

Private Label Strategies – Myths and Realities

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It is believed that the oldest profession in the world is trading. When traders went around the world selling their wares in exchange for money, goods, or services, the operative word was *Caveat Emptor* – Buyer Beware! If the product did not meet expectations, the buyer bore all the consequences once the transaction was completed. Since the identity or origin of the good was seldom known, buyers put a lot of trust in the trader selling the good. Essentially, the traders were extending their names and reputations to the goods they were selling. It was the era of implicit traders' brands -- a precursor to modern day store brands! The evolution from traders to trading places or small stores, where goods could be purchased for money, saw the emergence of goods with manufacturers' names attached, like the Remington revolver, as well as goods with no names, such as a bag of flour or sugar. Manufacturers' brands and traders' brands coexisted, but in distinct categories. As small stores grew into superstores, the concept of national brands grew with them.

Branding means burning, a practice dating back to the seventeenth century and associated with the process of marking an animal with a unique symbol so that the owner could identify it. With hundreds of categories and dozens of items within a category, branding performs the basic identification function for a large retailer. When the doctrine of *Caveat Emptor* (Buyer Beware) gave way to *Caveat Venditor* (Seller Beware), forcing sellers to take responsibility for products and discouraging them from selling products of dubious quality, brands began to perform the role of providing implicit warranty. Now, thanks to mass media channels and sophisticated marketing, national brands have established themselves as the primary goods of transaction in frequently purchased consumer goods. Brands like Coca-Cola and Starbucks represent not just identity and quality but status, image, emotion – a rich collection of tangible and intangible benefits.

While the traders' brands predate the national brands, modern-day store brands or private labels -- brands generally owned, controlled, and marketed exclusively by a retailer -- is a relatively recent phenomenon. They were introduced more than 100 years ago in some limited items such as tea, and they are now prevalent in over 60% of product categories in the United States (Fitzell 1992; Quelch and Harding 1996). According to the Private Label Manufacturers Association (www.plma.com), nearly one out of four products bought in U.S. supermarkets in 2009 was a store brand; market share rose to all-time record highs of 18.7% dollar share and 23.7% unit share. In fact, store brands accounted for almost 90% of all new revenue in the channel. Private label share in Europe is nearly 30% and may even reach 40%-50% over the next two decades, according to Kumar and Steenkamp (2007). Private labels are also beginning to take root in developing economies such as Asia and Latin America.

Despite the significant growth of private labels, the strategy specification for store brands or private labels has been reactive for the most part -- that is, store brand strategies are determined in relation to existing national brands. In this chapter, we adopt a similar stance and consider store brands as a means of increasing profits (or achieving other objectives) for the retailer, given a set of national brands that s/he carries or can carry in the product category. Store brands are thus an integral part of category management.

In particular, we address five broad questions related to store brand marketing strategy:

1. *Should a retailer introduce a store brand in a product category?*
2. *If so, whom should the store brand target?*
3. *How should the store brand be positioned?*
4. *What price should be charged for the store brand?*
5. *How should the store brand be promoted?*

We draw on conceptual, analytical, and empirical works from the academic literature, as well as anecdotes and opinions from the managerial literature, to provide insights into these five questions. In the process, we highlight some realities and dispel some myths about private label strategies. We conclude by summarizing key insights and providing some predictions and research directions for the future.

A CONCEPTUAL FRAMEWORK

Figure 1 presents a general framework for discussing private label strategies. The focal retailer purchases the national brands from the manufacturers at a wholesale price of W_{NB} per unit and sells it to the consumers at the retail price, P_{NB} . The retailer can also sell a store brand, supplied at cost C_{SB} per unit, at a retail price of P_{SB} . The retailer is competing with other stores in the market.

Given this setup, the profits to the retailer who purchases the national brand(s) at unit cost of W_{NB} , incurs fixed costs of F_{NB} , and sells q_{NB} units at price P_{NB} are,

$$(1) \quad \Pi_{NB} = \sum_{NB} (P_{NB} - W_{NB}) q_{NB} - F_{NB}$$

The profits from the store brand (using corresponding notations) are

$$(2) \quad \Pi_{SB} = (P_{SB} - C_{SB})q_{SB} - F_{SB}$$

The retailer's total category profits are $\Pi_{total} = \Pi_{NB} + \Pi_{SB}$.

It is assumed that the retailer will set its strategies to maximize category profits. A number of unique factors characterize the retailer's profit maximization compared to that of a national brand manufacturer:

- (i) Retailer has the potential to carry both national brands and its own competing store brand and can set prices and in-store promotion of both these brands.
- (ii) Retailer has the potential to source the national brand from the national brand manufacturer, third party supplier, or through own manufacturing.
- (iii) Category profits are more important than individual brand profits.

- (iv) However, in some categories the retailer may choose to forego profits for building store traffic.
- (v) The fixed cost for retailer is not only related to cost of salaries, utilities etc. but also opportunity cost of shelf space.

These factors play a role in the determination of private label strategies, which are discussed next.

STORE BRAND INTRODUCTION

The general premise is that the retailer will introduce a store brand if doing so increases category profits. In other words, the profits obtainable from the store brand should be large enough to offset possible loss in profits from the national brands. Using this condition, academics have identified a number of factors that could influence the decision to introduce store brand: (i) price substitutability; (ii) store brand quality; (iii) number of national brands; (iv) category volume and margin; (v) economies of scale; and others. Results related to some key characteristics are discussed below in the form of myth or reality question.

Myth or Reality 1 – Introduce Store Brands in Commodity Products. A major selling point for a store brand is its lower price relative to national brands. Therefore, it would seem obvious that store brands should be introduced in “commodity” products, where consumers have a high propensity to switch brands on the basis of price (Stern 1966). It is true that high price substitutability is conducive for increasing private label *market share*, as more consumers would switch from national brand to store brand for a given price differential. But, is it *profitable* for the retailer to introduce a store brand in that market? The answer is not obvious.

Researchers have shown that higher price substitutability between national brand and store brand increases the retailer’s category profits from store brand introduction. There are two explanations for this result. One rationale, offered by Raju, Sethuraman, and Dhar (1995a) and others, points to the high margins obtained from store brands. In their model, in equilibrium, the

retail margin on the store brand ($P_{SB}-C_{SB}$ in Equation 2) is greater than the corresponding margin on the national brand ($P_{NB}-W_{NB}$ in Equation 1). High price substitutability between national brand and store brand increases the quantity of private labels sold. Therefore, switching consumers to higher margin private labels increases retailer profits.

A second explanation, forwarded by Mills (1995) and Scott-Morton and Zettelmeyer (2004), states that high price substitutability makes national brands less indispensable, i.e., reduces the incremental contribution of national brand to channel profits, thus eroding manufacturers' bargaining power. Hence, retailers are able to extract higher profits and share of channel profit if there is a store brand that resembles the national brand.

While high price substitutability between national brand and store brand favor introduction, high price substitutability (price competition) among national brands deters store brand entry. When price competition among national brands is high, the average national brand retail price decreases. The decreased national brand price, in turn, depresses the price and retail margins for the store brand, resulting in lower category profits for the retailer. For example, if Coke and Pepsi compete with each other aggressively on price, there may be little room for a store brand to enter the market and be profitable.

Thus, commodity products, characterized by price substitutability, can be a double-edged sword when it comes to store brand introduction. The category is high on both price substitutability between national brands and store brands and among national brands -- the former favors store brand introduction while the latter detracts it. One strategy for the retailer is to reduce the number of national brands, and thus national brand price competition, in undifferentiated categories (simplify assortment without loss of variety) and introduce the store brand. An alternate strategy is to reap the benefits of the competing national brands and not introduce a store brand.

Myth or Reality 2 – Quality is important for a successful private label program. It is true that a store brand comparable in quality to that of national brands will increase price substitutability and lead to more store brand sales. Hoch and Banerji (1993) show a strong result, across 180 categories, that store brand quality is the most important determinant of private label share – even more important than price. This discussion considers the role of quality beyond its ability to influence price substitutability. Raju et al. (1995a) and related studies capture this role through brand strength or store brand loyalty – that is, high quality can reduce the need for a store brand to be priced much lower than national brands. Corstjens and Lal (2000) operationalize quality of store brand in terms of the fraction of consumers who try the store brand and find it “acceptable.” They show that total retailer profits are increasing in store brand quality, even if the store brand does not have a cost or margin advantage. The basic intuition is that a high-quality store brand differentiates stores from each other and increases store loyalty. Hence, even when a high-quality store brand is not profitable, the optimal strategy might be to introduce the high-quality brand because ancillary benefits derived through the purchase of goods elsewhere in the store by the loyal consumer may be greater. In our interviews (Sethuraman 2008), managers concurred. One even commented, “Exactly! For a store brand positioned as offering quality, it makes more business sense to focus on promoting store loyalty than simply go after national brands.” Thus, we state what managers perhaps already know: Emphasize quality store brands in order to enhance store brand share and store image.

Myth or Reality 3 – There is no place for a store brand when there are already many national brands. Schmalensee (1978) argues that preemptive product differentiation and proliferation by national brands in a market can deter a store brand entrant. He points to cereals as a category where numerous national brand varieties don’t leave much room for store brands.

Contrary to this common belief, Raju et al. (1995a) show analytically that retailers would find it more profitable to introduce a store brand in categories with a large number of national brands. They reason that it is easy to “sneak in” a store brand without affecting the profits of the existing brands when the number of existing national brands is large. While not explicitly modeling the number of national brands, Scott-Morton and Zettelmeyer (2004) argue that more manufacturers actively producing national brands indicates fewer barriers to entry; hence the retailer can easily find a supplier for its store brand. Managers tended to agree with the latter view and offered an additional supporting argument: When there are many national brands, each one, on average, tends not to be very strong. This therefore provides an opportunity for store brands to enter (Sethuraman 2008). So, when it comes to store brand entry in a fairly well-differentiated category, the more national brands the merrier, even if it means smaller private label share. It may also be pointed out that in the cereal category, the example used in Schmalensee (1978), private labels have witnessed reasonable growth; in January 2010, private label share exceeded 10%, according to Information Resources, Inc. (<http://www.privatelabelmag.com/issues/pl-march-2010/breakfast.cfm>).

Myth or Reality 4 – Retailers eye the high-volume/high-margin categories for store brand introduction. The profits for store brand, $\Pi_{SB} = (P_{SB} - C_{SB})q_{SB} - F_{SB}$, can be written as $\Pi_{SB} =$ [category margin + correction for store brand margin] (times) [category volume * store brand share] – fixed costs. In high-margin categories, store brand margin will be higher. In high-volume categories, for a given share, store brand volume will be higher. So, store brand profits will be higher in high-volume / high-margin categories. However, the effect on total retailer profits is not clear. In the same high-volume/high-margin categories, the retailer will stand to lose a greater amount from the national brands because of consumers switching to store brands.

So, perhaps a necessary condition for a retailer to introduce a store brand in high-volume mature categories is that the retailer's margin on the store brand should be higher than that for the national brand. (We discuss this idea in the following section).

In a survey by Sethuraman (2008), managers looked beyond margins and viewed category volume in terms of its components: household penetration (times) purchase frequency (times) price per purchase. All three components favor store branding. Higher household penetration provides visibility of store name and brand to a larger group of consumers; higher frequency provides the retailer with greater velocity and greater opportunity to be in the market baskets and the minds of consumers; higher price per purchase enables retailers to highlight the large price differential. (It is easier to showcase price differential in a five-dollar item than in a 50-cent item). Sethuraman (2009) finds the results on positive relationship between store brand introduction and category volume/margin to be sufficiently robust analytically, empirically, and managerially (Table 1, R5, R6) that we can deem them as a reality.

Myth or Reality 5 – Higher margin is the prime reason for store brand introduction. In a survey in the 1990's, retailers stated that the most important reason for carrying a store brand is better profit margins (Discount Merchandiser 1996). An argument for store brand introduction based on switching consumers from national brands must be predicated on the belief that retailers will gain higher margins from store brands than from the national brand that it is switching consumers from. Two explanations have been put forth for the higher margins from store brands (Sayman and Raju 2007). First, on the supply (cost) side, the general thinking is that store brand manufacturers do not have much market power, and their wholesale prices are close to marginal costs. Thus, retailers avoid the double marginalization problem when it comes to store brands. Second, on the demand (price) side, retailers compete vigorously on price of

national brands, driving prices and margins down. On the other hand, the store brand is proprietary to the retailer; consumers can not make direct price comparisons across retailers. And so, retailers have room to increase margins from store brands, thereby raising profits (Steiner 2004).

While it is generally true that percentage margins for store brands are higher, empirical evidence is mixed on dollar margins (see Sethuraman 2009, Table 1, R10). For example, Corstjens and Lal's (2000) illustration of a beverage category (from a Canadian retailer) indicates that, in fact, when all factors (deal allowances, warehousing, in-store labor, etc.) are taken into account, even net percentage margins from store brands may be lower than margins from national brands. It is generally true that retailers' cost of acquisition of store brands is less than the cost (wholesale price) of national brands ($C_{SB} < W_{NB}$); it is also true that price of store brands is generally lower than price of national brands ($P_{SB} < P_{NB}$). But the retailer's store brand margin is higher than national brand margin only if the cost differential between the two brands ($W_{NB} - C_{SB}$) is greater than the price differential ($P_{NB} - P_{SB}$). That is, $W_{NB} - C_{SB} > P_{NB} - P_{SB} \Leftrightarrow P_{SB} - C_{SB} > P_{NB} - W_{NB}$.

In summary, higher margin on store brands is neither a myth nor a reality. Retail margin depends on a number of factors, including whether the brand is positioned as a generic brand (low margin) or a premium brand (high margin). However, retailers whose private label programs hinge on higher store brand margin must institute proper accounting procedures to include all relevant costs in determining the relative margins.

If margins from store brands are higher than from national brands, retailers would be better off by diverting consumers to store brands. Otherwise, there should be other benefits or expectations from store brands. One such benefit is store patronage, which is discussed below.

Myth or Reality 6: Store brands increase store's share of consumer wallet. Retailer level data from the United Kingdom (Corstjens and Lal 2000) suggest that store brand penetration is positively related to store loyalty and store sales. Similarly, household-level data from the U.S. and Canada provide evidence that loyalty (as measured by share of expenditures from the store) increases with increasing household-level store brand penetration. Sudhir and Talukdar (2004) analyze household expenditures in 44 product categories from a large retailer and find that a household buying store brands in more categories is likely to spend more on any particular category. They suggest that a broader store brand line may be necessary for creating loyalty and differentiation. This “umbrella” effect is also supported by Sayman and Raju (2004a). Using data from 13 food categories and 122 U.S. retailers, they offer evidence that sales and number of store brands in other product categories increase the sales of the store brand in the target category. Hence, propensity to buy store brands increases the store's share of wallet.

In a recent article, Ailawadi, Pauwels, and Steenkamp (2008) find an inverted U-relationship between private label use and store loyalty. The authors estimate the model for two retail chains in the Netherlands and find that private label share significantly affects all three measures of behavioral loyalty in the study: share of wallet, share of items purchased, and share of shopping trips. In addition, behavioral loyalty has a significant effect on private label share. The virtuous cycle, where private label share increases store loyalty and store loyalty increases private label share, operates up to a certain level – private label share below 40% or so. After that, there may be reduction in store loyalty because heavy store brand buyers are often price-sensitive store shoppers (cherry pickers).

Overall, there appears to be evidence of a positive relationship between private label share and store's share of wallet and, up to a point, store loyalty and store brand share may reinforce each other.

STORE BRAND SEGMENTATION AND TARGETING

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, we discuss some myths and realities related to the nature of store-brand-prone consumers.

Myth or Reality 7 – Target the store brands at the high price-sensitive, low quality-sensitive consumers. Store brands have traditionally been viewed as lower-priced, lower-quality alternatives to national brands (Stern 1966). Hence, store brand consumers are deemed to be very price sensitive (or more price sensitive than national brand consumers) and not quality sensitive. Sayman and Raju (2007) and Sethuraman (2006) have conducted extensive reviews of the consumer literature and find mixed evidence. In 18 of 19 studies reviewed by Sethuraman (2006, Table 1), consumers stated that price is an important component in private label purchase. However, contrary to the traditional view, private label consumers are, in fact, quality sensitive. Fourteen out of 16 studies in Sethuraman (2006) 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 cited quality as a very important factor in private label purchase, while only 74% stated that price was important (Fitzell 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.

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 that of national brands. For instance, the Private Label Manufacturers Association's (PLMA) official website states the following: "When it comes to product quality, most consumers see virtually no difference between private label and familiar national brands. In a 2010 GfK study for PLMA ...nearly all of the shoppers who did switch (from national brand to store brand) were pleased with their decision: 97% compared store brands favorably"

(<http://plma.com/storeBrands/sbt10.html>). An August 2005 *Consumer Reports* study that tested 65 products finds that many store brands are at least as good as national brands.

Myth or Reality 6 – Target the store brands at the low-income, less-educated, large families. 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 who are generally less educated and have large families (Fitzell 1992). Only six out of 18 studies in Sethuraman (2006) supported this economic view, and four studies actually showed the opposite – that is, low-income consumers are less likely to purchase private labels than middle-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.

A review by Sayman and Raju (2007) indicates that, 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). 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. The dilemma, then, for the store brand marketer is whether demographic variables can be used as the bases for segmentation and targeting. Our 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 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.

Myth or Reality 7 – Target the store brands at national brand deal-prone consumers.

If demographics do not explain store brand propensity, does deal proneness explain it? One question of interest is whether users of national brand promotions and store brands are the same consumers. Ailawadi, Neslin, and Gedenk (2001) find that national brand deal users and store brand buyers entail different psychographics. In particular, out-of-store promotions (coupons, flyers, etc., which involve active consideration and planning) are associated with hedonic benefits such as enjoying shopping, while store brand usage is related with economic benefits and cost-related characteristics. The authors also find that there are four distinct segments: deal-focused, store-brand-focused, deal and store brand users, and non-users. Summarizing the

findings in the literature, Sayman and Raju (2007) assert that deal proneness is not an intrinsic characteristic of store brand purchasers.

STORE BRAND POSITIONING

In the context of competition between national brands and store brands, store brand positioning is 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?

Myth or Reality 8 – Position the store brand close to the national brand. There is a tendency among grocery retailers to increase the sales of private labels at the expense of national brands by positioning the store brand close to the national brand. Academic research supports this conventional wisdom. Several researchers (e.g., Mills 1995; Scott-Morton and Zettelmeyer 2004; Raju, Sethuraman, and Dhar 1995a) unanimously suggest that retailers would be better off (obtain higher category profits) if they positioned 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 the store brand 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 for the store brand to mimic it.

Empirical findings from Sayman, Hoch, and Raju (2002), and from Sethuraman (2004), indicate that many retailers’ behavior tends to be consistent with this prediction. In particular,

when store brands do target a particular national brand, the targeted brand is the leading brand in 80% of the cases. The authors also find that the likelihood of targeting a national brand is greater when the national brand has higher market share. 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? Some reasons may be cost of imitating and/or not wanting to alienate the national brand manufacturer.

Sethuraman (2004) offers a market-driven reasoning and shows that positioning a store brand close to the national brand may not be profitable for the retailer if the national brand manufacturer can significantly expand category demand through investments in non-price marketing activities such as advertising, and/or if the store brand can garner a significant portion of the market with low-reservation-price consumers who cannot afford the national brand. In a similar vein, Choi and Coughlan (2006) show that, when two national brands are undifferentiated in features, it is better for the private label to position away from them by offering a different feature (e.g., private label pasta in large package sizes or fat-free sour cream).

Thus, positioning the store brand closer to the national brand is optimal (i) in mature products with limited category expansion and (ii) if retailers' store brand margins are greater than their margins on the national brands. However, there are many situations in which close store brand positioning may not be optimal.

STORE BRAND PRICING

What price should a retailer 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.

Myth or Reality 9 – The lower the store brand price relative to national brand, the better.

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 belief that 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. Pauwels and Srinivasan (2004) observe that retailers tend to increase the price of the national brand and maintain a high price differential between that brand and their own store brand. The reason for this overpricing of the national brand may be the retailers' focus on increasing private label share as opposed to profits (Chintagunta et al. 2002).

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).

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 (2003) 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 2004). Pricing of store brands vis-à-vis national brands is complex (see Pauwels and Srinivasan 2007 for a detailed discussion). 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. However, the price differential cannot be too low, as consumers will pay a premium for national brand image, even if they perceive the store brand to be equivalent.

STORE BRAND PROMOTIONS

Store brands generally do not promote through media advertising. The promotion options for these brands are primarily price promotions (shelf price discounts), coupons, and features/displays. Of these, price promotion is most common.

Myth or Reality 10 – Store brands should not price promote. There are two aspects to price promotions: discount frequency and discount depth. Theoretical assertions and empirical evidence are mixed for discount frequency. A number of analytical models (Lal 1990; Narasimhan 1988; Rao 1991) recommend that private labels not promote in equilibrium. The general intuition for the above result is as follows. The incentive for national brands to price promote stems from having to charge a regular price to cater to its loyal customer base and occasionally make forays into the switcher segment through price cuts. Because store brands are primarily viewed as brands with little loyalty and which cater mainly to the price-sensitive (switcher) segment, this incentive does not arise. The pricing role of store brands is to simply protect its switcher segment from encroachment. In this situation, store brands do not promote unless their switcher base is significantly threatened. Tellis and Zufryden (1995) develop an

optimization model for retailer discounts and conduct extensive analysis to understand how optimal discounts vary with brand characteristics. They find that in none of their sensitivity analyses were promotions for private labels recommended because consumers' response to price promotions is so low. The low sales response is also supported by the asymmetric price tier effect proposed by Blattberg and Wisniewski (1989), which states that low-priced private labels do not gain much sales through price discounting.

The exception to the above theoretical result comes from Raju, Srinivasan and Lal (1990), which states that the weak store brand (with lower loyalty) should promote more often because the retailer can offer smaller discounts than the strong national brand. These authors also find empirical evidence supporting their proposition. The same argument is also made by Shankar and Krishnamurthi (2007), who find from their decision-support model that the optimal discount frequency of private labels is greater than the optimal discount frequency for large national brands. The reason for this occurrence is because the optimal deal depth is lower for store brands than for national brands.

There is greater consensus on discount depth. All four game-theory models (Lal 1990; Rao 1991; Narasimhan 1988; Raju et al. 1990) directly or indirectly state that the average discount of higher-priced national brands is greater than the average discount of lower-priced private labels. This assertion is supported by the decision models of Tellis and Zufryden (1995) and Shankar and Krishnamurthi (2007); the asymmetric price-tier effect theory of Blattberg and Wisniewski (1989); and has strong external validity -- Sethuraman (2009, Table 2, M15).

In summary, private labels discount fairly frequently. Managers and researchers need to better understand the profitability of private label discounts. However, private labels do (rightly) offer shallower discount than national brands in both absolute and percentage (of price) terms.

CONCLUSION

In this section, we summarize the key strategies for private label marketing and provide some predictions and future research directions.

Summary of Key Strategies

1. In relatively undifferentiated products, cost permitting, it is better for the retailer to reduce the number of competing national brands (assortment) and introduce a store brand of acceptable quality.
2. In differentiated products, it is okay to introduce a store brand even if there are many national brands, so long as the store brand can generate incremental volume.
3. High-volume / high-margin categories are conducive for store brand introduction, especially if store brand margin is greater than margin from national brands.
4. Introducing a store brand of good quality and increasing private label share can increase store loyalty and share of total purchases in the store, up to a point.
5. Demographic variables are not good predictors of private label purchase. Nevertheless, it is useful for store brands to target low-income consumers in addition to the core middle-income households, to increase private label share and consumer welfare.
6. It is better to position the store brand close to the national brand in mature categories with limited market expansion and where store brand margins are greater than national brand margins. It is better to not position close to the national brand when the store brand can cater to a market unserved by the national brand or in growth categories where national brands can expand category demand through advertising.
7. When retailers close the quality gap between national brands and the store brand, it is optimal to reduce the price differential between the two brands. However, the price differential can not be too low (less than 15%), as consumers are generally willing to pay an image premium for the national brand.
8. It is not clear whether private labels should be discounted less frequently than national brands. However, it is fairly evident that the discount size (amount of discount) should be smaller for store brands than for national brands.

Trends and Predictions

We offer some predictions related to private label sales and marketing based on our reading of the literature and understanding of the groceries market.

Private Label Share. It is well known that private label sales and market share in grocery products have grown globally in the last ten years. Recent growth has been partly attributed to recession. Will the growth trend continue post-recession? We think it will, up to a point. When retailers are establishing a foothold with their private labels, they are doing so increasingly with quality products at value prices. Thus, there is some inertia once consumers have switched to store brands. At least we do not expect to see a significant drop in private label share post-recession. But will private labels account for 40-50% of category volume, on average, as some are predicting? We think this situation is unlikely because of consumers' need for variety (a case in point is consumers' reduced patronage of Sears in the 1970's when it overemphasized private labels), retailers' profitability and inability to manage private label at that volume, and retail competition (dollar stores and other discount stores may offer the national brands at value prices and draw away consumers). It is worth noting that even Aldi's, an exclusive private label seller, is planning to add some national brands to improve variety and counter competition.

Private Label Offerings. There is clearly a general trend towards quality equivalence between private labels and national brands, though the quality differential may vary across products and retail outlets. We believe, at least in the case of retailers with strong private label programs, that product quality will cease to be a differentiator between national and store brands. Competition will be based on value and store image for store brand and status and brand image for the national brands. We will also see emergence of premium private labels in some limited categories, like pasta and chocolates, and niche private labels in some other categories like nutrition or diet products, but we do not think they will be a force to reckon with. Traditional (standard) private labels will continue to dominate the market.

Private label Sourcing. We believe there will be increasing use of national brand manufacturers as suppliers of private labels. Both retailers and manufacturers are recognizing the potential mutual benefits. Private labels are here to stay. Manufacturers believe, if you can't beat 'em, join 'em! Competition from other manufacturers, excess capacity, and reduced demand during tough economic times have forced retailers to rethink their supply strategies. It is also in the interest of retailers to obtain private labels from national brand manufacturers for quality assurance and better category management.

Private Label Marketing. As the quality gap between national brands and store brands closes, we should see a general reduction in the price gap. But at the same time, national brands will continue to command a price premium above the Just Noticeable Difference threshold of about 15%. As quality becomes less of a differentiator and national brands compete on the basis of image and coupons, retailers will increase their in-store non-price promotions of store brands through displays and features. At the same time, both retailers and leading manufacturers will develop some cooperative marketing arrangements for increasing category profits.

Future Research

Based on our review, we believe the following research topics are important and germane for future analytical and empirical research:

Private Label Sourcing. When selecting a store brand supplier, the retailer has three options: (i) procure from an independent (fringe) manufacturer; (ii) obtain from a national brand manufacturer (dual branding); or (iii) produce its own store brands. Broadly, there are two considerations for both the retailer and the manufacturer to participate in dual branding: cost consideration and strategic consideration. Cost consideration relates to the cost advantage that a national brand manufacturer may have compared to other potential suppliers. Strategic

considerations include (i) quality assurance and (ii) increased cooperation from the national brand manufacturer, especially in a market where there are many store switchers. It is difficult to obtain data on dual branding because of the desire for manufacturers not to divulge the information. Nevertheless, we need better understanding of why a manufacturer would supply private labels and why a retailer would accept the same (see Kumar, Radhakrishnan and Rao 2010 for some analytical work and Chen et al. 2010 for some empirical work on this topic).

Premium Private Labels. While most of the analysis is based on one store brand per category, some retailers may follow a two-tier or three-tier store brand strategy (Steiner 2004). For example, Wal-Mart has two apple juices, the low-priced Great Value and the premium Sam's American Choice. Some retailers may introduce multiple store brands that target different national brands -- possibly for better trade terms from both brands. (Sayman and Raju 2004b). In particular, Kumar and Steenkamp (2007) say premium private labels is perhaps the hottest trend in private label retailing. However, we have little understanding of what such private labels represent, what the right conditions are for introducing premium labels, or their profitability. Geyskens, Gielens, and Gijsbrechts (2010) explore the effect of introducing economy and private labels on the sales of national brands and standard private labels. More work is needed.

Retail Margins. Margins are the backbone of private label introduction and strategies. It is relatively easy to compute retailers' margin on national brands, but computation of store brand margins may be a bit more complicated since relevant costs include the administration of the private label program. Retailers should institute proper accounting procedures to compute store brand margins. At the same time, theoretical and empirical researchers should shed light on whether and when retail margins on store brands are higher than those for national brands, along the lines of Ailawadi and Harlam (2004).

Retail Competition. The interaction between private label strategy and store competition is perhaps one of the least understood topics in this field. With increased sophistication in analytical and empirical modeling and availability of data across multiple stores, future research should address how retail competition influences private label strategy.

National Brand Competition. Managers believe that the manner in which private labels react to national brands and the manner in which national brands strategize against private labels depend on the nature of #1, #2, and #3 national brands. Hence, incorporating multiple, asymmetric national brands would better reflect real-world market conditions. Some researchers (e.g., Sayman, et al. 2002) have studied asymmetric national brand competition, but more work is needed.

Private Label Price Promotion. While conventional wisdom suggests that retailers should not price promote their private labels, they do in fact promote. The reasons for promoting private labels, as stated by retailers, include: (i) the need to protect store brand turf; (ii) the need to generate trial and repeat of store brand; and (iii) the desire to simply promote what customers want (Sethuraman 2008). We need better understanding of these motivations and more detailed analysis of the profitability of private label discounts.

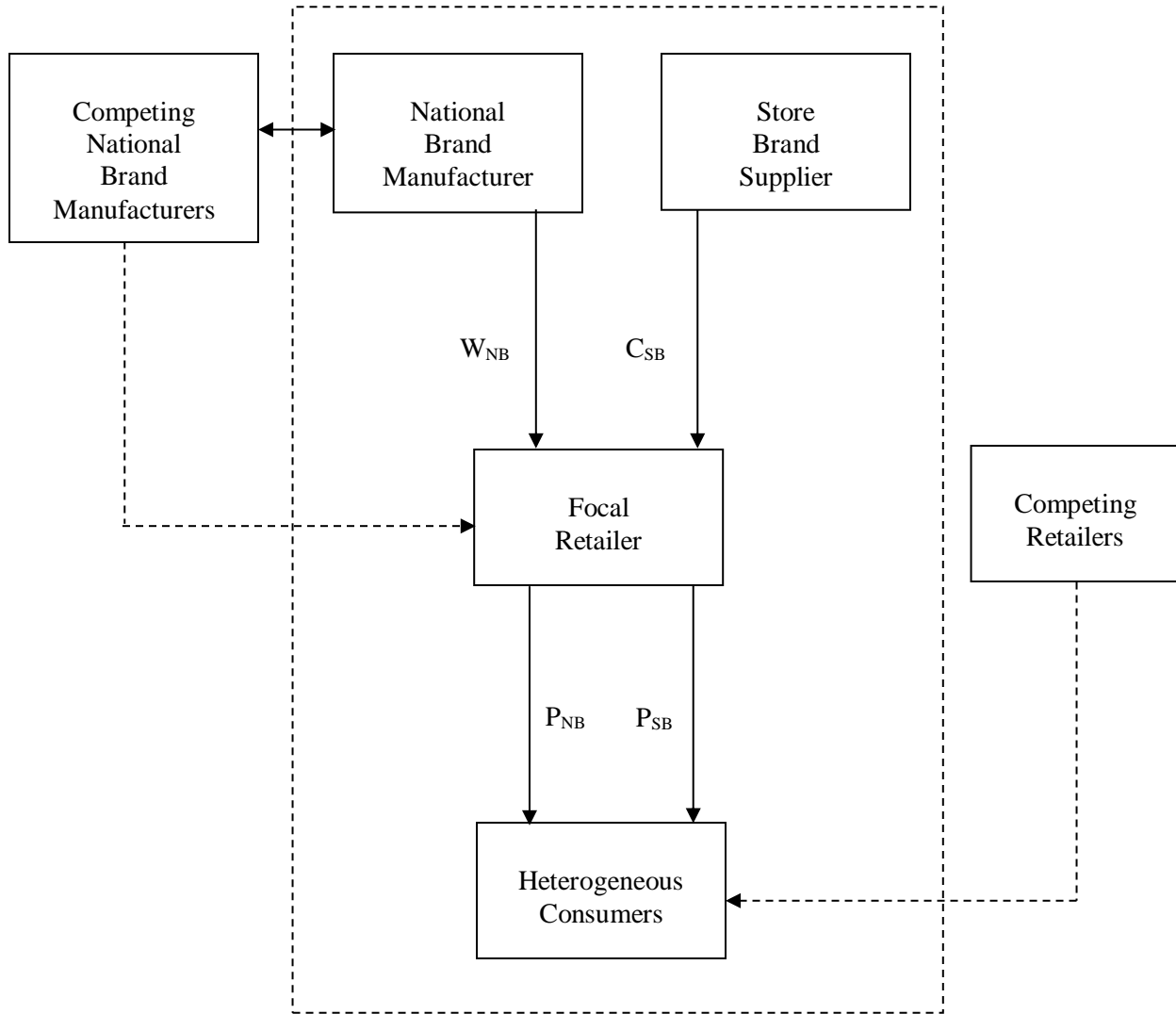
Private Label Non-Price Promotions. Non-price promotions include in-store promotions such as displays and features, as well as coupons, free samples, and gifts. There is mixed evidence on the effect of non-price promotions on private label sales. However, the research on non-price promotions is too limited to draw any meaningful recommendations.

Non-Grocery Products. The analytical models and empirical work have predominantly focused on grocery products. Would the results be different for non-grocery products, such as

appliances and apparel? Future research should incorporate the institutional and market structures pertinent to the non-grocery product markets.

Finally, the private label phenomenon is inherently dynamic and changing. We need to update our understanding of consumer behavior and retailer / manufacturer strategies with respect to national brand vs. store brand competition every 10 to 15 years.

Figure 1
Framework



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