create brand personality which is differentiated and sustainable [3].

There is still no generally accepted classification of retailers' private labels in scientific literature. An important criterion for their classification is the functions performed by the private labels, according to which they are divided into two types: economy private labels and image private labels [4] (See Fig. 2).

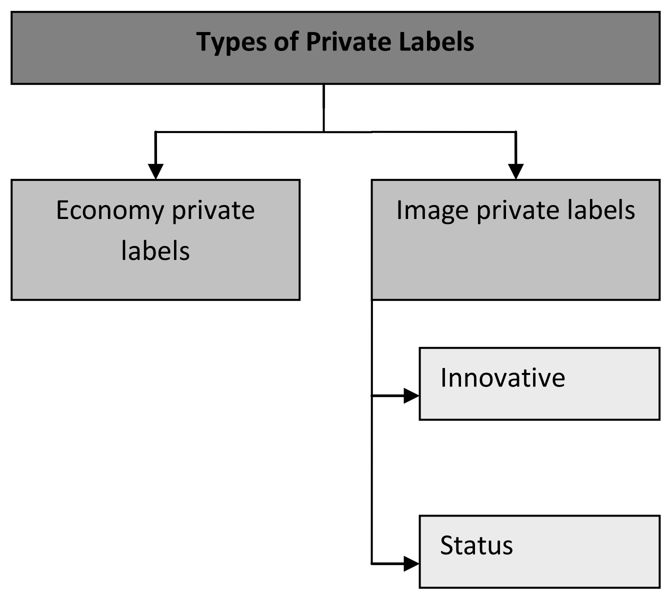

Figure 2 : Types of private labels according to the functions they perform

Economy private labels are the popular private labels of retailers and are oriented to customers who are price-conscious and mainly rationally-motivated to buy. They include primarily fast moving consumer goods; therefore this kind of private labels has the highest share in discounters and supermarkets. In fact, the traditional understanding of retailers' own brands overlaps with economy private labels.

Image private labels are the second type of private labels, which are subdivided into innovative and status. They represent a new trend in the brand strategy development and are created to enhance the favorable image of the retail chain at the expense of innovative and prestigious goods. Owing to their specificity, these niche solutions are designed for specific customer segments.

The innovative private labels are oriented primarily to customers-innovators who are highly interested in new goods. This is exactly the segment that enables their market entry. The large retailers have subdivisions that deal with scientific research and design, studying consumer demand and developing new products. Furthermore, they themselves often contribute to creating the demand.

The status private labels are oriented to the medium price segment and the premium segment. This premises the supply of expensive high quality private labels. They are generally supplied in hypermarkets and supermarkets, and the target consumers are interested in expensive quality goods, emphasizing the status of their owner. Ensuring a constant high quality requires a very thorough selection of a particular manufacturer and strict control over its operation. An example of a successful development of a premium private label is the President's Choice Premium coffee created by Canadian retailer Loblaw. The British retailer Tesco, which is second in sales revenues among retailers in Europe, has launched the so-called three-step approach to their private labels. It suggests that the retailer has private label products in all three price segments – low, medium and high. According to a GfK survey the number of private label items outside the lower price segment in Germany increased by 60% for the period 2006-2010 [5].

Summarizing what has been said so far it can be pointed that by creating image private labels and sometimes offering them at lower prices, the retailer pursues a strategic goal – to create consumer attachment to the retailer. Image private labels help to create a positive image, provide high confidence in the retailer and promote the sales of other goods.

b) Advantages of developing private labels

The intensive development of private labels is due to the advantages they provide to retailers themselves, as well as to manufacturers and consumers.

Private labels can be simply defined as profitable for retailers because they attract customers, generate turnover, allow them to have high profit margins and create customer loyalty. This makes them an important source of a competitive advantage for retail chains which develop their private labels. In a stagnant market they become a more appropriate solution being a cheap way for new product recognition. This is due to cost saving in advertising as retail chains rely entirely on their own advertising. The retailer's own image serves as a positive message to customers, and the outlets and brochures – as an advertising space. Furthermore, the positioning of their private labels in the stores is specially designated and attractively located. Retailers are seeking to position their private labels as the best value-for-money products. It should be emphasized that the guarantee of quality is crucial as it creates the consumer confidence in brands. Thus, it can be transferred to other categories of private label products of the same retailer, and also to the retailer's goods as a whole.

Private label goods of a retailer are traditionally offered at low prices, which led to their rise in the global financial crisis and the resultant recession. The aim of the retail chains to minimize losses has made them improve the strategies for customer relations, a key element of which are private labels.

Synovate, a leading global market research firm released in late August 2009 a survey of 26 markets through canvassing 17 300 people, which clearly demonstrated that consumers in most markets switch to retailers' private labels. This applies to products in 12 categories, such as dairy products, other essential goods, cosmetics and retailers' alcohol brands, including products in which this trend has been observed for the first time, e.g. coffee [6].

Supplying private label quality products at the lowest price is not an easy task. In order to achieve their goal, retail chains need to carefully choose manufacturers-suppliers of the goods that can meet their high requirements and quality standards.

The following important factors facilitate the effectuation of low prices:

- Large orders and the effect of economy of scale reducing the product costs;
- Negotiating maximum discounts with suppliers for the purchase of large consignments of goods;
- Professional management, adequate logistic scheme and presence of distribution centres allowing for a substantial reduction in operating costs;
- cost savings in advertising private label products.

Private labels are developed by retailers themselves. There are subdivisions in the organizational structure of large retail chains, which deal with the complex management of the chain's private labels and are incessantly looking for an opportunity to develop and expand them. They assign the developed product specifications to manufacturing companies usually selected via competitions. In turn, manufacturers must have a background and very good market positions to afford to produce under a retailer's private label. This reduces the risk for the retailer to produce private label products of low quality.

The manufacturers of a retailer's private label goods can also benefit significantly.

First, making a profit from the high turnover. The manufacturers of a retailer's private label product in many cases serve all (or most) of the chain's stores, although located in different foreign markets.

Second, protection against cheap competitive proposals.

The use of private labels as brands accompanying the manufacturer is a very good solution in this regard. Before the advent of retailers' private labels many manufacturers produced the so-called co-brands to protect themselves from competitors offering lower prices. These brands are sold at lower prices than the other brands of the same manufacturer in the same product category in order to attract price-conscious consumers. Thus, price increases do not necessarily cause a loss of market share. In the proliferation of retailers' private labels they can successfully play the role of co-brands.

If the retailers' private labels take up too great a share in the sales of a given manufacturer (over 20%), the risk for this manufacturer is serious due to the minimal profit margins and the possibility that a retailer may switch the supplier. Therefore, the manufacture of private label products can be chosen by the manufacturer as a way of further capacity utilization. Furthermore, it is necessary to establish proper partner relationships between manufacturers and retail chains in order to reduce risks.

The main advantages for the consumers of retailers' private label goods relate to the low prices of these products in an optimum quality/price ratio and also the purchase of goods of guaranteed consistent quality. Moreover, consumers procure the purchase of original goods due to the specific mode of organizing their production and distribution. This advantage increases its importance in image private labels.

The distribution of private label goods is most significant in Europe (i.e. Western Europe); at the end of 2008 they formed 28.3% of retail sales, and worldwide their share was 20% on average [7]. According to AC Nielsen private label sales will reach 30% of the global commodity turnover in 2020 [8].

The strategy which all large European and American retailers follow is to increase the private label share in their total sales, accompanied by the expansion of product categories which they cover. For example, Metro retail chain, along with its most famous food brand Aro, has three more food brands – Four Seasons for confectionery, Casa Roma for spaghetti, macaroni, etc. and Metro Quality for goods on the higher price list. Watson is a brand of black appliances, Alaska – of white appliances, Timor - of lingerie, Don Pablo – of different types of port wine, Charles House – of whisky, Budget – of spare parts and accessories. Clever, the private label of Billa is successfully positioned in all markets where the chain operates and, having an assortment of about 400 products, it is a powerful weapon against discounters. Also the performance of its about 80 private label products is very good – My (cosmetics), as well as Chef Menu (the convenience brand) [9].

In Bulgaria, the private labels of retail chains were not known until 8 years ago, but due to the turbulent expansion of West European retailers in the Bulgarian market and the increase in the level of concentration and competition in the retail sector, the share of the private labels of retail chains in their commodity portfolio is constantly rising. This finding is supported by the annual survey of GfK, which indicates that the value share of the private labels of retail chains operating in Bulgaria is as follows : 2008 – 2.8% , 2009 3.7 % 2010 – 5.9 %, and in 2011 it amounted to 11.1% [10].

The leading retailers in the Bulgarian market, such as Metro, Kaufland, Billa, Lidl and Carrefour, include the highest private label share (20-30%) in their product portfolio and their aggressive domestic expansion (especially Kaufland and Lidl) logically leads to an increase in the share of private label goods in the total retail sales.

The author's own survey of managers of leading retailers in Bulgaria shows that they include private labels in their main competitive advantages, along with service, product assortment, image and customer loyalty schemes [11]. It is private labels that provide the clearest differentiation of retailers because of their originality and uniqueness.

II. Conclusion

The survey of retailers' policies conducted regarding their private labels leads to the following major conclusions:

- The development and supply of retailers' private label goods is a significant competitive advantage, particularly in increased competition, economic crisis and narrow market;
- There is a direct proportional relationship between the degree of concentration in the retail sector and the share of private label goods;
- The quantity of private label goods in a retail chain is directly proportional to the development of the retail chain itself;
- The discount retail chains offer more private label products compared to the other retailers because they apply a low-price strategy;
- In order to enhance the effect, the retail chains had better diversify their private label strategy in the direction of supplying private label goods in the three price segments: low, medium and high;
- Retailers as well as manufacturers of such goods, and of course, consumers draw benefits from the development of private labels;
- The professional management of retailers' brand portfolio is a crucial factor for the competitive positioning of their private labels.

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