Oxera

Agenda

Advancing economics in business

Correctly labelled? The economic benefits of retailer own-brands

Grocery retailers play an important role in our shopping patterns, with grocery sales representing around half of all retail sales in the EU. A significant proportion of these sales are supplied by large grocery retailers, some of which sell goods under their own-brand labels. Various government, regulatory and industry organisations have expressed both positive and negative views about the impacts of own-brands—here we explore some of the issues around them, and attempt to correct some common misconceptions

A retailer own-brand is a product or service that carries either the brand of the retailer or a separate brand name controlled by the retailer. Some organisations have highlighted the vigorous competition that own-brands can help to create for branded products, or have raised concerns about the impacts of own-brands on other retailers and suppliers.

In September 2010 Oxera published a report,[1] commissioned by the European Retail Round Table (ERRT), identifying the benefits of grocery retailers' own-brands and addressing common misconceptions about them.[2] Based on publicly available sources of evidence, and information provided by ERRT members, the report approached the issue of own-brands from the perspectives of consumers, retailers and suppliers, and the findings are summarised here.

The evolution of retailer own-brands

In some cases, early own-brands simply provided an inexpensive alternative to branded products—typically generic grocery items with the grocery retailer's branding. Retailers first began to expand their own-brand products by offering a range of price/quality combinations. Some retailers added further sub-brands at different points in the price/quality hierarchy, and sub-brands catering for particular customer preferences or demands, such as organic or allergen-free brands. Many grocery retailers design, develop and market-test their own-brand products before contracting out the final production, in the same way that many branded-goods manufacturers do.

Own-brands are valuable brands in their own right, in some cases adopting brand names that are distinct from the name of the retailer. The prevalence of own-brands varies widely between retail sectors (see Table 1 below).

Grocery sales represent around half of all retail sales in the EU.[3] Within the grocery retail sector there are marked differences in own-brand penetration between product categories. As shown in Table 2 below, own-brand products are less prominent in personal care than in food and drink and household care. Even within food and drink there is substantial variation. Own-brand penetration also varies significantly between European countries.

The economic impact of retailer own-brands

Why are brands and own-brands valuable to consumers?

In economic terms, a brand is a method by which firms can build a (usually long-term) relationship with existing and potential consumers about various aspects of their products or services, including advertising, packaging and customer experience.

In providing the consumer with an implicit 'guarantee' about aspects of the product, such as price, quality, innovation or service, the existence of a brand benefits the consumer. Once a brand has been established in the minds of consumers as having certain attributes, if these attributes no longer hold, the value of the brand will be diminished. As such, the brand owner has an incentive to ensure that these attributes (eg, attractive price, high quality, good after-sales service) continue to apply in order to maintain the value of the brand.

Table 1 The use of own-brands differs between retail sectors

Own-brands predominate	Mixture of brands and own-brands	Brands predominate
Home improvement/DIY stores	Grocery retailing – Some niche own-brand-only retailers (eg, Aldi) – Large players mix own-brands and brands (eg, Tesco, Asda/Wal-Mart) – Niche alternative routes to market (eg, specialised food retailers, farmers' markets)	Perfumes—retailer own-brands are rare
Clothing retailers—some boutique stores sell multiple brands, but single-brand stores predominate in many European countries	Over-the-counter pharmaceuticals—competition between low-price, own-brands/generics and heavily marketed branded medicines	Electrical retailers—some very large chains have low-priced own-brands, but well-known electrical brands are the norm

Source: Oxera.

Table 2 Own-brand penetration varies considerably across product categories

Top ten categories	Own-brand % share	Bottom ten categories	Own-brand % share
Aluminium foil	49	Face moisturiser	3
Complete ready meals	47	Shampoo	3
Milk	43	Insect control	3
Rubbish/refuse bags	40	Beer/lager/ale	3
Meat/poultry/game	39	Deodorant	3
Fish/shellfish/seafood	39	Toothpaste	3
Vegetables[1]	38	Baby formula	2
Vegetables[1]	36	Lipstick/gloss	2
Kitchen paper/kitchen towel	33	Baby food	1
Cheese	33	Chewing gum	1

Note: These are the top and bottom ten of the 80 survey categories in 38 countries. Although these figures are from 2005, Oxera is not aware of any more recent publicly available data. [1] 'Vegetables' were split into two separate categories.
Source: Adapted from Nielsen (2005), 'The Power of Own-brand: A Review of Growth Trends Around the World', September.

Impact on consumers

The dynamics of the grocery supply chain in Europe, as elsewhere, are driven by consumer demand. Overall, the economic theory and evidence reviewed for Oxera's report suggest that own-brands provide benefits to consumers—for example, by delivering new products and value for money. In addition, consumers who buy branded products rather than own-brands benefit indirectly where increased competition from own-brands forces branded alternatives to compete more vigorously.

The report also considers whether retailers could use their own-brand products to harm competition (for example, by forcing branded rivals out of the market), allowing retailers to raise prices or lower quality, range or service to the detriment of consumers. However, in a recent working paper on the retail sector, the European Commission stated that competition among grocery retailers is strong:

> One of the key findings ... is that competition at retail level is fierce, both between retailers themselves and increasingly between different retail formats.[4]

The Oxera report concludes that because retailers are considered to face fierce competition, the balance of branded goods and own-brands in stores will continue to be driven by what consumers demand.

Benefits of positive and negative spillovers—in some cases brands can apply to a single product, and the incentive to maintain the brand's value relates to the sales of that product. For brands that cover a range of products (eg, cars or hotel chains), there can be spillover (ie, externality) effects between the products:

- if one product in the range fails to maintain the standards embodied by the brand, this can affect consumers' views of all products in the range (negative spillovers), so there is an additional incentive for brand owners to ensure that all products meet the required standards;

- improvements to the brand image can benefit all products in the range, so there is a greater incentive to invest in the brand image since the costs are in effect shared between the products (positive spillovers).[5]

Grocery own-brands often cover a wide variety of products so the beneficial spillover effects are likely to be stronger than for those manufacturer brands that encompass narrower product ranges or single products.

Choice and variety—retailer own-brands bring new products to the market that often differ from existing manufacturer brands. This provides a benefit to consumers in terms of the choice and variety of goods on offer. In addition, product quality may be high due to spillover effects (see above).

One concern is that increased market shares of own-brands may reduce variety and choice for consumers by cutting the shelf space available for other brands. In the extreme, the complete crowding out and/or foreclosure of branded products could also reduce the intensity of competition in some product lines, harming consumers.

However, an increased market share for own-brands does not necessarily equate to a reduced availability of other brands. If consumers value variety then, in the absence of significant market power, retailers will have an incentive to offer alternatives. Furthermore, variety is expensive for retailers in terms of sourcing, stocking and labelling, and some of this cost will be passed to consumers. If retailers are competing hard with each other, as the evidence suggests, competition should drive retailers to ensure the balance between price and variety that consumers demand.[6]

Limited space on store shelves may reduce variety, and may be due to planning regulations rather than retailers' strategic decisions.

Informational benefits—the structure of modern own-brand ranges, with each brand covering a variety of products, allows consumers to make informed choices about products without having to invest time in understanding the specific attributes of each product.

Impact on retailers

Own-brands help to stimulate competition and innovation between retailers by providing an additional dimension on which retailers can compete. Own-brand innovation, such as the introduction of niche sub-brands, allows retailers to win customers by differentiating their offerings from rival chains.

Own-brands allow retailers to work more closely with their suppliers to source the products that consumers demand. They can also help retailers to achieve better terms and lower input prices from both own-brand and branded suppliers, thus benefiting consumers as well as retailers. In the case of own-brand suppliers in particular, lower input prices for retailers may be the result of improved retailer bargaining power, or reduced supplier costs such as scale efficiencies and the absence of brand development costs.

Impact on suppliers

From the perspective of the supplier, the picture is more complex. The existence of retailer own-brands provides new routes to market for small suppliers to produce for mass markets which they may otherwise struggle to access, given the costs and risks involved in developing a brand. Conversely, own-brands can help to increase retailers' bargaining power in relation to their suppliers, which may be perceived negatively by suppliers where it allows retailers to negotiate more favourable terms.

Own-brands and buyer power—buyer power is essentially bargaining power that buyers have over their suppliers to set prices. In general, buyer power has been characterised as either:

- 'monopsony power' (the opposite of monopoly power)—where a powerful buyer can force prices below the competitive level by withholding demand; or
- 'bargaining power'—where more powerful buyers negotiate greater individual discounts than less powerful buyers.[7]

Although retailer bargaining power may be perceived negatively by suppliers, it may have no detrimental impact on final consumers and can provide the impetus for increased efficiency and innovation by suppliers. There is an important difference between anti-competitive buyer power, which risks harming competition and ultimately consumers, and unequal bargaining power, which is a purely bilateral issue between suppliers and buyers.[8]

In some cases the introduction of own-brands may enable a retailer to achieve better deals from branded suppliers, since it is able to replace a branded product on its shelves with a competing own-brand equivalent. However, a retailer depends on attracting customers, and will lose customers to competitors if it does not stock their preferred brands. This is particularly the case with well-known, must-have brands:

When suppliers are producers of 'must-carry' brands, suppliers tend to hold a stronger bargaining position than their retail counterparts.[9]

In general, retailers have no interest in forcing efficient suppliers out of the market since this would tend to harm their own interests—retailers benefit from healthy competition at the supplier level because it keeps their input costs low. One exception would be if the retailer could itself become a supplier with significant market power and thereby enhance its total margin.[10] Given that the essence of retailer 'bargaining power' is that the supplier level is fragmented and highly competitive, and given that the retailer level is also competitive, own-brands are unlikely in general to give retailers the incentive to foreclose suppliers in a way that harms consumers or efficient suppliers. If there were any harm to competition in this respect, it would be reasonable to expect some evidence of it such as high margins on those product markets from which suppliers are foreclosed. A recent European Commission working paper indicates that, at the aggregate level, fierce competition has:

> translated into lower net operating margins for retailers (e.g. according to data presented by the retail sector, retail margins are on average around 4%, even lower on fresh produce where they near 2%) and has contributed to cheaper prices for consumers on the long term. Such findings seem to contradict wide-spread perception that retailers currently have the highest margins in the food supply chain.[11]

Own-brands and supplier innovation—innovation can be beneficial irrespective of whether it occurs at the retailer or supplier level. Own-brands might cause a reduction in innovation only if they reduce the incentives for suppliers to innovate.[12] The effects of own-brands on suppliers' incentives to innovate are mixed.

On the positive side, the ease of entry may make it simpler for innovative suppliers of own-brands to enter the market to compete against branded products, and the enhanced rivalry may induce suppliers of both to innovate in order to sustain a competitive advantage.

On the negative side, if retailers were to use their position as distributors of branded goods to copy their innovations, this would tend to reduce overall innovation. Own-brands might copy innovations in this way if the relationship between retailers and branded-goods suppliers involved the suppliers providing information about their innovations before new products are brought to market.

The balance of positive and negative effects is an empirical question. Following an investigation into concerns about the link between the growth of own-brand products and the rate of investment in innovation, the UK Competition Commission found no evidence that selling own-brand goods has had a detrimental effect on the level of R&D expenditure at an aggregate industry level.[13] Moreover, insofar as the Competition Commission was able to investigate innovation at a product level, it found no evidence of a detrimental effect:

> grocery retailers as customers and competitors of own-label products are not producing an identifiable effect on competition.[14]

Conclusions

Grocery retailers play an important role in most consumers' shopping patterns, and are therefore often the subject of close scrutiny from regulators, governments and industry organisations. Their own-brand ranges are no exception.

For grocery retailers, own-brands can help to stimulate competition and innovation by providing an additional competitive dimension. The existence of own-brands can also provide opportunities for small suppliers to produce for mass markets. On the other hand, own-brands can increase retailers' bargaining power with suppliers. However, in general, while retailers may want to get the best deals from suppliers, they would not have a long-term interest in forcing efficient suppliers out of the market since this may be expected to harm their own interests; retailers benefit from healthy competition at the supplier level because it keeps their input costs low.

Ultimately, however, the grocery supply chain exists to supply consumers, and the economic theory and evidence reviewed for Oxera's report suggest that, overall, own-brands provide benefits to consumers—for example, by helping to deliver new products and value for money.

[1] Oxera (2010), 'The Economic Benefits of Retailer Own-brands', prepared for the European Retail Round Table, September.
[2] ERRT is a network of business leaders established to express the views of large retailers on a range of issues of common interest. Their businesses operate worldwide and represent a cross-section of the retail sector. ERRT members are Asda/Wal-Mart, C&A, Carrefour Group, Delhaize Group, El Corte Inglés, H&M, IKEA, Inditex, Kingfisher, Marks & Spencer, Mercadona, METRO Group, Royal Ahold and Tesco.
[3] European Commission (2010), 'Commission Staff Working Document on Retail Services in the Internal Market—Accompanying Document to the Report on Retail Market Monitoring: "Towards More Efficient and Fairer Retail Services in the Internal Market for 2020"', July 5th.
[4] European Commission (2009), 'Competition in the Food Supply Chain—Accompanying Document to the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: "A Better Functioning Food Supply Chain in Europe"', SEC(2009) 1449/2, Commission Staff Working Document, [COM(2009) 591], p. 9.
[5] See Ezrachi, A. and Reynolds, J. (2009), 'Advertising, Promotional Campaigns, and Private Labels', in A. Ezrachi and U. Bernitz (eds), *Private Labels, Brands and Competition Policy, the Changing Landscape of Retail Competition*, Oxford: Oxford University Press.
In its internal market scoreboard publication, the European Commission noted that in grocery retailing, 'one of the main drivers behind lower prices is the density of hyper-markets and discount stores. Growth in this sector however is often restricted by different urban planning laws that can impose severe restrictions on shop size and opening hours.' See European Commission (2002), 'Internal Market Scoreboard - N°10', May.
[7] See Doyle, C. and Inderst, R. (2007), 'Some Economics on the Treatment of Buyer Power in Antitrust', *European Competition Law Review*, **28**:3, March.
[8] As highlighted in European Commission (2009), 'Competition in the Food Supply Chain—Accompanying Document to the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: "A Better Functioning Food Supply Chain in Europe"', SEC(2009) 1449/2, Commission Staff Working Document, [COM(2009) 591], p. 18.
[9] Ibid., p. 7.
[10] The circumstances in which this would be the case are rather limited, and could be tested only by looking on a product-by-product basis at the incentives of a retailer to foreclose non-own-brand products. This aspect was beyond the scope of the Oxera report.
[11] European Commission (2009), 'Competition in the Food Supply Chain—Accompanying Document to the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: "A Better Functioning Food Supply Chain in Europe"', SEC(2009) 1449/2, Commission Staff Working Document, [COM(2009) 591], p. 9.
[12] Without a compensatory increase in the incentive for innovation on the part of the retailer.
[13] Competition Commission (2008), 'The Supply of Groceries in the UK: Market Investigation', Final Report, Appendix 9.10, paras 41–44.
[14] Ibid., para 44.

If you have any questions regarding the issues raised in this article, please contact the editor, Dr Gunnar Niels: tel +44 (0) 1865 253 000 or email g_niels@oxera.com

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