

## MARKET ENTRY TO THE BRITISH GROCERY TRADE THROUGH PRIVATE LABEL

Julian Smith\*

The PA report for Coras Trachtala, "Exports to Great Britain — Scope for Improvement", identified four obstacles confronting Irish food companies hoping to expand their business in Britain. These were as follows: (1) limited marketing resources and lack of brand strength; (2) problems of getting into the large multiple outlets; (3) costs of distribution, and (4) lack of innovative products [PA, 1984].

Branding a product for the British market is not only a costly exercise beyond the resources of many small Irish companies, but also a very risky one. Private label business gets around most if not all of the obstacles identified by PA. Indeed it has been suggested that British retailers will look overseas for private label suppliers if their current local suppliers decline to do so as they lift out of recession and prefer to devote more of their capacity to their brands [Themistocli and Associates, 1984]. Other market entry options such as distributors' brands, or aiming for other segments like the catering market or the food processing industry, are not the subject of this paper.

Much has been written about the threat to manufacturers' brands from private label brands. However, such comment has centred mostly on the position of companies already established in the market. In contrast, this paper is concerned with the options facing a potential market entrant — his own brand versus that of the dealer. To produce under a manufacturer's brand or private label is essentially a strategic decision in the sense that it involves matching the company's resources to the market environment. While branded business may be more profitable, it may be far riskier for a company with few internal resources to enter that business. Indeed, Porter (1980) talks of "sequenced entry", where a company enters a market initially through private label with a view to moving into the branded business in the longer term. But how should such business be approached? This paper attempts to evaluate the suitability of Porter's framework to the particular circumstances.

\* The author is Marketing Adviser at Coras Trachtala (Irish Export Board). The views expressed in this paper are solely those of the author.

## Terminology

Several terms are used to describe the various branding options facing manufacturers. The following distinction is used throughout this paper:

*Brands:* This term will be used to cover instances where the manufacturer creates a brand name for his product, and attempts to give it a "personality" through pack design and probably advertising. The objective of the manufacturer is to win brand loyalty from the consumer. Companies pursuing this route must then organise the selling, merchandising and distribution of these products. This is the option undertaken by the 'textbook' marketing companies such as Unilever, Kelloggs and Proctor & Gamble. The term "national brands" is often used to cover this category as the manufacturers invariably seek to make the brands available on a national basis.

*Private label:* This term is used to encompass all brands which are exclusive to any retailer or wholesaler. There are a variety of terms which are used instead of private label, such as "house brands", "dealer brands", "own label" and also "generics". This last type deserves brief comment.

Much has been written about the recent rise of generic labels, i.e. products with a minimum of packaging. Some commentators have differentiated these from the more traditional private label goods. The latter's packaging more closely resembles that of the manufacturer's brand and these are defined as matching the quality of the brands. In contrast, they see the 'generics' as offering the minimal acceptable level of quality at the lowest possible prices.

However, this is a generalisation that does not hold in each case. Different retailers use their generic ranges in different ways. Carrefour (UK) claim that they only introduce a generic range where independent analysis shows that the quality is as good or better than the equivalent manufacturer's brand [Checkout, 1982]. Fine Fare, by contrast, admit that the quality of their generic range is not always equal to the manufacturer's brand, but is of "acceptable quality". However, Fine Fare also have a private label range which they use to offer quality comparable to the manufacturer's brand at lower prices. Carrefour do not have any such private label range.

The important point for a manufacturer negotiating a private label contract with an individual account is how that account "positions" the brand (i.e. comparable quality to manufacturer's brand versus minimum acceptable quality). The following table illustrates how some major British retailers "position" their private label ranges:

Table 1: *Generic Prices in Britain*

RETAILER	% below manufacturer's brand	% below private label
Presto	45.9	28.6
Carrefour	25.7	none
Fine Fare	39.6	17.2
International	30.4	none
Tesco	45.0	23.4

Source: A.C. Neilson (GB), 1982

### Drawbacks to the Private Label Option

The private label route is no panacea. However, most of its detractors work for large manufacturers heavily committed to branding. As well as being in a better position to consider the branded route, their less successful brands are often the ones faced with delisting by a retailer planning a private label introduction.

The profitability of private label business for a manufacturer is unclear, but the indications are that margins can be as much as a fifth lower [Marketing, 1984]. Unfortunately, it is not clear if this refers to absolute margins or percentage margins, or indeed if costs are comparable. Porter (1980) identified conditions under which profitability can be forced down by buyers and virtually all of these apply in the context of private label business. They are:

- (1) The business accounts for a large proportion of the seller's output. (Often true for private label suppliers.)
- (2) The product accounts for a large proportion of the buyer's budget. (The volume potential of a product category is an important consideration for a trader developing a private label line.) [Simmons and Meredith, 1984].
- (3) The product is undifferentiated from the competition. (Private label products are often specified in detail by the retailer to match branded products.)
- (4) Switching costs are low, i.e. the buyer incurs few costs in switching to a new supplier. (Marks and Spencer's vigorous screening process for new suppliers would mean their switching costs are relatively high, but they can be much higher for an industrial user who might have to change equipment or write off a stock of spare parts.)
- (5) The buyer is earning low profits. (Many traders have cited poor margins in a product category as a reason for developing private label [Simmons and Meredith, 1984].)
- (6) The buyer could conceivably integrate backwards. (However, the

Co-op is the only British grocery retailer which has significant manufacturing operations [Simmons and Meredith, 1984].

(7) The product is unimportant to the quality of service offered by the buyer to his customers. (This condition probably does not hold, even for the 'minimum acceptable quality' products.)

(8) The buyer has full information on production costs. (Known cost contracts are a 'modus operandi' for some retailers such as Marks and Spencer.)

(9) The buyer can influence the consumer's decision. (A buyer decides whether or not there will be a private label alternative and the consumer has no way of influencing the supplier choice.)

Consequently, it must be admitted that the private label is unlikely to be as profitable as a successful branding strategy. It is, however, far less risky and far less demanding on resources. The other major drawback of the private label is that the manufacturer establishes no consumer franchise as he might with his own brand. Instead, any consumer loyalty that does exist will belong to the store and there is evidence to suggest they are developing loyalty [Krauser and Eassie, 1982]. The other great threat is that existing suppliers of branded merchandise may sell spare capacity in competition with the aspiring market entrant. Often they do so on a marginal costing basis in the hope of being able to build up their branded business again in a short space of time. Indeed, some manufacturers of branded products sometimes supply a private label simply to retain the listing of their struggling brand.

### Trends in Private Label Business

It is hard to discern any clear trends in private label business. While private label is here to stay, even the major chains in any country seem to be unsure of the optimum level. The share by country for private label does vary significantly and can be accounted for by the policies that key retailers have adopted in each country. The data in Table 2 indicate the variations that can be found. The private label share of any product category also varies between different countries reflecting the product categories that the key retailers have included in their private label portfolio. Retailers everywhere are constantly testing new products in their private label range.

Table 2: *Private Label Shares in Selected Countries (1978)*

GREAT BRITAIN	22%
FRANCE	11%
SWITZERLAND	50%
BELGIUM	5%

Table 3: *Comparison of Private Label Shares in Selected Countries*

Private label as a % of total	France	GB	US
50plus	Canned veg.		
45plus	Jams		
40plus			
35plus			Canned veg.
30plus			
25plus		Tea	Jams
20plus			
15plus			Tea

Source: World Distribution Quarterly, February 1983.

In 1984 the proportion of lines carried by British grocers which contained a private label option varied from 0.2% to 29%. Leading retailers adopt quite different policies in the development of private label business. Sainsburys have had a very profitable record in recent years, where they have reduced the amount of business on a private label basis. They admit that the manufacturers' brands have grown almost twice as fast as their private label range. Tesco, in contrast, are going in the opposite direction. Indeed, as Table 4 shows, retailers are constantly changing their policies on the emphasis to be given to private label [Simmons and Meredith, 1984]. Finally, where private label has gained it has been at the expense of secondary brands [The Grocer, 1981]. This makes the branded option an even more risky market entry strategy.

Table 4: *Proportion of Packaged Groceries Sold Under Private Label*

RETAILER	1977	1980	1983
Sainsburys	63%	54%	53%
Tesco	23%	21%	30%
Safeway	32%	28%	34%
Waitrose	41%	42%	48%

Source: Adapted from Simmons and Meredith, 1984.

### Retailers' Interest in Private Label

The recent revival of private label in Britain is different in character from the early 1970s. At that time, private label ranges were sold on a "low price" platform. Some retailers are now positioning private label ranged on a quality platform – even to the extent of being dearer than the branded product! In some categories there is evidence that private label penetration has pushed down profits so much that manufacturers

have little incentive to invest in R&D or advertising [The Grocer, 1983]. These functions, traditionally the manufacturers' responsibility, are being taken up by retailers, as evidenced by their recruitment of marketing and product development personnel. These are the signs of their efforts to act on their stated intention of becoming the consumers' buying agents rather than the manufacturers' selling agents. Private label is a long-term strategic move for these retailers, not just a short-term profit tactic.

It has been suggested by McKinsey in the US that retailers do not fully realise the profit implications of private label business to themselves [Progressive Grocer, 1982A]. They contend that many of the retailers for whom they have worked were making decisions purely on the basis of percentage gross margin. Consequently, they were often overlooking absolute margins (which could be lower on private label items because of the lower prices, even though the percentage margin was higher). Also omitted in some cases were the cost of branch deliveries of private label products (the manufacturers' responsibility in the case of brands) and the opportunity cost of shelf space (that could be more profitably given over to a manufacturer's brand). Margins on brands were also understated as retrospective payments from manufacturers (the LTAs and promotional payments made by cheque and never appearing on the manufacturer's invoice) were omitted from their calculations. It is also important to note that the part of profit earned by way of interest on the chain's positive cash flow could suffer if increased use of private label reduces total cash receipts.

### Consumer Acceptance

Private label's future is securely founded in the consumer acceptance they have achieved. In the US, 43% of consumers surveyed said a good selection of private label products was an important criterion in store choice [Progressive Grocer, 1982B]. And another study found that private label loyal purchasers continued to buy private label even when they switched stores [Livesey and Lennon, 1978]. Trial rates as high as 45%, with repeat rates averaging 75%, have been reported in the case of Fine Fare's Yellow Pack range [Sheath and McGoldrick, 1981]. It should be remembered that Yellow Packs were introduced alongside a conventional private label range and they appear to have taken only 20% of their business from that range. The other 80% came from the manufacturers' brands. Some commentators maintain that these products are really a phenomenon of the recession and will decline in better times. Research on the acceptability of 'generics' in both the US [The Grocer, 1982] and Britain [Sheath and McGoldrick, 1981] shows that

their appeal is just as strong, if not more so amongst the better educated, younger and more affluent consumers. These consumers cited the lack of elaborate packaging and advertising as reasons for purchasing these products. In Belgium, the Consumer Association welcomed their introduction on this basis [Marketing in Europe, 1983].

Research has also unearthed some surprising uses for such ranges. For example, in Britain they found that Fine Fare's Yellow Pack biscuits were being bought for the children and McVities were bought by the same household for guests [Sheath and McGoldrick, 1981]. Livesey and Lennon's (1978) study indicates that there is a ceiling on the share private label can achieve amongst consumers. Some consumers would not switch from manufacturer brands at any price differential (the actual proportions varying with the product category). This study also provided evidence that consumers perceive differences between the private label offerings of different stores.

### Export Market Entry Implications for Irish Food Manufacturers

As far as one can generalise, private label has made the largest and most stable inroads in those product categories characterised by a multitude of manufacturers' brands, none of which has a dominant share. There is a general trend towards experimenting with higher value products, as most of the commodity-type categories have already been tried [Themistocli and Associates, 1984]. What is important for the individual manufacturer is what is likely to happen to his product category, in the markets of interest to him and amongst the key accounts in those markets. Most of the literature on private label is concerned with the viewpoint of larger manufacturers whose national brands are threatened by private label introductions by key customers. However, a useful framework for a smaller company seeking to enter a market through private label is to be found in Porter's "Competitive Strategy" (1980).

In a study in the US on private label, Cook and Schutte (1967) identified *formal buyer selection* as a characteristic of the more profitable private label suppliers. So companies should rank retailers or wholesalers in order of the preference in which they would ideally like to supply them. Porter identified four factors to be considered in ranking buyers:

*\*Match purchasing needs to capabilities:* It was noted earlier that different retailers position their private label products differently. So, for example, if an Irish company is capable of producing a quality

product and developing new varieties, then Sainsburys would be a more attractive customer than Fine Fare for their Yellow Pack range as Sainsburys' quality controls mean they are less likely to switch suppliers. On the other hand, if a company is capable of producing a more standard line at a low cost, Fine Fare's Yellow Pack range would be a more appropriate prospect. In other words, identify your prospects and rank them in line with your capabilities.

*\*Growth Potential:* Manufacturers should also consider the growth potential of their potential customers and satisfy themselves that it is compatible with their own objectives. The most cursory examination of the last few years' statistics will show which accounts offer the best growth potential.

*\*Structural Position:* This refers to the buyer's place in the industry — his "intrinsic power" — and secondly, the buyer's propensity to exercise this power. He is more likely to exercise such power if and when the product is one on which he competes, or one that accounts for a high proportion of his budget. Clearly, such situations are to be avoided if possible as margins will be very tight. There is evidence that the smaller multiples in Great Britain have problems in identifying manufacturers willing to supply their (relatively) smaller private label requirements. They may, however, represent attractive opportunities for many Irish producers [Simmons and Meredith, 1984].

*\*Cost of Servicing:* Some retailers will require delivery to a central warehouse whereas others will insist on individual branch delivery. Depending on the manufacturer's own circumstances this could be an opportunity or a problem.

As well as Porter's suggestions on buyer selection, companies producing private label products ought to keep fixed costs low in case any business is lost. For companies competing on a cost basis, this is crucial as they can find themselves competing with manufacturers whose also-ran brands have been de-listed and who sell the resultant spare capacity at prices calculated to do no more than ensure short-term survival. Indeed, there is evidence that companies following a mixed brand policy do not allocate all costs to private label business, particularly R&D costs [Cook and Schutte, 1967].

## Conclusions

Private label has long been frowned upon, largely by the heavy branders! However, for many resource scarce Irish companies it may be the only route into the British grocery trade. It may be less profitable than the



branded option, but this should be no surprise as it is far less risky. Given the need to build an indigenous exporting base in the food sector, there is a need to establish through research that it can be a profitable and long-term business. There is also a need to develop a set of guidelines for companies entering this type of business.

The usefulness of Porter's framework needs to be tested, but intuitively it seems promising. Other factors (e.g. reliability of customers volume forecast and credit commitments) might emerge as discriminators between the high and low profit earners amongst private label suppliers.

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