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2006

WORKING PAPER SERIES

ISSUE TWO

NO. 06-002

MARKETING SCIENCE INSTITUTE

MSI Reports

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2006

WORKING PAPER SERIES

ISSUE TWO

NO. 06-002

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MSI Reports (ISSN 1545-5041) is published quarterly by the Marketing Science Institute. It is not to be reproduced or published, in any form or by any means, electronic or mechanical, without written permission.

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Private-Label Marketing Strategies in Packaged Goods: Management Beliefs and Research Insights

Raj Sethuraman

What's the best way to market private labels? This review analyzes 11 common management beliefs, and compares them to the findings of 56 academic studies. What emerges are some surprising contradictions to conventional wisdom.

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Report Summary

Retailers must answer a number of questions when considering how to market a private label. Retailers' focus on maximizing private-label sales, combined with the traditional view of private labels as low-priced competitors to national brands, have led them to embrace certain beliefs and practices for selling their private labels.

Academic research conducted over the last 40 years has examined those traditional beliefs about private-label marketing practice. In some cases, the studies have validated them; in other cases, the studies have refined them, called them into question, or even contradicted them. In this paper, Raj Sethuraman examines 11 common management beliefs and, drawing on a review of 56 academic studies, looks at the marketing literature's insights into those same beliefs.

Among the common beliefs that marketing research supports are the belief that it is good to introduce a private label into a high-dollar-volume category and the belief that store brand customers are price sensitive. Marketing research negates other common beliefs about store brand consumers, however—for example, that store brand consumers are poorly educated, have low incomes, and are not very quality sensitive.

Insights from academic research also help refine some beliefs. For example, while conventional wisdom states that retailers should introduce store brands in commodity products with high levels of price competition, marketing research suggests that this decision depends on the type of price competition. If the price competition between the national brand and the store brand is high, it is more profitable to introduce a store brand; however, if the price competition among national brands is high, then it may not be profitable to introduce a store brand.

Similarly, while common belief holds that retailers should always position their store brands close to the national brands, academic literature specifies the market conditions when positioning a store brand close to the national brand is profitable, and when it may not be profitable. ■

Introduction

Private labels, or store brands, have become a force to reckon with in the United States. Dollar sales of private labels in grocery products grew at an average annual rate of over 7% from 1996 to 2004, nearly twice the growth rate of national brands. As a result, the dollar share of private labels grew from about 14% in 1996 to about 16% in 2004. The unit volume market share in the United States is about 20% (ACNielsen 2003).

The growth of private labels has spawned a wide range of academic and managerial literature on store brands. A casual online subject search reveals several hundred practitioner articles, most of them focused on how well private labels are doing or what private-label marketers can do to increase sales. Part of the reason for equating sales with success may be the implicit belief that increasing sales of private labels automatically leads to increased profits. For example, in an address to the Private Label Manufacturers association, Hoyt and Company noted that the average retailer's margin from private labels is about 34% compared to the margin of 24% that retailers obtain from national brands (http:// www.hoytnet.com/presentations.htm-Private Label Profitability).

This belief in the importance of maximizing private-label sales, combined with the traditional view of private labels as low-priced competitors of national brands, is the foundation for retailers' other beliefs and consequent sales practices relating to private labels—what I call *common management beliefs* regarding private labels.

On the academic research front, there has been a significant growth in research on private labels, especially since the 1980s. These studies include behavioral and survey-based research focused on identifying the characteristics of the store brand consumers, empirical research that estimates the effect of marketing actions on national brand and private-label sales with the help of scanner data, and analytical research which employs mathematical models to understand the competition between national brands and store brand and prescribe "optimal" marketing strategies. In some cases, these studies have validated common beliefs about private-label marketing; in other cases, they have refined, questioned, or negated some of the traditional beliefs.

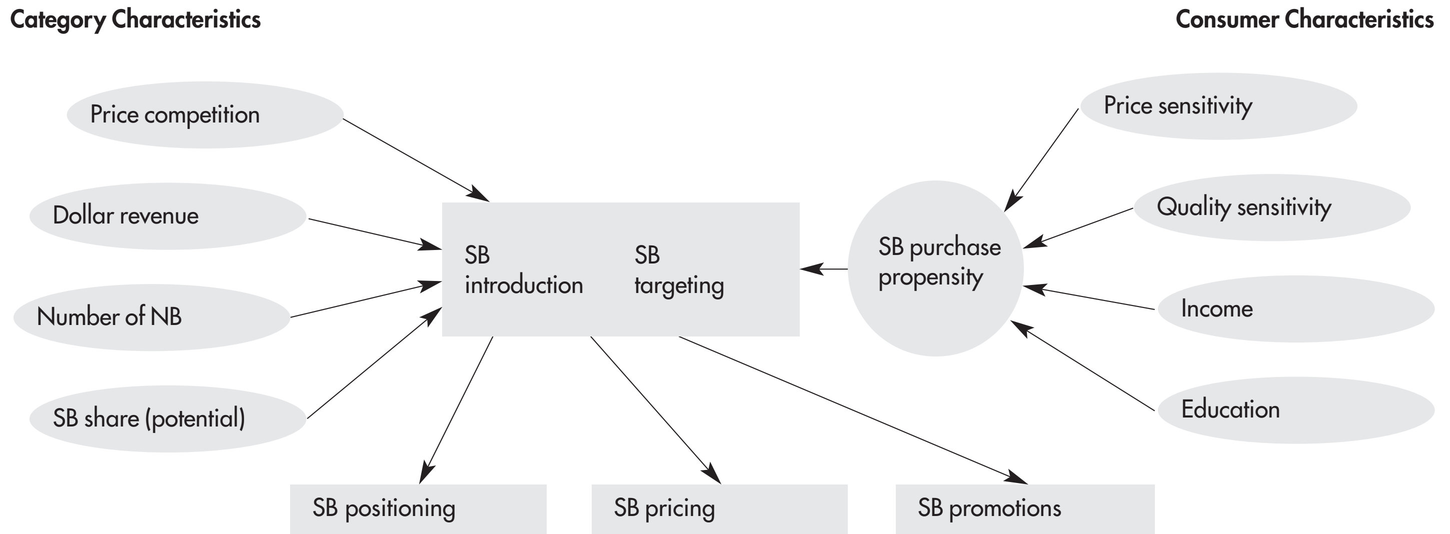
The purpose of this research is to state the common management beliefs about private-label marketing strategies in packaged goods and point out what refinements on those beliefs academic research has to offer. This discussion, I hope, will lead to development of better, more profit-oriented private-label strategies. Through this process, I also hope to highlight the usefulness of academic research for marketing practice, in the context of private-label marketing.

Figure 1 is a visual representation of the framework I use to present these common beliefs and academic insights. First, the retailer must decide whether to introduce a store brand or not. In conjunction with the introduction decision, the retailer also decides which consumers to target with the store brand. If the retailer decides to introduce a store brand, the next decision is how to position the store brand for the selected target market and what price and promotion strategy to adopt.

Retailers will make a better decision regarding whether or not to introduce a store brand if they understand what marketplace factors are conducive to store brand introduction. There are several factors that may influence store brand introduction. In this report, I discuss four category characteristics that have been the focus of academic research.

The retailer's next step, deciding on how to position the store brand, depends on what types of consumers are likely to purchase private labels. There are several demographic, social, and psychological characteristics that determine con-

Figure 1
Framework for Presenting Common Beliefs and Academic Insights
NB = national brand; SB = store brand



sumers' propensity to purchase private labels. In this paper, I discuss four consumer characteristics that academic research has examined.

In the pages that follow, I first cover academic insights that deal with the introduction of store brands and then examine insights that deal with store brand targeting. Validations and refinements related to store brand pricing, positioning, and promotion strategies follow, and I conclude by summarizing the academic insights and suggesting some directions for future research.

Insights on Factors Influencing Store Brand Introduction

For each of the 11 pairs of influencing factors and targets of influence discussed below, I first present the common management belief and then the insights that academic research has contributed.

1. Price competition → Store brand introduction

Common Management Belief. Store brands generally sell on the basis of low price and are not advertised in public media such as local or national television. It is therefore natural to assume that private labels will do well in product categories in which consumers purchase predominantly based on (lower) price and are not influenced by advertising. Managers and researchers have taken this traditional wisdom regarding private labels to mean that store brands should be sold in commodity products for which there is little differentiation among brands in a category (Stern 1966; U.S. National Food Marketing Commission 1966). These categories are characterized by high consumer price sensitivity. Hence, the common belief (CB) is that:

CB-1: It is good to introduce store brands in commodity products characterized by high levels of price competition among brands.

Insights from Academic Research. Raju, Sethuraman, and Dhar (1995a) address this issue and provide useful insights. They use a game-theoretic model to study optimal (profitable) store brand introduction. Rather than investigate just private-label sales or profits, they consider changes to total category profits

for the retailer (profits from both national brand and store brand) as a result of store brand introduction.

Raju, Sethuraman, and Dhar (1995a) find that higher cross-price sensitivity (a measure of price competition) between national brands and the store brand makes store brand introduction more profitable. This finding is consistent with CB-1: if national-brand consumers are likely to switch to the private label because of its lower price, then it is reasonable to introduce a store brand. However, Raju, Sethuraman, and Dhar (1995a) note that there is one other measure of price competition that must be considered when introducing a private label, and the effect of that measure runs in the opposite direction. It is this: if the cross-price sensitivity among national brands in the category is high, retailers may find it less profitable to introduce a store brand. This is because when the price competition among national brands is high, the average national-brand retail price decreases, which in turn depresses the price and retail margins for the store brand, resulting in a smaller total category profits for the retailer. For example, if Coke and Pepsi fight intensely on the basis of price, there may be little room for a store brand to enter the market and be profitable.

Raju, Sethuraman, and Dhar (1995a) find empirical evidence to support their theory. The implication for retailers is that they should take into account not only the price competition between national brands and the store brand, but also the price competition among national brands. In other words, even when dealing with price-sensitive "commodity" products, if there are already established national brands competing intensely on price, it may be better for the retailer not to introduce a store brand, but rather to exploit the benefits of the manufacturers' price competition. Hence, I state the following academic insight (AI):

AI-1: It is good to introduce private labels when the cross-price sensitivity between national brands and the store brand is high, but the cross-price sensitivity among national brands is not high.

2. Category size → Store brand introduction

Common Management Belief. While the gross margin on sales in grocery products is about 25%, the net margin (after incorporating fixed costs) can be as low as 1%. Therefore, retailers would like to obtain higher total profits by increasing their dollar revenues. They reason that the introduction of store brands will have a greater beneficial effect on the business if the store brands are introduced in high-volume categories, and so:

CB-2: It is good to introduce store brands in high-dollar-volume categories.

Insights from Academic Research. No optimization model has explicitly analyzed category size (say, G in total dollar revenue). Raju, Sethuraman, and Dhar (1995a) point out that as category size increases, equilibrium prices are unaffected but equilibrium quantities of both national brands and the store brand increase by a factor of G, resulting in the following:

[Incremental profits from store brand introduction with category size (G)] = $f(G)$ * [Incremental profits from store brand introduction with category size (1)], (1)

where f is an increasing monotonic function. Thus, category sales act simply as a scale factor when computing profitability. If the incremental profit from store brand introduction is positive, then the higher the category sales, the greater the profits. However, if the incremental profit is negative, then losses will increase as category sales increase. The model by Raju, Sethuraman, and Dhar (1995a) does not consider the fixed cost of store brand introduction. Morton and Zettelmeyer (2004) argue that, for the same private-label market share, the larger the revenues in a category, the larger the absolute revenues from the store brand available to offset the fixed cost of the store brand's intro-

duction, and therefore the greater the benefit from introducing a store brand.

Raju, Sethuraman, and Dhar (1995a) and Morton and Zettelmeyer (2004) both find a positive relationship between category sales and store brand introduction using market-level data. Based on these findings, I state the following academic insight:

AI-2: When conditions are conducive to store brand introduction, the higher the category sales, the greater the retailer's profit incentive to introduce a store brand.

3. Number of national brands → Store brand introduction

Common Management Belief. It is commonly believed that there is no place for a store brand when there are already a large number of national brands. Accordingly, Schmalensee (1978) argues that preemptive product differentiation and proliferation by incumbents in a market can deter a store brand entrant. The share of a store brand would be lower in a proliferated market, and the resulting lower production efficiency is an obstacle to store brand entry.

CB-3: It is bad to introduce store brands in categories in which there are already a large number of national brands.

Insights from Academic Research. Raju, Sethuraman, and Dhar (1995a) show through analytical modeling that the common belief need not be true. In fact, retailers may find it more profitable to introduce a store brand in categories with a large number of national brands, because although the introduction of a store brand decreases the retailer's profits on the national brands in equilibrium, when the number of national brands is large to begin with, the introduction of an additional (store) brand does not have as large a negative impact on the profits the retailer makes from the national brands. In other words, it is easy to "sneak in" a store brand without affecting the profits of the existing brands when the number of existing brands is large. Though not explicitly modeling the number of national brands, Morton and Zettelmeyer (2004) argue that more manufacturers actively producing national brands indicates fewer barriers to entry, which means the retailer can more easily find a manufacturer for its brand.

Using market-level data on 426 grocery products, Raju, Sethuraman, and Dhar (1995a) find that the likelihood of store brand introduction is higher in categories in which there are a large number of national brands. Using similar market-level data, Morton and Zettelmeyer (2004) also generally find a positive relationship between number of national brands and the likelihood of store brand introduction. Based on this evidence from academic research,

AI-3: Store brands are often introduced in categories in which there are a large number of national brands. This action may be driven by incremental profit considerations or ease of entry.

4. Potential store brand market share → Store brand introduction

Common Management Belief. In general, management believes that if it is likely that the private label will gain a high market share, the environment is conducive to store brand entry. As stated in the introduction section, managers often equate private-label penetration (market share) with profitability, assuming that the higher the private-label share, the greater the retailer profits. Therefore:

CB-4: It is good to introduce store brands in those categories in which the store brand is likely to obtain high market share.

Insights from Academic Research. Academic research points out that CB-4 need not always hold. For example, as stated in AI-3, categories with several national brands can be more conducive to store brand introduction than categories with fewer national brands, but in such categories, store brand market share will be lower. In other words, there may be instances in which it would be profitable to introduce a store

brand even if it does not gain a significant market share. There may also be instances in which store brands gain a significant market share, but are not profitable. Ailawadi and Harlam (2004) conclude that high store brand share may be detrimental to category dollar profits for the retailer and recommend a proper balance between national brands and store brands.

AI-4: A profitable private-label introduction strategy need not necessarily correlate with obtaining high market share.

Private-label Segmentation and Targeting Strategy

Which types of consumers should the store brand target? To begin with, retailers should aim for those consumers who would be most willing to purchase store brands. This leads one to ask, Which consumers are those? Below I discuss four consumer characteristics that have been the focus of academic research.

5. Price sensitivity → Store brand proneness

Common Management Belief. Store brands have traditionally been viewed as lower-priced, lower-quality alternatives to national brands. Hence, people who do not want to pay a high price for the national brand, or who cannot afford to pay the high price, will buy the store brand. The common view holds that:

CB-5: Store brand consumers are very price sensitive (or more price sensitive than national-brand consumers).

Insights from Academic Research. Identifying the characteristics of store brand consumers is one of the oldest research topics in the area of private labels, dating back to the mid-sixties (e.g., Frank and Boyd 1965; Myers 1967). Through an online subject search and a review of articles in major marketing journals, I identified 26 studies published during 1965-2004 that related certain psychographic and demographic characteristics directly or indirectly to store brand proneness. Table 1 summarizes the findings from these studies. The data related to price sensitivity are in column 3.

There is ample evidence in the literature that, consistent with conventional belief, private-label consumers are price sensitive. In my literature review, 18 of 19 studies that discuss this aspect found that price is an important component in private-label sales. A 1990 Gallup survey also found that 74% of consumers interviewed cite price as a very important factor in private-label purchase. However, there is little evidence on the relative price sensitivity of store brand and national-brand consumers.

AI-5: Price tends to be an important criterion for store brand consumers in making brand choice decisions.

6. Quality sensitivity → Store brand proneness

Common Management Belief. The traditional view that store brands are meant to cater to those consumers who desire low prices, even if it means giving up on quality to some extent, suggests the following:

CB-6: Store brand consumers are not very quality sensitive.

Insights from Academic Research. Table 1 (column 4) summarizes the findings from various studies that discuss the relationship between private-label proneness/purchases and quality sensitivity. Contrary to the traditional view, private-label consumers are, in fact, quality sensitive. Fourteen out of 16 studies in the literature review find a strong positive relationship between quality or quality consistency of store brands and private-label proneness or private-label purchases. In fact, there is reasonable evidence indicating that quality may be of equal or greater importance than price in influencing private-label purchase. For example, in a 1990 Gallup survey, 83% of consumers interviewed

Table 1

Studies Identifying Store Brand Consumers

(+ = Positive relationship; – = Negative relationship; 0 = No relationship; ? = Ambiguous relationship)

		CB-5 Price sensitivity	CB-6 Quality sensitivity	CB-7 Income	CB-8 Education
	Expected Sign	(+)	(–)	(–)	(–)
1	Ailawadi, Neslin, and Gedenk (2001)	+	–	–	?
2	Batra and Sinha (2000)	+	+		
3	Bellizzi et al. (1981)	+	+		
4	Burger and Schott (1972)	+		0	+
5	Burton et al. (1998)	+		–	+
6	Coe (1971)			+	
7	Corstjens and Lal (2000)		+		
8	Cotterill, Putsis, and Dhar (2000)	+	0		
9	Cunningham, Hardy, and Imperia (1982)	+		0	+
10	Dhar and Hoch (1997)	+	+	–	0
11	Erdem, Zhao, and Valenzuela (2004)	+	+		
12	Fitzell (1992)	+	+	+	
13	U.S. National Food Marketing Commission (1966)	+		+	+
14	Frank (1967)			0	+
15	Frank and Boyd (1965)			–	+
16	Hoch (1996)	+		–	+
17	Hoch and Banerji (1993)	0	+		
18	Hoch and Lodish (2001)	+			
19	Morton and Zettelmeyer (2004)		+	0	0
20	Murphy (1978)			+	
21	Myers (1967)	+	+	0	+
22	Richardson, Dick, and Jain (1994)	+	+		
23	Richardson, Jain, and Dick (1996)	+	+	–	0
24	Rothe and Lamont (1973)	+	+	–	-
25	Sethuraman (2000)		+	?	+
26	Sethuraman and Cole (1999)	+	+	?	0
	Totals + / – / 0 or ?	18 / 0 / 1	14 / 1 / 1	4 / 7 / 7	9 / 1 / 5

cited quality as a very important factor in private-label purchase, while only 74% stated that price was important (Fitzell 1992).

Additionally, evidence from cross-category analysis suggests that quality explains more of the variation in private-label shares than price does (e.g., Dhar and Hoch 1997; Hoch and Banerji 1993; Sethuraman 1992). Similarly, in a comprehensive study of store brand proneness Richardson, Jain, and Dick (1996) find that perceived quality is more important than perceived value for money in influencing consumers' propensity to purchase store brands. Erdem, Zhao, and Valenzuela (2004) find that quality uncertainty is the key determinant of differences in store brand market share across countries, more important than price sensitivity. Corstjens and Lal (2000) recommend the introduction of high-quality private labels by retailers even if there is no margin advantage for the store brand, because quality private labels increase store loyalty. Based on these findings, I offer the following refinement.

AI-6: By and large, quality is an important criterion for store brand consumers when choosing among brands. (It may be even more important than price.)

Of course, many private-label marketers have realized the importance of quality in selling their brands and have taken steps to raise the quality of their store brands to be on par with the quality of national brands. For instance, the Private Label Manufacturers Association's official website states the following: "Private label items consist of the same or better ingredients than the manufacturer brands, and because the retailer's name or symbol is on the package, the consumer is assured that the product meets the retailer's quality standards and specifications" (Private Label Manufacturers Association, http://www.plmainternational.com/plt/pltEn.html). Consistent with these claims, a recent study by Meyers Research Center for the Private Label Manufacturers Association reports that by a 51% to 49% margin, consumers say they prefer the taste of private-label items over their national brand counterparts in 12 popular grocery items (*PL Buyer* 2005). An August 2005 *Consumer Reports* study that tested 65 products finds that many store brands are at least as good as national brands.

7. Annual household income → Store brand proneness

Common Management Belief. Because store brands are viewed as lower-priced, lower-quality alternatives to national brands, it is a logical next step to believe that store brands are intended to serve the needs of a relatively lower-income segment of the population (Fitzell 1992). The common belief is that:

CB-7: Store brand consumers have lower incomes than national-brand consumers.

Insights from Academic Research. Empirical evidence is mixed. Only 7 out of 18 studies I reviewed (see column 5 of Table 1) supported this economic view; 7 studies indicated null or ambiguous relationships, and 4 studies showed the opposite—that is, low-income consumers are less likely to purchase private labels than middle-income consumers. Coe (1971) offers a detailed explanation for this reversal based on follow-up interviews: (1) lower-income respondents had less education than middle-income respondents and hence equated price with quality, (2) they felt they could trust name brands more, (3) they did not know the extent of the price differential between national and store brands, and (4) they trusted advertising more as a source of information. Relatedly, the U.S. National Food Marketing Commission (1966) observed that higher-income consumers understood the private-label concept better than lower-income consumers. Fitzell (1992) also laments that the very consumers for whom private labels would make the most sense are more loyal to national brands because of their lack of knowledge about store brands and the imagery associated with name brands.

Sethuraman and Cole (1999) find a relationship that may explain these divergent findings. They find that the relationship is nonmonotonic. In particular, middle-income consumers appear to be the most receptive to private labels. Low-income consumers are less receptive for the reasons stated above; high-income consumers are less receptive because they can afford to buy the national brands at a higher price. Myers (1967), who conducted one of the earliest comprehensive studies on profiling private-brand buyers, finds that middle-class housewives are the strongest acceptors of private labels. Bellizzi et al. (1981) observe that private labels don't do very well among low-income consumers. All this evidence shows that middle-income consumers are more likely to purchase private labels than low-income consumers. Based on these observations, I offer the following insight:

AI-7. Store brand consumers generally belong to neither low-income nor high-income families; they tend to be from middle-income households.

8. Education → Store brand proneness

Common Management Belief. The belief that store brands cater to the low-income segment also leads to the inference that they are likely to be less educated.

CB-8: Store brand consumers are less educated than national-brand consumers.

Insights from Academic Research. Nine out of the 15 studies I reviewed indicated a significant positive relationship between education and store brand purchase. More-educated consumers are likely to be more informed about quality (Hoch 1996), more confident about their evaluative abilities, less brand loyal (Cunningham, Hardy, and Imperia 1982), and perceive little quality difference between national and store brands (Sethuraman 2000). Hence, academic research negates the stereotypical view that store brand consumers have lower incomes and are less educated.

AI-8: Store brand consumers are, on average, more educated than national-brand consumers.

By and large, private-label consumers tend to be middle-income, educated, older consumers with large families. However, these socioeconomic variables account for only 4%-5% of the variation in private-label purchases (Dhar and Hoch 1997; Frank 1967). Ailawadi, Neslin, and Gedenk (2001), however, point out that although the direct effect of demographics on store brand usage may be weak, they have significant indirect effects through their relationships with psychographic variables such as price consciousness, which influence store brand purchase.

The modest explanatory power of demographic variables has led some researchers to conclude that private and national brands are consumed by households with virtually the same demographic characteristics (Frank 1967). The dilemma then for the store brand marketer is whether demographic variables can be used as the bases for segmentation and targeting. My view is that while they cannot form the primary basis for segmenting the market, the collective knowledge gained from past research can be exploited for developing targeting strategies. First, store brand managers should target the middle-income, educated consumers, since those consumers appear more prone to purchasing private labels. Second, store brand marketers may also consider attracting the low-income consumers by educating them about store brand quality and making them aware of the price differentials. This targeting would not only increase private-label market share but can also increase overall consumer welfare.

A few studies have investigated the relationship between store brand usage and nondemographic variables, especially psychographic and personality characteristics. For example, store brand consumers tend to be less impulsive, smart shoppers (Burton et al. 1998), are slightly more variety seeking (Ailawadi, Neslin, and Gedenk 2001), and tend to be enthusiastic, sensitive, and submissive (Myers 1967). However, these individual studies are few and differ considerably in the variables they investigate, limiting our ability to obtain meaningful, generalizable insights.

Private-Label Marketing Strategies

9. Store brand introduction → Store brand positioning

Common Management Belief. In the context of competition between national brands and store brands, store brand positioning is broadly conceptualized as the extent of similarity to the national brand. Retailers attempt to position their store brand close to the national brand in at least four ways: by reducing the perceived quality gap between the national brand and the store brand, by imitating national-brand packaging, by placing the store brand on the shelf next to the national brand, and by using shelf talkers with “compare and save” or similar slogans. The central question for retailers is: Should the store brand be positioned close to the national brand or not?

There is a general tendency among grocery retailers to want to increase the sales and market share of private labels at the expense of national brands by positioning the store brand close to the national brand (Luhnow and Terhune 2003; Private Label Manufacturers Association 2006).

CB-9: Cost permitting, it is good to position the store brand close to the national brands.

Insights from Academic Research. Academic research supports and further strengthens the conventional wisdom. Several researchers (e.g., Mills 1995; Morton and Zettelmeyer 2004; Raju, Sethuraman, and Dhar 1995a; Sayman, Hoch, and Raju 2002) unanimously suggest that retailers would be better off (obtain higher category profits) if they position their store brands close to the national brands. Sayman, Hoch, and Raju (2002), in particular, further strengthen this assertion. They show that if there are two symmetric national brands, it is better to position close to one of them than to stay in the middle. If the national brands are not symmetric, i.e., they have different market shares, then it is profitable for the store brand to go after the national brand with the larger share. In fact, the larger the share of the national brand, the more profitable it is to mimic it. Based on these findings, I offer the following academic insights:

AI-9a: If there are two symmetric (broadly equivalent) national brands, it is more profitable to position the store brand close to one of them than to position in the middle.

AI-9b: If national brands have different market shares, it is better to position the store brand against the national brand that has the larger market share.

AI-9c: The greater the national-brand market share, the more profitable it is for the retailer to position the store brand against it.

Findings from Sayman, Hoch, and Raju (2002) and Sethuraman (2003) indicate that many retailers' behavior tend to be consistent with AI-9b and AI-9c. In particular, when store brands do target a particular national brand, in 80% of the cases, the targeted brand is the leading brand, consistent with AI-9b. They also find that the likelihood of targeting a national brand is greater when the national brand has higher market share, consistent with AI-9b. However, interestingly, in both these studies, store brands targeted a particular national brand in only about 30% of the categories. Why might retailers fail to target a particular national brand? One obvious reason might be cost. While in theory it may be appropriate to position close to the national brands, in practice, it may be cost prohibitive to do so. There may be other reasons as well, such as retailer reluctance or implicit agreements with manufacturers. But could there be market-driven reasons for not positioning close to the national brands?

Sethuraman (2003) alludes to two specific market conditions under which positioning a store brand close to the national brand may not be beneficial for the retailer. Using a parsimonious game-theoretic model that incorporates national-brand advertising, he shows that the conventional view probably holds for most mature grocery products: for those products, a store brand predominantly obtains its sales through brand switching from national brands, and national-brand advertising has little impact in expanding category demand. However, positioning a store brand to compete intensely with the national brand is not necessarily beneficial to the retailer if the store brand can gain a significant portion of the market that is not served by the national brand. The intuition for this result is fairly obvious and relates to the notion of segmentation. If there is a sizable group of consumers who cannot afford the national brand, but are willing to purchase the store brand at lower prices, the retailer may find it more worthwhile to cater to this price-sensitive segment than to pursue the national-brand consumers. In this context, Ailawadi and Harlam (2004) advance the idea of a balanced mix of national brands and store brands.

Second, retailers may be better off not positioning the store brand close to the national brand if the manufacturer can expand category demand through advertising or other nonprice marketing investments. This would be the case for products in the early stage of the life cycle; for those products, marketing would promote purchase of the product by increasing awareness and educating consumers. The same holds for hedonistic products, for which advertising can increase perceived consumption pleasure and induce consumers to purchase. By positioning the store brand close to the national brand, the retailer would force the national-brand manufacturer to focus on price reduction and discourage the manufacturer from investing in category-demand-enhancing activities, an action that could be detrimental to both the manufacturer and the retailer in a growing market. Based on these results, I have the following refinements:

Positioning a store brand close to the national brand may not be profitable for the retailer

AI-9d: if the national-brand manufacturer can significantly expand category demand through investments in nonprice marketing activities such as advertising, and/or

AI-9e: if the store brand can garner a significant portion of the market with low-reservation-price consumers who cannot afford to purchase the national brand.

10. Store brand introduction → Store brand pricing

Common Management Belief. What price to charge for the store brand? Because the store brand is generally a follower, pricing decisions have focused on what price differential to maintain between national brands and the store brand. The private-label sales maximization objective and the notion that the purpose of private labels is to wean consumers away from the national brands leads to the following belief:

CB-10: It is good to charge a low price for the store brand and to maintain a large price differential between national brands and the store brand.

Empirical evidence supports the existence of this pricing behavior. Using extensive in-store experiments in analgesics and other product categories, Hoch and Lodish (2001) found that store brand analgesics were priced 45% lower than national brands when a 30% price differential appeared to yield more category profits. Sethuraman and Cole (1999) estimated the reservation price differential distribution for 130 consumers across 20 grocery product categories in one market. From this data, they derived the optimal price differential by assuming different relative costs of national brands and the store brand. In general, the actual price differential was higher than what would be predicted by the model. Using new industrial organization models, Meza and Sudhir (2002) also show that retailers tend to behave nonoptimally, especially when it comes to pricing the national brand that the store brand is imitating. In particular, they tend to increase the price of the national brand and maintain a high price differential between that brand and their own store brand (also see Pauwels and Srinivasan 2004). The reason for overpricing the national brand may be the retailers' focus on increasing private-label share as opposed to profits (Chintagunta 2002).

Insights from Academic Research. A recurring theme in most academic research, based on category profitability considerations, is to point out that a large price gap between national brands and the store brand is not necessarily desirable. In addition, a number of theoretical studies have shown that when retailers close the quality gap between national brands and the store brand, as they have attempted to do in recent times, they can obtain higher profits by also reducing the price gap (Mills 1995; Raju, Sethuraman, and Dhar 1995b; Sayman, Hoch, and Raju 2002; Sethuraman 2003).

Does this mean that when consumers perceive very little quality differential between national brands and the store brand, the price differential can be reduced to near zero? Managerial literature has opined that if the price differential is small, then consumers will not purchase the store brand because they will not see its value (e.g., Donegan 1989). Recent empirical evidence supports this viewpoint. Sethuraman (2000) and Applebaum, Gerstner, and Naik (2002) have found that even if consumers perceive that national and store brands are physically identical, they are willing to pay, on average, about a 20%-30% price premium for national brands. This reputation economy has also been documented in the economics literature (Steiner 2002). Based on these findings, I have the following refinements:

AI-10a: When a store brand is positioned to be similar to national brands, it is profitable for the retailer to reduce the price differential between it and the national brands.

AI-10b: However, the price differential cannot be too low as consumers will pay a premium for national brands even if they perceive the store brand to be equivalent.

11. Store brand introduction → Store brand price promotions

Common Management Belief. Observation in supermarkets and statistics from scanner data (e.g., Rao 1991; Sethuraman 1996) indicate that store brands are generally price promoted less frequently than the top-tier national brands. This practice makes sense at the outset. Store brands are already sold at a lower regular price and are catering to the more price-sensitive consumers. One can understand retailers deciding that there is, therefore, less need to further reduce the price on a temporary basis. National-brand manufacturers, on the other hand, have an incentive to occasionally reach out to this price-sensitive segment by lowering their price, and hence have a greater incentive to price promote. The conventional wisdom, therefore, is:

CB-11: Store brands should be price promoted less frequently than top-tier national brands.

Insights from Academic Research. The predominant view from academic research appears to support the common opinion that store brands should be less extensively promoted than national brands. In the competition between the "strong" (national) brands and the "weak" (store) brands, consumers can be categorized into three broad segments:

1. Loyal segment (national brand)—those who would always purchase only the national brand so long as its price is below their reservation price for the brand.

2. Brand-switching segment—those who switch brands depending on the price differential between national and store brands.

3. Price shoppers—those who always purchase the lower-priced brand.

The loyal segment for the store brand is assumed to be negligible. Many analytical researchers study price promotions by incorporating the above segments. Four published papers are pertinent in this context. Their model structure and results are compared in Table 2.

There are three conclusions that can be gleaned from these studies. The first is that the presence of a store brand with less brand loyalty can trigger price promotions (trade deals) by the national brands (Lal 1990). Second, three of the four papers (all but Raju, Srinivasan, and Lal 1990) state that the weak store brand promotes less often than the strong (premium) national brands, or does not engage in price discounting at all. All papers indicate that the store brand's discount is less than the national brands' discounts. Sivakumar (1997) and Ailawadi, Neslin, and Gedenk (2001) also recommend the use of EDLP (everyday low pricing) for the store brands.

Another major source of support for the recommendation that private labels should price pro-

Table 2
Comparisons of Price Promotion Models

Study Characteristics	Studies Narasimhan (1988)	 Lal (1990)	 Raju, Srinivasan, and Lal (1990)	 Rao (1991)
Competition	1 strong brand 1 weak brand	2 national brands 1 local (store) brand	1 strong brand 1 weak brand	1 national brand 1 private label
Retailers	No retailer	Single retailer	No retailer	No retailer
Segments considered	Loyal segment and switchers	Loyal segment and switching segment	Loyals, who can be switched with a certain price differential	Switching segment and price shopper segment
Cost structure	Cost of manufacturing strong and weak brand equal and set to zero	Equal and set to zero	Equal and set to zero	Equal and set to zero
Game structure	Single-period, profit-maximizing model	Infinite-period, model-maximizing; discounted profits	Single-period, profit-maximizing model	Single-period, sequential decision: first regular price, then promotion
Key equilibrium result	The premium-priced brand will offer a higher discount and promote more often. The (store) brand with the least pulling power should charge a low regular price and not discount at all.	If the switching segment is large and discount rate not high, the two national brands offer trade deals in alternate periods. The private label does not discount.	The weak store brand promotes more often than the strong national brand but offers a smaller price discount.	National brands promote with some probability of attracting the price shoppers. Private labels do not promote.

mote less comes from the concept of the asymmetric price-tier effect introduced by Blattberg and Wisniewski (1989). The asymmetric price-tier effect states that when the high-price-tier/high-quality (national) brands cut prices, consumers of the low-price-tier/low-quality (store) brands switch up to the high-priced brand. However, when the low-priced/low-quality (store) brands discount, few national-brand consumers will switch to the low-quality store brand. The strategic implication is that retailers should probably not promote their private labels because they will not significantly affect national-brand sales. Early studies provided support for the notion of asymmetry in price promotion effect (e.g., Allenby and Rossi 1991; Hardie, Johnson, and Fader 1993; Sethuraman 1992).

Recent research has refined the notion of the asymmetric price-tier effect and has shown that the asymmetry does not always favor the high-priced national brand. The direction of asymmetry depends on the price-quality positioning (Bronnenberg and Wathieu 1996), the measure used, that is, cross-price elasticity or absolute cross-price effect (Sethuraman, Srinivasan, and Kim 1999), the distribution of the reservation price differential (Sivakumar 1995), the nature of the category, that is, promotion intensive or not (Lemon and Winer 1993), the nature of the choice set (Heath et al. 2000), the nature of segment targeted (Ailawadi, Neslin, and Gedenk 2001), and the presence of feature/display (Lemon and Nowlis 2002). The implication is that each retailer may need to assess the nature of the asymmetry in its particular product market and make appropriate price promotion decisions.

Two empirical-generalization studies (Sethuraman and Srinivasan 2002; Sethuraman, Srinivasan,

and Kim 1999) provide some specific guidelines with respect to private-label price promotions. First, the two studies show that when making price promotion decisions, absolute cross-price effect (change in unit sales of a brand for $1.00 change in the price of a competing brand), and not cross-price elasticity (percentage change in sales of a brand for 1% change in the price of a competing brand), is the appropriate measure of cross-price effect. Most prior empirical studies have considered elasticities only. Second, price differences have little influence over asymmetry in absolute cross-price effects. What strongly influences asymmetry in absolute cross-price effects is differences in brand market share. In particular, for the same absolute price discount, lower-share brands take away more sales from higher-share brands than vice-versa. This result is intuitive: a lower-share brand has a larger pool of consumers to attract through discounts than a higher-share brand.

Based on all of the above (mixed) findings, I state the following refinements from academic research:

AI-11a: In most cases, private labels should be price promoted less extensively than national brands.

AI-11b: However, there may be cases in which AI-11a does not apply. Such cases include categories that are highly promotion intensive and markets in which national brands have very high market shares.

AI-11c: Other things being equal, private labels with small market share should engage in price discounts more than private labels with large market share.

AI-11d: The price promotion decision should involve consideration of absolute cross- and own-price effects rather than price elasticities.

Nonprice promotions include in-store promotions such as displays and features, as well as coupons, free samples, and gifts. There is some evidence indicating that display/feature promotions by national brands affect private-label share and vice versa (Cotterill, Putsis, and Dhar 2000). Lemon and Nowlis (2002) find that the combined effects of display/feature promotions are greater for the low-tier (store) brands than for the high-tier (national) brands. Private-label consumers are less influenced by nonprice deals such as gifts and prizes (Burton et al. 1998). However, the research on nonprice promotions is too limited to draw any meaningful recommendations.

Conclusion

The main objective of this paper is to communicate to store brand managers the insights that have been obtained from academic research conducted over the last 40 years that might enable them to develop better private-label marketing strategies. The appendix table summarizes the common management beliefs about private-label marketing and the related insights arising from academic research.

I believe this summary and the related discussion can be useful to national-brand managers as well in determining the appropriate marketing strategy for their brands. For example, among the insights listed is the fact that consumers will pay an image premium for national brands even when they perceive the store brand to be of equivalent quality (AI-10b). National-brand managers should find ways to maintain and enhance this image premium.

This paper should also be useful to academic researchers in several ways. First, it presents many important articles on private-label strategy and shows how these publications are linked and translated in terms of marketing strategies. Second, this paper also points to potential directions for future research on private-label marketing strategies. For example, the biggest lacuna, I believe, is the current lack, in the academic literature, of clear and specific guidelines for private-label price and nonprice promotion

strategies. More analytical models, focused empirical analysis, and decision support systems may be needed to address this gap in the literature. Also, I should note that my recommendations only pertain to grocery products marketed in the United States. More research is needed in other durable goods categories, such as apparel and appliances, and on private-label marketing in other parts of the world.

It should be pointed out that the literature review I offer in this study is specifically focused on identifying whether certain common management beliefs about private-label marketing strategies are supported by the findings of academic research or not. There are many other issues related to the private-label phenomenon that I do not cover, including determining optimal reactions of national brands to private-label introduction, sourcing of private labels, and the relationship between channel power and private-label share, among others. These issues warrant further research. ■

Appendix

A Summary of Common Beliefs (CB) and Academic Insights (AI) Regarding Private-Label Marketing Strategies

Strategy Type	Common Management Beliefs	Nature of change	Insights from Academic Research
Introduction	CB-1: It is good to introduce store brands in commodity products characterized by high levels of price competition among brands.	Partly supported and partly negated	AI-1: It is good to introduce private labels when the cross-price sensitivity between national brands and the store brand is high, but the cross-price sensitivity among national brands is not high.
	CB-2: It is good to introduce store brands in high-dollar-volume categories.	Conditionally validated	AI-2: When conditions are conducive to store brand introduction, the higher the category sales, the greater the retailer's profit incentive to introduce a store brand.
	CB-3: It is bad to introduce store brands in categories in which there are already a large number of national brands.	Negated	AI-3: Store brands are often introduced in categories in which there are a large number of national brands. This action may be driven by incremental profit considerations or ease of entry.
	CB-4: It is good to introduce store brands in those categories in which the store brand is likely to obtain high market share.	Supported with caution	AI-4: A profitable private-label introduction strategy need not necessarily correlate with obtaining high market share.
Segmentation and Targeting	CB-5: Store brand consumers are very price sensitive (or more price sensitive than national-brand consumers).	Validated	AI-5: Price tends to be an important criterion for store brand consumers in making brand choice decisions.
	CB-6: Store brand consumers are not very quality sensitive.	Negated	AI-6: By and large, quality is an important criterion for store brand consumers when choosing among brands. (It may be even more important than price.)
	CB-7: Store brand consumers have lower incomes than national-brand consumers.	Negated	AI-7: Store brand consumers generally belong to neither low-income nor high-income families; they tend to be from middle-income households.
	CB-8: Store brand consumers are less educated than national-brand consumers.	Negated	AI-8: Store brand consumers are, on average, more educated than national-brand consumers.
Positioning Strategy	CB-9: Cost permitting, it is good to position the store brand close to the national brands.	Strengthened	AI-9a: If there are two symmetric (broadly equivalent) national brands, it is more profitable to position the store brand close to one of them than to position in the middle.

		Supported and refined	AI-9b: If national brands have different market shares, it is better to position against the national brand that has the larger market share.
		Supported and refined	AI-9c: The greater the national-brand market share, the more profitable it is for the retailer to position the store brand against it.
			Positioning a store brand close to the national brand may not be profitable for the retailer
		Conditionally negated	AI-9d: if the national-brand manufacturer can significantly expand category demand through investments in nonprice marketing activities such as advertising, and/or
		Conditionally negated	AI-9e: if the store brand can garner a significant portion of the market with low-reservation-price consumers who cannot afford to purchase the national brand.
Pricing Strategy	CB-10: It is good to charge a low price for the store brand and to maintain a large price differential between national brands and the store brand.	Conditionally negated	AI-10a: When a store brand is positioned to be similar to national brands, it is profitable for the retailer to reduce the price differential between it and the national brands.
		Additional insight	AI-10b: However, the price differential cannot be too low as consumers will pay a premium for national brands even if they perceive the store brand to be equivalent.
Promotion Strategy	CB-11: Store brands should be price promoted less frequently than top-tier national brands.	Supported	AI-11a: In most cases, private labels should be price promoted less extensively than national brands.
		Conditionally negated	AI-11b: However, there may be cases in which AI-11a does not apply. Such cases include categories that are highly promotion intensive and markets in which national brands have very high market shares.
		Conditionally negated	AI-11c: Other things being equal, private labels with small market share should engage in price discounts more than private labels with large market share.
		Relevant insight	AI-11d: The price promotion decision should involve consideration of absolute cross- and own-price effects rather than price elasticities.

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Report No. 06-108
"Private-Label Marketing Strategies in Packaged Goods: Management Beliefs and Research Insights" © 2006 Raj Sethuraman; Report Summary © 2006 Marketing Science Institute