The economic benefits of retailer own-brands

Prepared for the European Retail Round Table

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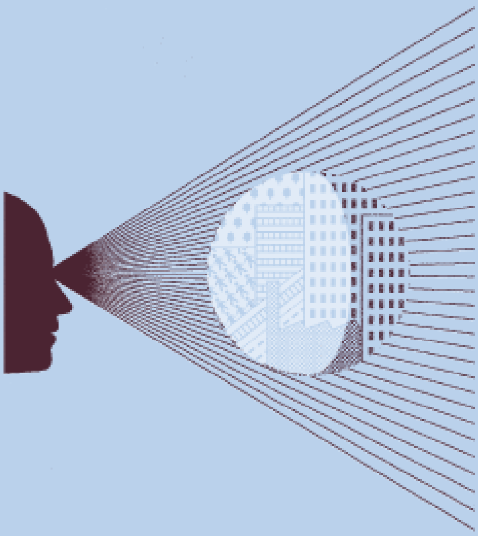

Executive summary

Understanding own-brands

A retailer own-brand is a product or service that either carries the brand of the retailer or a separate brand name that is controlled by the retailer. Historically, own-brands were sometimes referred to as 'private labels', with typical examples being generic grocery items simply labelled with the grocery retailer's branding. Over time, own-brands have become increasingly sophisticated. Retailers began by expanding their own-brand ranges to offer a range of 'good, better, and best' price/quality combinations and later added further sub-brands and niche ranges. Rather than simply adding labels to generic products, many grocery retailers design, develop and market-test their own-brand products before contracting out the final production, in much the same way as many branded-goods manufacturers do.

The role of this report

This report contributes to the debate on grocery retailers' own-brands. Grocery retailers play an important role in the shopping routines of most Europeans, with grocery sales representing around half of all retail sales in the European Union.[1] A significant proportion of these sales are supplied by large grocery retailers. Various government, regulatory, and industry organisations have expressed views about the impacts of own-brands, in some cases highlighting the vigorous competition that they can help to create for branded products; in other cases, raising concerns about their impacts on other retailers and suppliers.

This report, commissioned by the European Retail Round Table (ERRT), approaches the issue of own-brands from the perspectives of consumers, retailers and suppliers. Using publicly available sources of evidence, supplemented with information provided by ERRT members, this report identifies the benefits of grocery retailers' own-brands and addresses common misperceptions about them (a full cost–benefit analysis is beyond the scope of this report).

Impact on consumers

The dynamics of the grocery supply chain in Europe, as elsewhere, are driven by the demands of consumers. Overall, the economic theory and evidence reviewed for this report suggest that own-brands provide benefits to consumers, for example, by helping to deliver new products and value for money. In addition to the direct benefits to consumers of own-brands, consumers of other brands benefit indirectly where increased competition from own-brands forces branded alternatives to compete more vigorously in terms of offering higher quality, increased levels of innovation, or lower prices.

The report also considers whether retailers could use own-brands to harm competition (for example, by forcing branded rivals out of the market), allowing retailers to raise prices or lower quality, range or service. Retailers are considered to face fierce competition and this suggests that the balance of branded goods and own-brands in stores will continue to be driven by what consumers demand.

[1] European Commission (2010), 'Commission staff working document on Retail Services in the Internal Market—Accompanying document to the Report on Retail Market Monitoring: "Towards more efficient and fairer retail services in the Internal Market for 2020"', July 5th.

Impact on retailers

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

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

Impact on suppliers

From the perspective of the supplier, the picture is more complex. The existence of retailer own-brands provides new routes to market for small suppliers to produce for mass markets which they may otherwise struggle to access given the costs and risks involved in developing a brand. On the other hand, own-brands can help to give retailers additional bargaining power in relation to their suppliers, the exercise of which may be perceived negatively by suppliers where it allows retailers to negotiate more favourable terms. However, in general, while retailers have an interest in getting the best deals from suppliers they have no long-term interest in forcing efficient suppliers out of the market because this would tend to harm the retailer's own interests. For example, retailers benefit from healthy competition at the supplier level because it keeps their input costs low.

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1 Introduction

1.1 Purpose of the report

The European Retail Round Table (ERRT) commissioned Oxera to produce a report on the economic impacts of grocery retailers' own-brands.[2,3] Using publicly available sources of information, supplemented with information provided by ERRT members, this report identifies the benefits of grocery retailers' own-brands and addresses common misperceptions about them. A detailed quantification of the costs and benefits of own-brands is beyond the scope of this report; rather, the report aims to contribute to the wider debate about the role and impact of own-brands.

1.2 Retailing and own-brands

The growth of own-brands in Europe over the past 50 years has been driven by what the European Commission describes as 'fierce' competition between grocery retailers.[4] Retailers win or lose customers on the basis of the value for money and quality of service they offer. Markets characterised by strong competition tend to deliver good outcomes for consumers. Competition drives suppliers and retailers to offer better deals to consumers—in terms of lower prices, better quality, new products and more choice.[5]

1.3 The importance of consumers

The growth of own-brands has come about as a result of consumer demand. Evidence for this comes from the penetration of own-brands, which varies significantly between retail product categories. Where own-brands are demanded by consumers, they can achieve a significant share of supply; however, in the categories where consumers prefer manufacturer brands, or where brand products compete successfully and innovate to maintain their position, the shares of own-brands remain low. For example, own-brands account for half of the sales in some retail product categories and only a few percent of the sales in others (see Table 2.2 below).

The dynamics of the grocery supply chain are also driven by consumer demand. In contributing to the debate on the impact of own-brands on the grocery retail supply chain, the report also considers the ultimate impact on consumers. Own-brands have both a direct impact on consumers, through the price, range and quality of groceries, and an indirect impact, through any influence of own-brands on supplier and retailer innovation.

[2] ERRT is a network of business leaders established to express the views of large retailers on a range of issues of common interest. Their businesses operate worldwide and represent a cross-section of the retail sector. ERRT members are Asda/Wal-Mart, C&A, Carrefour Group, Delhaize Group, El Corte Inglés, H&M, IKEA, Inditex, Kingfisher, Marks & Spencer, Mercadona, METRO Group, Royal Ahold, and Tesco.

[3] Oxera is one of Europe's foremost independent economics consultancies. Established in 1982, it has built a reputation for providing critical economic insight to an international list of clients including governments, regulators and major companies. Oxera has significant experience in the grocery retail sector, including advising the Co-operative group in the UK on a number of significant acquisitions, such as the takeover of Somerfield in 2008; and advising own-brand soft-drinks manufacturers Cott Beverages and Macaw on their 2006 merger. Oxera also advised Clover SA in relation to allegations of cartel behaviour in the dairy industry in South Africa.

[4] European Commission (2009), 'Competition in the food supply chain—Accompanying document to the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: "A better functioning food supply chain in Europe"', SEC(2009) 1449/2, Commission Staff Working Document, [COM(2009) 591], p. 9.

[5] UK Office of Fair Trading (2002), 'Competition is for consumers', speech by John Vickers, Director General of Fair Trading, to the Social Market Foundation, February 21st.

1.4 Structure of the report

The report begins by defining own-brands and discussing their role in the supply chain (section 2). It then assesses their impact (section 3). The report highlights the beneficial impacts of retailers' own-brands on consumers, through lower prices, increased choice and innovation (section 3.1). It also considers the impact of own-brands on retailers and their suppliers, and explains why increased competition being driven by retailers among their suppliers benefits both consumers and efficient and innovative suppliers (sections 3.2 and 3.3).

2 The importance of own-brands in the grocery supply chain

This section of the report places own-brands into the context of the overall grocery retail supply chain. It then discusses the role of own-brands in the past and present, and how they may evolve in the future.

2.1 What is an own-brand?

A retailer own-brand is a product or service that either carries the brand of the retailer or a separate brand name that is controlled by the retailer. Own-brand products can be supplied by firms that specialise in own-brands but also by those also supplying branded products. In the past, own-brands were sometimes referred to as 'private labels', with typical examples being generic grocery items simply labelled with the grocery retailer's branding. Over time own-brands have become increasingly sophisticated, with retailers first expanding their own-brand offerings by offering a range of 'good, better, and best' price/quality combinations and then adding further sub-brands and niche ranges.

Rather than simply adding labels to generic products, many grocery retailers design, develop and market-test new products before contracting out the final production, in much the same way as many branded-goods manufacturers do.

What is an own-brand?

The Private Label Manufacturers Association offers the following definition:

> Simply put, [own-brands] are products that stores put their own names or brands on. They may be called private labels, house brands, own-brands or retailer brands, but they all have one thing in common – they are manufactured and brought to market in much the same way as the familiar national brands they sit next to on store shelves.

Source: www.plma.com/storeBrands/sbt10.html, accessed on June 5th 2010.

2.2 The food retail value chain

Food producers supply some goods (eg, fresh vegetables) directly to retailers while other goods are supplied via various processors. The degree and complexity of the processing varies considerably; for example, milk usually undergoes various forms of heat treatment and is then bottled before being supplied to retailers, while prepared meals involve multiple inputs and multiple stages of processing and packing before being supplied to retailers. The grocery retailing layer of the industry includes a variety of players, ranging from large chains (eg, METRO, Tesco) to small convenience stores (eg, some are part of corporate groups, such as SPAR, while others are independent).

Sales of own-brand goods, as a proportion of total sales, vary by retailer, country and product category. At one extreme some stores exclusively (or almost exclusively) stock own-brand products. For example, the discount grocery retailer, Aldi, largely stocks own-brand products, and the premium grocery retailer, Marks & Spencer, has, until very recently, sold purely own-brand goods; at the other extreme, some stores stock no (or almost no) own-brand products. Most grocery retailers opt to offer a mix of own-brand and branded products. This is the model adopted by retail chains such as Real, Tesco, Carrefour and Delhaize. These choices by retailers are consistent with the evidence that own-brands are an important—but far from the sole—reason why consumers choose their supermarket. For example, in 2008 the UK Competition Commission found that around 20% of shoppers choose their grocery retailer on the basis of own-brand ranges.[6]

In principle, the retailer might influence the sales of own-brand versus branded goods by its choices regarding allocation of shelf space and in-store promotions. However, shelf space will also be allocated based on a product's rate of sale since allocating less shelf space to a popular product would be risky in terms of shelf stock running out too quickly.[7] The same logic applies to branded goods: consumer demand—and hence the product's rate of sale—will be a key influence on decisions regarding which products to stock and how much shelf space to allocate to each product. Therefore, in reality there are limits to the proportion of own-brands in most full-service grocery retailers because shelf space is primarily decided by customer preference. In general, own-brand-only supermarkets tend to remain niche players.

An example from Albert Heijn in the Netherlands illustrates the point that consumer preferences drive the variety and choice of brands and own-brands on retailers' shelves. In 2006, Albert Heijn opened a new test store in Heemskerk. The store offered both brands and own-brands, but provided a reduced choice in both segments. Customers were unhappy with the reduced choice of brands and own-brands so Albert Heijn extended the range in the test store with 600 additional products, both brands and own-brands. The message that Albert Heijn took from this test was that it is vital for its stores to provide sufficient choice in branded as well as own-brand products.

2.3 Own-brands: brands like any other

Grocery retailer own-brands are sophisticated brands in their own right, as described below.

– **Own-brands are brands in their own right**, in some cases adopting own-brand names that are distinct from the name of the retailer. For example, the 'George' range of clothing is sold in Asda/Wal-Mart stores but as a separate brand that does not feature the Asda name.

– **In many cases grocery retailers research, develop, market-test and specify products** before contracting out the production element to a third party. For example, at Dutch retailer Albert Heijn, the firm's merchandising team decides, on the basis of customer needs and market potential, on a product segment where new own-brand products should be developed. The merchandiser then sets out—together with Albert Heijn's buying team—the specifications that the new product must satisfy. The buyer explores the market and draws up a list of potential suppliers able to produce and supply the product. Once a supplier has been chosen, a panel of consumers has to pass judgement on the products before they can become a permanent part of the Albert Heijn range.[1]

  In the case of Albert Heijn's recently introduced AH Groentechips (vegetable chips), pressure on the margins of existing crisp/potato chip lines and a lack of differentiation between retailers led the Albert Heijn category manager to search for a novel product concept. Market research in the UK and Switzerland, where innovative crisps varieties (eg, wasabi crisps, vegetable crisps and fruit crisps) are more widely available, gave the category manager insights into potential new products. Albert Heijn's buyer then identified suppliers that could produce vegetable crisps and had all the necessary regulatory approvals. Potential suppliers then supplied Albert Heijn with samples for internal testing. Discussions between the category manager, buyer, quality manager and the preferred supplier led to an initial decision on texture and taste. The product was then tested among 90 consumers and received positive feedback. Supplier cost, pricing, shelf placement and packaging design were all completed, and the new product was publicised internally within Albert Heijn before being introduced in-store. The total lead-time was 25 weeks.

– **Own-brands are not limited to the grocery sector**. Outside the grocery retail sector, the

[6] Competition Commission (2008), 'The supply of groceries in the UK: market investigation', Final Report, Appendix 9.10, para 6.

[7] The UK Competition Commission's referred to this issue in its report into an own-brand carbonated soft drinks merger. See Competition Commission (2006), 'Cott Beverages Ltd and Macaw (Holdings) Ltd merger inquiry', Final Report, para 4.41.

penetration of own-brands varies from sector to sector. In each case, manufacturers and retailers can be expected to choose a mix appropriate to the consumer and their own operations. This results in a variety of outcomes. For example, some are very own-brand-focused (eg, DIY stores such as Brico, B&Q, Hagebau), some are more mixed (eg, over-the-counter pharmaceuticals), and others are very brand-focused (eg, perfumes).

[1] Source: Adapted from information provided to Oxera by Albert Heijn.

Table 2.1 The importance of own-brands differs between retail sectors

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

Source: Oxera.

2.4 Past, present and future of own-brands

Past—own-brand products have a long history in grocery retailing, and can be traced back to the early 1900s when they were first introduced by grocery retailers in North America. In Europe, major players such as Migros, Aldi and Tesco all grew their businesses based partly on 'the development and proliferation of their own-brands'.[8]

In some cases, early own-brands simply provided an inexpensive alternative to branded products—typical examples being generic grocery items simply labelled with the grocery retailer's branding. Over time, own-brands have become increasingly sophisticated.

Retailers first began to expand their own-brand products by offering a range of price/quality combinations, sometimes described as 'good, better, best'.[9] Some retailers have since added further sub-brands at different points in the price/quality hierarchy, and sub-brands catering for particular customer preferences or demands, such as 'organic' ranges and allergen-free brands.

Present—customers are happy to choose own-brands in some product categories but not others. As shown in Table 2.2, own-brand products are less prominent in personal care (eg, moisturiser, lipstick, shampoo) than in food and drink and household care (eg, kitchen paper). Yet even within food and drink there is substantial variation: 43% penetration for milk but only 1% for baby food.

[8] See http://www.retailcustomerexperience.com/article/21480/The-evolution-of-own-brands-at-retail, accessed September 17th 2010.
[9] Planet Retail (2010), 'Private Label: The brands of the future', May.

There are also instances when the shares change quite markedly in a product segment within a relatively short period. For instance, between 2001 and 2005 own-brand yogurt declined from 21% to 5% of total sales in the UK.[10] More generally, the market research firm Mintel has stated that market shares within product categories are 'continually shifting' between own-brand and branded products.[11]

Table 2.2 Own-brand penetration varies considerably across product categories

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

Note: [1] Top/bottom ten of the 80 categories covered by the survey in 38 countries. Although these figures are from 2005, Oxera is not aware of any more recent publicly available data on the same basis. [2] Vegetables were split into two separate categories.
Source: Adapted from Nielsen (2005), 'The Power of Own-brand: A Review of Growth Trends Around the World', September.

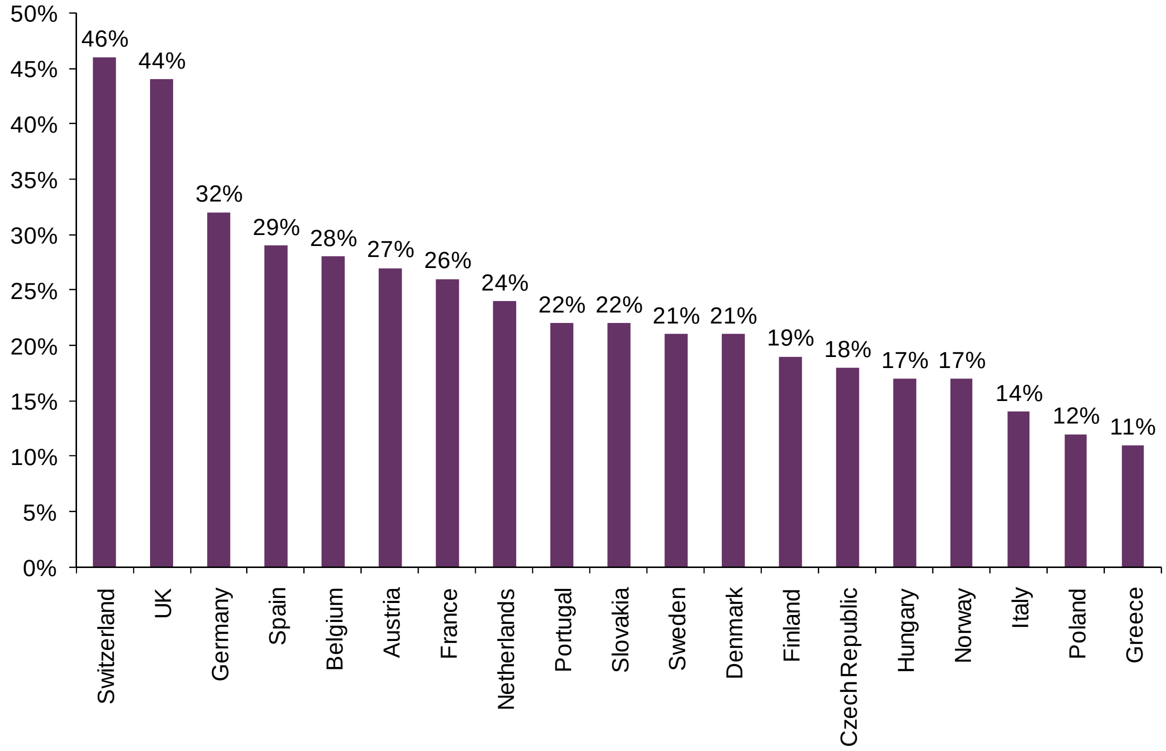
It is notable that own-brands appear to have the highest levels of penetration in product categories that have not traditionally featured strong manufacturer brands, such as meat, ready meals, dairy and fresh produce. Own-brand penetration is lowest where branding has traditionally been strong, such as for toiletries, personal care and alcohol. This is consistent with the hypothesis that, rather than forcing existing manufacturer brands out of the market, own-brands flourish in categories where there are no other strong brands. In these categories the branding provided by the retailer's own-brand adds value to what might otherwise be a pure commodity product.

As well as varying by product category, own-brand penetration varies significantly between European countries, as shown in Figure 2.1 below. The UK had a 44% rate of penetration for own-brands in 2009, compared with Poland and Greece, where penetration was 12% and 11% respectively.

These significant differences in own-brand penetration, both between product categories, but more importantly between countries, suggest that it does not make sense to have any one-size-fits-all, EU-wide policy relating to own-brands. Instead, based on the principle of subsidiarity, any action in relation to own-brands should be devolved to Member States, based on the particular features of their national retail markets.

[10] Competition Commission (2008), 'The supply of groceries in the UK: market investigation', Final Report, Appendix 9.10, para 8.
[11] Ibid., para 43.

Figure 2.1 Own-brand penetration in Europe varies significantly by country



Source: Nielsen, based on 2008 data.

Future—while there has been growth in the share of own-brands over time, there are likely to be limits to this continuing indefinitely. Many consumers continue to demand branded products. Own-brand-only supermarkets have remained niche players in most European markets. Grocery retailers have very limited powers to impose own-brands on consumers, given that choice of product is ultimately the consumer's decision, as the example of the Albert Heijn test store in section 2.2 illustrates. In the UK, Marks & Spencer—for over 125 years an own-brand-only store—has recently started to sell around 400 manufacturer-branded products.[12]

It should also be noted that while retailers will continue to develop their own-brand strategies, brand owners will continue to respond and innovate in order to maintain their market position. Recent developments in the area of fast-moving consumer goods (FMCGs) include major European brand owners such as Proctor & Gamble and Danone developing strategies to compete with own-brands across a range of price/quality combinations, rather than concentrating solely on premium products.[13]

[12] See http://www.marketingmagazine.co.uk/news/950567/Marks---Spencer-introduces-first-branded-goods-125-years/, accessed September 17th 2010.
[13] OC&C Strategy (2010), 'FMCG Champions – Fahrt Durch Turbulente Zeiten: Trends und Strategien im Konsumgütermarkt 2009'.

3 The economic impact of own-brands

3.1 Introduction

This section considers the economic impacts that own-brands have on consumers and businesses, and considers the wider impacts on innovation. It identifies the benefits of grocery retailers' own-brands and addresses common misperceptions about them.

3.1.1 Why are brands and own-brands valuable to consumers?

In economic terms a brand is a method by which firms can build a relationship with existing and potential consumers about various aspects of their products or services. Branding tends to involve a long-term relationship between the supplier and the customer that can cover various aspects of the products or services in question, including advertising, packaging and customer experience.

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

3.1.2 How do own-brands affect consumers and suppliers?

The impact of own-brands can be horizontal (felt across one level in the supply chain) or vertical (felt between levels in the supply chain). This is because own-brands are both a competitor in the market at the retail level and controlled by one of the routes to market for branded products. To address both types of impact, this section of the report looks separately at consumers, retailers and suppliers.

3.2 The impact of own-brands on consumers

3.2.1 The benefits of competition for consumers

Competition between firms is generally recognised as being beneficial for the European economy and for individual Member States. Part of the role of the European Commission is to ensure that competition in the EU market is not distorted and that markets operate as efficiently as possible, thereby contributing to the welfare of consumers and to the competitiveness of the European economy.[14]

In a recent working paper on the retail sector, the European Commission states that competition among grocery retailers is strong:

> One of the key findings of the current exercise is that competition at retail level is fierce, both between retailers themselves and increasingly between different retail formats.[15]

[14] Taken from the European Commission website (ec.europa.eu/dgs/competition/index_en.htm), accessed June 3rd 2010.

[15] European Commission (2009), 'Competition in the food supply chain—Accompanying document to the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: "A better functioning food supply chain in Europe"', SEC(2009) 1449/2, Commission Staff Working Document, [COM(2009) 591], p. 9.

As noted in the introduction to this report, competition tends to deliver benefits to consumers by incentivising suppliers and retailers to offer better deals, in terms of better quality, lower prices, new products, and more choice.[16]

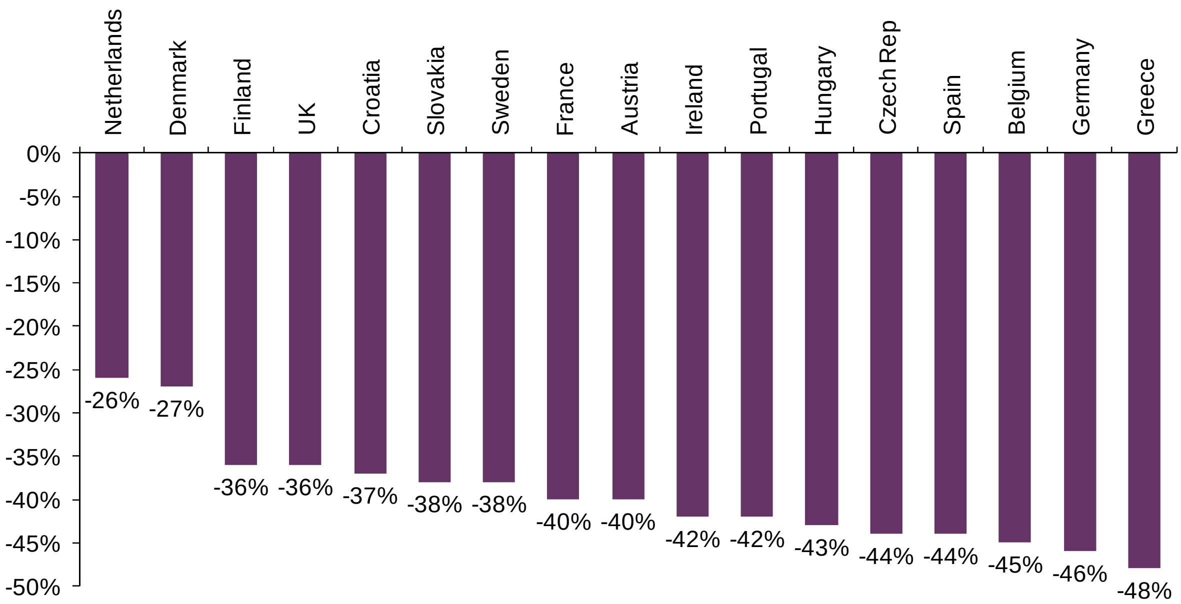
For instance, UK retailer Asda has put consumers at the centre of decisions on improving its products with its 'Chosen By You' range, which was independently endorsed by a representative sample of over 250,000 consumers, under the supervision of an external research agency.

3.2.2 Own-brands are on average less expensive than branded products

Figures from Datamonitor for the UK show that 41% of all grocery sales at the end of July 2009 were own-brands, up from 38.2% in 2008.[17] Although a combination of factors is likely to have contributed to the growth in sales of own-brands over this period, one factor may have been the economic downturn that followed the worldwide financial crisis. Datamonitor also reports that own-brand goods are 22% cheaper than branded goods on average.

This picture is repeated across Europe and further afield. All of the 38 countries covered by the 2005 Nielsen survey had lower average prices for own-brands than branded products. Figure 3.1 shows the results for the 17 EU countries included in the worldwide sample.

Figure 3.1 Average price differences between brands and own-brands for a sample of European countries



Note: Chart shows all 17 European countries covered by the Nielsen survey, which included 38 countries worldwide.
Source: Adapted from Nielsen (2005), 'The Power of Own-brand: A Review of Growth Trends Around the World', September. Oxera is not aware of any more recent publicly available data on the same basis.

As explained in section 2, modern own-brands offer more to consumers than simply low prices. However, some large grocery retailers do offer a separate 'value' range that tends to be cheaper than equivalent branded products. The existence of this low-priced option, which would not necessarily be available in the absence of own-brands, provides a benefit to consumers. Recently, premium retailers have also begun to offer 'value brands' in order to

[16] UK Office of Fair Trading (2002), 'Competition is for consumers', speech by John Vickers, Director General of Fair Trading, to the Social Market Foundation, February 21st.
[17] The *Times* (2009), 'Own-label sales rise as shoppers rein in their spending', August 17th.

allow consumers to pick between high-price/premium and low-price/value items within a single store, rather than shopping at multiple stores.

3.2.3 Own-brands can also benefit consumers of branded products through increased competition

The existence of own-brands can benefit consumers who buy exclusively or predominantly branded products. The introduction of own-brands in a product category increases the competitive pressure on existing branded products. A 2006 report by the Institute of Grocery Distribution notes that:

> Rising private label penetration across Europe presents a key challenge for suppliers regardless of whether they are a 100% branded goods supplier, a supplier of both branded and private label goods, or a 100% private label supplier.[18]

Brand owners can react in a number of ways, including lowering their own prices to compete with the own-brand entrant, increasing quality, or innovating in order to differentiate the branded product from the own-brand alternative.

3.2.4 In a well-functioning market levels of quality and variety are driven by what consumers demand

At the most basic level, retailer own-brands, by their nature, bring new products to the market that often differ in some respects from existing manufacturer brands. This provides a benefit to consumers in terms of the choice and variety of goods on offer.

In addition, as discussed in section 3.1 above, retailers have a particularly strong incentive to ensure product quality across all of their own-brand products. This is due to the potential for negative spillovers and damage to the brand of the retailer as a whole if quality standards are not met for any particular product or category.

It has been argued that increased market shares of own-brands may reduce variety and choice for consumers by reducing the shelf space available for other brands. Indeed, in the extreme, the complete crowding out and/or foreclosure of branded products could reduce not only variety but also the intensity of competition in some product lines, harming consumers.

In this regard, a number of points should be considered:

– an increased market share for own-brands does not necessarily equate to a reduced number of other brands available on retailers' shelves. If consumers value variety then retailers will continue to have an incentive to offer alternatives;

– more generally, it is costly for retailers to provide a variety of choice, and competition drives retailers to ensure the balance between price and variety that consumers demand.

Where shelf space is severely limited, this may be due to planning regulations rather than retailers' strategic decisions. National planning regulations in many cases limit the size of stores or place additional regulatory burdens on stores over a particular size, which can lead retailers to build stores with sub-optimal amounts of shelf space. As noted by the Irish Competition Authority:

> First, restrictions on size limit the extent of competition between retailers. Second, **restrictions on size limit inter-brand competition. These effects combine to limit consumer choice and value**[19] [emphasis added]

[18] Institute for Grocery Distribution (2006), 'European Private Label Growth: Strategic Responses for Suppliers and Retailers', August, p. 15.

Restrictions on store size imposed by planning regulations are also noted by the European Commission in its Internal Market Scoreboard, and in the recently published Commission staff working document on retail services in the internal market.[20]

3.2.5 Informational benefits

As explained in section 2, the evolution of own-brands in many large European grocery retailer chains has been from a single 'house brand', through a hierarchy of 'value', 'standard', and 'premium' own-brands, to a more complicated structure which introduced more levels into the hierarchy and also supplements it with niche own-brands such as 'organic' and allergen-free own-brand ranges.[21]

This structure of own-brands, with each brand covering a variety of products, allows consumers to pick the quality/price mix that suits them, or to make other informed choices about the products they buy, without having to invest time in understanding the specific attributes of each product. A good example of this is the 'AH puur&eerlijk' (AH pure&honest) range, recently launched by Dutch supermarket chain, Albert Heijn.

Box 3.1 Case study Netherlands—Albert Heijn's 'AH pure&honest' own-brand range

Background

In May 2009, Albert Heijn launched AH pure&honest, an innovative umbrella brand that helps consumers to identify and choose ethical products. The range includes organic and fair-trade products, sustainably caught fish, free-range meat and environmentally friendly non-food items. Albert Heijn currently stocks 340 products in the AH pure&honest range and plans to increase the range to 450 by the end of 2010, and to over 500 in 2011.

Clear branding across product categories provides informational benefits for consumers

Albert Heijn opted for a single brand to represent those products made with particular care towards people, animal welfare, nature and/or the environment to make it easier for consumers to make informed choices. All AH pure&honest products are certified and/or have quality control labels such as the Dutch Eko label for organic products or the Beter Leven (better life) label granted by the Dutch animal welfare organisation, Dierenbescherming, for organic and free-range meat products.

AH pure&honest provides informational benefits for consumers who wish to shop in an environmentally and socially responsible way. In the absence of an umbrella brand such as AH pure&honest, such consumers would need to examine each individual product in order to ascertain its environmental and social credentials.

Statistics from Albert Heijn suggest that the new brand is making it easier for customers to understand and make informed choices. For example, 75% of customers who bought free-range meat with the new AH pure&honest branding had previously purchased Albert Heijn's regular own-brand meat.

Source: Based on Ahold (2010), 'Albert Heijn's 'AH pure&honest' brand attracts new customers', May 17th, and discussions with representatives from Ahold.

3.2.6 Multi-product own-brands can provide additional consumer benefits

In some cases brands can apply to a single product, and the incentive to maintain value of the brand relates to the sales of that particular product. However, many brands cover a range

[19] The Competition Authority (2008), 'The Retail Planning System as Applied to the Grocery Sector: 2001 to 2007 Grocery Monitor: Report No. 3', July.

[20] European Commission (2002), 'Internal Market Scoreboard - N°10', May. European Commission (2010), 'Report from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Retail Market Monitoring Report: "Towards more efficient and fairer retail services in the Internal Market for 2020"', July 5th, p. 6.

[21] Planet Retail (2010), 'Private Label: The brands of the future', May.

of products (eg, car brands or hotel chains), in which case there can be spillover (or ‘externality’) effects between the products associated with the brand. These spillover effects can work in two ways:

– if one product in the range fails to maintain the standards embodied by the brand, this can affect consumers’ views of all products in the range (negative spillovers), so there is an additional incentive for brand owners to ensure that all products meet the required standards. In grocery retailing the risk of these negative spillovers may lead to higher standards in areas such as hygiene and food safety;

– improvements to the brand image can benefit all products in the range, so there is a greater incentive to invest in the brand image where the brand covers a range of products since the costs are effectively shared between the products (positive spillovers).[22]

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

3.3 The impact of own-brands on retailers

The introduction of own-brands has had a number of impacts on grocery retailers, such as providing an additional dimension on which retailers can compete for customers, allowing retailers to differentiate their offer from rivals by innovating and changing their own-brand offerings, as described in section 2.4 above, and in some cases allowing retailers to achieve better terms and lower input prices from suppliers. To the extent that own-brands increase the bargaining power of retailers over their suppliers, this is likely to be of benefit to retailers, and their customers. Increased competition, as a result of increased pressure from retailers, may lead to efficiencies and innovation among suppliers. The issue of own-brands and buyer power is discussed in detail in section 3.4 below.

3.3.1 Own-brands and retailer innovation

Innovation is widely recognised as a key driver of economic growth. The European Commission’s ‘Europe 2020’ strategy, which aims for smart, sustainable and inclusive growth, has innovation as one of its ‘Flagship Initiatives’. There is a commitment to increase investment in research and development (R&D) to 3% of EU GDP (currently below 2%, compared with 2.6% in the USA and 3.4% in Japan).

The European Commission describes its flagship ‘Innovation Union’ initiative as aiming to:

> ‘improve framework conditions and access to finance for research and innovation so as to ensure that innovative ideas can be turned into products and services that create growth and jobs’.[23]

In the absence of own-brands, grocery retailers would become distributors of products. Own-brands allow retailers to take advantage of their in-depth knowledge of their customer base and to design and market-test new products. Products can be innovative in a number of ways. For example, grocery retailers have innovated in the past by providing price/quality combinations that did not previously exist as brands had not moved into that area—sometimes referred to as ‘white space’ between existing product ranges—or by offering products in a different way, such as through different store formats, or over the Internet.

[22] See Ezrachi, A. and Reynolds, J. (2009), ‘Advertising, Promotional Campaigns, and Private Labels’, in A. Ezrachi and U. Bernitz, *Private Labels, Brands and Competition Policy, the Changing Landscape of Retail Competition*, Oxford University Press.
[23] European Commission (2010), ‘Communication from the Commission: Europe 2020: a strategy for smart, sustainable and inclusive growth’, March 3rd.

Retailers also tend to have a close, day-to-day relationship with consumers, which gives them an advantage in being able to tailor products to consumers' needs. Retailers can also innovate by changing their own-brand offerings to better meet the needs of consumers. As described in section 2, own-brands have evolved very significantly since their introduction as retailers have expanded their ranges and adapted their offerings based on their customer knowledge (as shown in the Albert Heijn example detailed in Box 3.1). Some years ago, Tesco introduced a niche own-brand range called 'Free From', designed to cater specifically for customers with food allergies or intolerances. Another UK retailer, Asda, offers an own-brand range of children's foods called 'Great Stuff', which is free from all artificial flavours and colours.

Finally, the fact that retailers offer own-brands is an innovation in itself, as retailers in some industries have replaced the traditional model of retailer as distributor with one where the retailer is more integrated into, and has more influence within, the whole supply chain.

3.4 The impact of own-brands on suppliers

This section considers the following issues.

– What is the impact of own-brands on the balance of bargaining power between retailers and their suppliers? Does the existence of own-brands harm the competitive process at the supplier level—eg, by leading to the exclusion of efficient suppliers?

– Does the strength of own-brands affect the incentives on suppliers to innovate? If own-brands replicate some of the packaging and features of branded goods, will this reduce the incentives of brand owners to innovate?

It is important to keep in mind that impacts on both suppliers and retailers are intermediate outcomes. As noted in the introduction to the report, the dynamics of the grocery supply chain are driven by the demands of consumers. Impacts on other groups in the supply chain should therefore be considered in terms of the follow-on impact on consumers.

It is also worth noting that smaller suppliers may benefit significantly from own-brands since large grocery retailers can enable access to a very large customer base without the sunk costs of building a brand. This would tend to enhance competition at the supplier level, to the benefit of consumers. For example, in the case of Tesco, Branston has been a supplier of fresh potatoes to Tesco since 1989. Starting with small volumes, the business has grown to become Tesco's largest supplier of fresh potatoes. Tesco has been working with another of its suppliers, Hilton Food Group, a meat-packing specialist, since 1994. As a result of its partnership with Tesco in the UK, Hilton has opened factories in the Netherlands, Sweden and Poland, supplying other major international retailers.[24]

Owners of branded products are also affected by retailer own-brands. However, concerns that branded products will eventually be displaced completely by own-brands must be tempered by the fact that, as discussed in section 2.2, there are in practice limits to the levels of own-brand share for most full-service grocery retailers as their offer is defined by what customers demand. In general across Europe, own-brand-only supermarkets tend to remain niche players, which suggests that many consumers continue to demand branded products.

The European Commission's DG Competition offered the following view in 1996 on the limits to the growth of own-brands' share of grocery sales:

> Private-label supply has grown in the past, perhaps particularly so in the last few years because of the difficult economic climate in the UK and Ireland. However, it would seem

[24] Source: Tesco, email from Tesco to Oxera dated July 7th 2010.

> mistaken to assume that private-label growth will continue to grow indefinitely and ultimately eliminate all branded products.[25]

Thus far, the Commission's prediction has been borne out by the evidence. Although own-brands have continued to play an important role, branded products have remained a key part of the offering of most retailers in the grocery sector. In many product categories, the penetration of own-brands remains low (see Table 2.2 above).

Box 3.2 Small and medium-sized enterprises remain a key source of supply for French grocery retailers

In France, recent research undertaken by Nielsen for the Fédération des Entreprises du Commerce et de la Distribution shows that manufacturer brands are increasing in prominence in supermarkets—in particular, those produced by small and medium-sized enterprises (SMEs). The research draws the following conclusions.

– The average number of SME brands' products in French supermarkets/hypermarkets increased from 23.1% in 1999 to 28.0% in 2008.

– The average number of own-brand products in French supermarkets/hypermarkets increased from 19.0% in 1999 to 23.8% in 2008. Of these own-brand products, 82.9% were manufactured and/or supplied by SMEs.

– The average number of major brand products in French supermarkets/hypermarkets declined from 57.9% in 1999 to 48.1% in 2008.

– Evidence suggests that, over time, SMEs working with large retailers have successfully expanded their business into regions of France where they were not previously active.

– In the French market as a whole (supermarkets and hypermarkets), 41.7% of new products in 2008 were SME brands, 25.7% were own-brands and 32.7% were major brands.

Source: Fédération des Entreprises du Commerce et de la Distribution and Nielsen (2010), 'PME - Commerce: Mieux Travailler Ensemble', March.

3.4.1 Own-brands and bargaining power

Buyer power is essentially power that buyers have over their suppliers to set prices for the goods or services they purchase. In general, buyer power has been characterised in one of two ways:

– **'monopsony power'** (the mirror image of monopoly power)—a powerful buyer can force prices down below the competitive level by withholding demand;

– **'bargaining power'**—rather than the powerful buyer lowering the market price, as in the above model, the bargaining power model allows more powerful buyers to negotiate greater individual discounts than less powerful buyers.[26]

Although it may be perceived negatively by suppliers, retailer bargaining power generally has no detrimental impact on final consumers and can provide the impetus for increased efficiency and innovation by suppliers. There is an important difference between anti-competitive buyer power, that risks harming competition and ultimately consumers, and

[25] Source: European Commission (1996), 'Commission Decision – Case No IV/M.623 – Kimberly-Clark/Scott', January, pp. 1–87.

[26] Based on Doyle, C. and Inderst, R (2007), 'Some economics on the treatment of buyer power in antitrust', *European Competition Law Review*, **28**:3, March.

unequal bargaining power, which is a purely bilateral issue between suppliers and buyers. This was highlighted by the European Commission in a recent staff working paper.[27]

In some cases the introduction of own-brands may enhance the ability of retailers to achieve better deals from branded suppliers, insofar as it gives the retailer outside options to replace a branded product on its shelves with a competing own-brand equivalent. This point is further explained in Box 3.3. However, there are clear limits; a retailer depends on attracting customers, and will lose customers to competitors if it does not stock its customers' preferred brands. This is particularly the case with well-known, must-have brands:

> When suppliers are producers of 'must-carry' brands, suppliers tend to hold a stronger bargaining position than their retail counterparts.[28]

Box 3.3 Economic theory: what determines bargaining power?

The recent economic literature on buyer power makes clear that while buyer size relative to suppliers is not in itself the key to buyer power, it can provide a rough proxy. More relevant are the 'outside options' that each player in the negotiation has available.

In the case of retailers, outside options could include the ability to switch suppliers, and the ability to sponsor new entry, both of which may be more credible options for larger retailers than for smaller players.

On the suppliers' side, where large retailers act as 'gatekeeper' to a substantial proportion of a supplier's potential market, this may reduce the seller's outside option as it may not be feasible to rely on other routes to market if negotiations with a retailer were to break down.

Source: adapted from Inderst, R. and Mazzarotto, N. (2006), 'Buyer Power: Sources, Consequences, and Policy Responses', preliminary draft, October 5th.

In general, retailers have no interest in forcing efficient suppliers out of the market since this would tend to harm their own interests. For example, retailers benefit from healthy competition at the supplier level because it keeps their input costs low.

Indeed, a retailer has no incentive to reduce the level of competition at the supplier level, unless, by so doing, the retailer can itself become a supplier with significant market power and thereby enhance its total margin.[29] Given that the essence of retailer 'bargaining power' is that the supplier level is fragmented and highly competitive, and given that the retailer level is also competitive, it is unlikely that own-brands in general give retailers the incentive to foreclose suppliers in a way that harms consumers or efficient suppliers. If there were any harm to competition in this respect, it would be reasonable to expect some evidence such as high margins on those products in which suppliers are foreclosed. As noted in section 3.2, a recent European Commission working paper indicates that at the aggregate level fierce competition has led to low retailer margins:

> One of the key findings of the current exercise is that competition at retail level is fierce, both between retailers themselves and increasingly between different retail formats. This has also translated into lower net operating margins for retailers (e.g. according to data presented by the retail sector, retail margins are on average around 4%, even lower on fresh produce where they near 2%) and has contributed to cheaper prices for

[27] European Commission (2009), 'Competition in the food supply chain—Accompanying document to the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: "A better functioning food supply chain in Europe"', SEC(2009) 1449/2, Commission Staff Working Document, [COM(2009) 591], p. 18.

[28] Ibid., p. 7.

[29] The circumstances in which this would be the case are rather limited, and could be tested only by looking on a product-by-product basis at the incentives of a retailer to foreclose non-own-brand products, which is beyond the scope of this report.

consumers on the long term. Such findings seem to contradict wide-spread perception that retailers currently have the highest margins in the food supply chain.[30]

Box 3.4 Case study: Carrefour's relationships with its suppliers

The importance of SMEs for the Carrefour Group
Almost 80% of Carrefour's suppliers are SMEs. A partnership with a large retailer such as Carrefour can assist SMEs to expand and potentially enter new markets.

Maintaining good relationships
SMEs are a key source of supply for the group. 80% of SMEs that work with Carrefour have been doing so for more than ten years and less than 3% leave annually. In France, the rate of termination of commercial relations with suppliers of basic food products is 0.33% per year.

Launched in France in July 2006, the Carrefour Guaranteed Partnership is an illustration of the group's approach to supplier relationships. It guarantees reliable and stable markets to French regional producers. Hypermarkets make contractual commitments to volumes of purchases before the start of production. In 2007, this applied to 224 suppliers, for 220,000 tonnes of fruit and vegetables.

Legal protection for suppliers in France
In France, the 'abuse of economic dependence' has been specifically prohibited since 1986, with buyers liable for fines of up to 5% of company turnover if they break the law. Where a supplier is economically dependent on a distributor (such as a grocery retailer), the buyer must not abuse its power over the supplier—for example, by terminating contracts without notice or reason, or applying discriminatory conditions that are not justified.

Source: Oxera, based on information provided by the Carrefour Group.

3.4.2 Own-brands and supplier innovation

As set out in section 3.2, innovation can be beneficial irrespective of whether it occurs at the retailer or supplier level. Insofar as own-brands might cause a reduction in innovation, this would occur only if they reduce the incentives for suppliers to innovate.[31] The effects of own-brands on suppliers' incentives to innovate are mixed.

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

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

The balance of positive and negative effects is an empirical question. Following an investigation into concerns about the link between the growth of own-brand products and the rate of investment in innovation, the UK Competition Commission found no evidence that the role of retailers in selling own-brand goods has had a detrimental effect on the level of R&D expenditure at an aggregate industry level.[32] Moreover, insofar as the Competition

[30] European Commission (2009), 'Competition in the food supply chain—Accompanying document to the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: "A better functioning food supply chain in Europe"', SEC(2009) 1449/2, Commission Staff Working Document, [COM(2009) 591], p. 9.

[31] Without a compensatory increase in the incentive for innovation on the part of the retailer.

[32] Competition Commission (2008), 'The supply of groceries in the UK: market investigation', Final Report, Appendix 9.10, paras 41–44.

Commission was able to investigate innovation at a product level, it did not find evidence of a detrimental effect:

> Our assessment of trends and innovation in own-label sales leads us to conclude that grocery retailers as customers and competitors of own-label products are not producing an identifiable effect on competition.[33]

Innovation activity may come from own-brand products as well as from the brands.[34] The Competition Commission gives the example of the yogurt product category, where a fall in demand for own-brand products 'stimulated own-label innovation activity by Tesco, and led to the introduction of the 'inner goodness' range (including a cholesterol-lowering drink and yogurt).'[35]

While it is difficult to measure the rate of innovation with any precision, market research by Mercadona in the food sector indicates that the rate of innovation among its 'integrated suppliers' (suppliers of Mercadona's own-brand products) is higher than the average for suppliers in that sector.[36]

Mercadona has more than 100 integrated suppliers, located in Spain and also internationally. These play a strategic role in Mercadona's Total Quality Model. The following statistics, based on recent research carried out by Mercadona, indicate that its integrated suppliers are involved in significant amounts of innovation.

– 88% of Mercadona's integrated suppliers have innovated in products during the last seven years.

– 63% of Mercadona's integrated suppliers have innovated in the market in which they operate.

– 47% of Mercadona's integrated suppliers have launched an innovative product which has subsequently been applied by other manufacturers.

– During the period 2000–10, 394 innovative products were launched in the market, representing 4.2 products per integrated supplier—71% of these products were launched between 2006 and 2009.

– Investment made by Mercadona's integrated suppliers in general innovation totalled €268m in 2009.[37]

Rather than following the lead of well-known brands, own-brand suppliers can lead the way on innovation. The following case study provides examples of innovations by Mercadona's suppliers in perfumery, cleaning and household goods sectors in Spain.

[33] Competition Commission (2008), 'The supply of groceries in the UK: market investigation', Final Report, Appendix 9.10, para 44.
[34] Branded and own-brand goods may be produced by the same manufacturer.
[35] Competition Commission (2008), 'The supply of groceries in the UK: market investigation', Final Report, Appendix 9.10, para 43.
[36] Mercadona (2010), 'Analysis of innovation in the integrated suppliers of Mercadona', Executive Summary, June, p. 9.
[37] Mercadona (2010), 'Analysis of innovation in the integrated suppliers of Mercadona', June.

Box 3.5 Innovation by own-brand suppliers to Mercadona in perfumery, cleaning and household goods

Supplier RNB Comésticos, Valencia.

RNB Comésticos has a team of 15 technicians in its research, development and innovation department as well as nine more staff in its department for product development. They are responsible for the development of innovative products and designs such as the following.

– The own-brand product line of fragrances and cosmetics for men called '9.60'. The design was undertaken by the Valencian designers Lavernia and Cienfuegos, and was included in the 2007 edition of Taschen's 'DESIGN NOW', a worldwide reference for design featuring 90 of the world's leading designers.

– The new line of own-brand body sprays, 'Deliplus', and the new collection of own-brand fragrances for teenagers, 'Monogotas' undertaken by the designer Pati Núñez, won the National Award for Design in 2007.

Francisco Aragón, Murcia.

Francisco Aragón has a team of five technicians in its in-house research, development and innovation department and another five people in the product development department.

Francisco Aragón won a 2008 Liderpack national packaging award for a new line of shoe-cleaners, under the Mercadona own-brand 'Bosque Verde'.[1] The prize was awarded for its innovative and easy-for-use design for the customer, since as its application is done sideways it is much easier and comfortable for use.

Note: [1] For details see: http://folcomuns.firabcn.es/S011/guanyadors_premis_liderpack2008_en.pdf.
Source: Oxera, adapted from information provided by Mercadona.

4 Conclusions

This report contributes to the debate on the role of own-brands using publicly available sources of information, supplemented with information provided by ERRT members. The report has examined the impacts that own-brands have on consumers, retailers and suppliers, specifically identifying the benefits of grocery retailers' own-brands and addressing common misperceptions about them. The report draws the following conclusions.

Consumers

The dynamics of the grocery supply chain in Europe and what retailers offer their consumers are driven by the demands of those consumers. Overall, the economic theory and evidence reviewed for this report suggest that own-brands provide benefits to consumers, for example, by helping to deliver new products and value for money. In addition to the direct benefits to consumers of own-brands, consumers of other brands may benefit indirectly where increased competition from own-brands forces branded alternatives to compete more vigorously in terms of higher quality, greater innovation and lower prices.

The report considers whether own-brands could be used by retailers to harm competition (for example, by forcing branded rivals out of the market), allowing retailers to raise prices or reduce quality, range or service. However, Europe's competition authorities tend to regard grocery retailing as being characterised by 'fierce' competition, which drives retailers to offer lower prices, better quality, new products and increased choice. This suggests that the balance of brands and own-brands in stores will continue to be driven by what consumers demand rather than retailers forcing out branded products.

Retailers

The report has also considered the effects of own-brands on retailers. Own-brands are likely to play a role in the ongoing competition and innovation among different grocery retailers. For example, own-brands provide an additional dimension on which retailers can compete for customers and allow them to differentiate their offering.

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

Suppliers

From the perspective of the supplier, the picture is more complex. The existence of retailer own-brands provides new routes to market for small suppliers to produce for mass markets which they may otherwise struggle to access given the costs and risks involved in developing a brand.

On the other hand, own-brands can help to give retailers additional bargaining power in relation to their suppliers, the exercise of which may be perceived negatively by suppliers where it allows retailers to negotiate more favourable terms. However, in general, while retailers have an interest in getting the best deals from suppliers they have no long-term interest in forcing efficient suppliers out of the market because this would tend to harm the retailer's own interests.

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