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PRIVATE LABEL BRANDS: BENEFITS AND CHALLENGES PINGO DOCE CASE STUDY

José Cevada
Universidade Católica Portuguesa (Porto)

Joana César Machado
Universidade Católica Portuguesa (Porto)

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Pingo Doce Case Study

José Cevada
School of Management and Economics,
Universidade Católica Portuguesa, Porto
josecevada_3@hotmail.com

Joana César Machado
School of Management and Economics and CEGE,
Universidade Católica Portuguesa, Porto
jcmachado@porto.ucp.pt

Abstract

This working paper analyzes the growing importance of private labels in today's modern distribution, and the main opportunities and threats they raise for retailers and national brands. Our main purpose was to: (1) analyze consumer´s perceptions of private label brands, (2) identify their critical relevance for retailers; (3) understand how national brands can benefit from private labels' sustainable growth and (4) identify the major challenges they bring for different types of national brands (namely, A Brands and B Brands).

We used a case study approach and analyzed the strategy of Pingo Doce brand, a private label that belongs to Jerónimo Martins group. Among other relevant findings, we found evidence that the drop in Pingo Doce's market share, in 2013, was the result of a strategic move to significantly improve consumers' quality perceptions, and, simultaneously, keep a profitable balance between the private label and national brands.

Keywords: private label brands; retailers; national brands; benefits of private label brands

1. Introduction

This working paper will focus in analyzing the growing importance of private label brands. Therefore, we will analyze a Portuguese private label (Pingo Doce) that belongs to Jerónimo Martins group.

According to previous studies (Halstead & Ward, 1995), private labels market shares rise during economic downturns. Thus, this looks like the appropriate moment to analyze their growing power. Moreover, it is widely acknowledged that even after the economic recovery, only a few of the "new" private label's consumers' return to national brands. Furthermore, even before the recent recession hit, private label's growing success in many regions provided evidence that the growth of these brands was no longer a cyclical reaction to economic downturns (i.e., a trading down phenomenon), but a structural change in consumer behavior. Hence, this topic has high managerial and academic relevance. This study aims to contribute to this research domain by examining a case study of one of the most important Portuguese private labels.

This paper starts with a review of the relevant literature related with this study, namely with the definition of "private label". In this study we consider that private labels include all brands owned by the retailer, even when their names do not match with the name of the retailer (Hyman, Kopf, & Lee, 2009). Following the discussion on the state of the art we present the research methodology and discuss the main findings and outlines for further research paths.

2. Methodology

In order to evaluate the growing importance of private labels in today's modern distribution and understand the actual context of private label brands, we chose a qualitative and interpretative research methodology, and decided to adopt a case study approach. This methodology involved the analysis of market research reports and private label focused studies, as well as of relevant secondary data on an important Portuguese economic group (Jerónimo Martins) and its private label (Pingo Doce). The documental analysis included the analysis of financial reports and communication material, and was complemented by point of sale observations.

3. Literature Review

3.1. Private labels from the retailers perspective

We will begin this literature review by analyzing the relevance of private labels for retailers. According to Vahie and Paswan (2006), private labels are a truly important part of retailers business. In fact, private label products allow retailers to improve their gross margins, although they are cheaper than products sold by national brands (Vahie & Paswan, 2006). Retailers are able to achieve this important cost advantage, because with private labels they are able to reduce producer's gross margins. The R&D expenses are almost negligible; retailers usually only advertise their corporate brand and face less intra-brand competition (competition between the same brand in different retail chains) (Lee & Hyman, 2008; Vahie & Paswan, 2006).

Private labels also allow retailers to differentiate themselves from competitors, and to improve customer's loyalty and purchase intention in their stores (Liu & Wang, 2008). There has been a substantial quality improvement of private labels during last years, which also gives retailers a relevant advantage. This was mostly due to the fact that some national brands started to produce private label versions of their own products, and also because private label ranges have started to include a premium segment (Steenkamp, Heerde, & Geyskens, 2010).

The rise of the private label market share and penetration is not so surprising. When retailers realized that having a direct access to consumer behavior can provide several advantages, they started to look for new ways to conquer a larger share of consumers´ wallet. Additionally, retailer chains have grown big enough to invest in the resources and competences needed to build their own brands. Actually, according to Gruver, Meacham, & Tager (2011) there is a clear link between organized retail consolidation and private label penetration. In Switzerland, for example, the top five retailers have more than 70 percent of the market share, and private labels have approximately 45 percent. On the other hand, Russia's low rate of retail consolidation (the top 5 retailers have about 20 percent of the market share), translates into less than 5 percent of private label penetration.

Another reason that explains the raise of private labels' market share and the increase in private label's differentiation is the growing inter-store competition. This was mainly due to the increasing presence of hard discount chains and retail industry concentration. However, the strategy to "fight" other supermarket chains and hard discounts chains must be different. Actually, in order to “fight” against hard discount chains, service-oriented supermarkets have introduced generic basic food products with a higher price discount (between 40 and 60 percent below national brands prices), and which should look and feel different from the “mainstream” private label offer. On the other hand, to fight against other service-oriented supermarkets, retailers should launch premium, and sometimes even innovative, private label products (Liu & Wang, 2008).

Thus, a full range of private label segmentation allows retailers to address several objectives: mainstream private label products (the ones that directly compete with mainstream national brand products) provide retailers a counterbalance to the negotiation power of their suppliers; generic ranges are useful to “fight” against hard discounter’s; private label differentiation generates higher consumer loyalty and improves the image of the full range; and the value range attracts the most price-sensitive consumers. Moreover, previous studies suggest that if a particular private label is strong in a given product category, this will globally improve the trust and the sales of this private label as a whole (Glynn & Chen, 2009).

3.2. The impact of private labels for national brands

After analyzing the importance of private labels and the main advantages that they bring to retailers, we will now analyze the impact that private labels have for national brands.

We start by highlighting that the majority of private label products are produced by the same companies that produce and own national brands. The production of private label products can bring advantages, but also disadvantages to these manufacturers. Producing private labels allows manufactures to benefit from learning and scale economies, to keep their lines occupied and reduce their unit cost. On the other hand, by producing for private labels, the manufacturer can “cannibalize” the sales of its own brand (Steenkamp et al., 2010). This happens because the manufacturer sells the product to the retailer with a low margin, allowing the retailer to sell the product (with its private label brand) at a substantial lower price than if it would be sold under the manufacturer’s own brand. This can be particularly harmful for the manufacturer when consumers are aware that, in a given product category, the content of the private label’s packaging and the content of the national brand’s packaging is the same (Steenkamp et al., 2010).

Regarding the strategy that national brands should use to deal with the opportunities and threats raised by private labels, there is not a unique, right and simple answer. According with Schreijen (2012), this will depend if the national brand wants to adopt a more conservative or a more disruptive strategy in regard to private labels, and also if it is an “A Brand” (the biggest or the second biggest player of a given product category) or a “B Brand” (a smaller player of a given product category).

A more “conservative” approach involves mainly changes in the Recommended Retail Price (RRP). However, although price increases can be a risky approach (especially because several important markets are facing an economic downturn or a slow recovery, and consumers are increasingly price sensitive), strong price promotions might significantly improve sales on the short run, but can put too much focus on price, and lead to a minor perceived difference between national brands and private labels (Steenkamp et al., 2010).

Another option for national brands, is to focus on innovation and differentiation (e.g., through the service offered to consumers) (Halstead & Ward, 1995), as well as on strong and insightful marketing campaigns, that might reduce the importance of price (Glynn & Chen, 2009; Halstead & Ward, 1995). Nevertheless, in respect to marketing campaigns, it is important to notice that even these campaigns can indirectly “help” private labels, since part of the campaign efforts, will always increase the consumption and awareness of the whole category (e.g., chocolate filled biscuits), and not only of the national brand.

In regard to innovation, packaging innovation is particularly important , as retailers tend to easily copycat the packaging of national brands, in an attempt to confuse consumers (Steenkamp et al., 2010). Actually, a survey in the United States, showed that half of private labels’ packaging was similar to leading brands’ packaging, in terms of color, size and shape (Scott Morton & Zettelmeyer, 2004).
Regarding more disruptive strategies, we will use the example of two national brands that developed interesting strategies to “play” the private labels’ “game”. The first of these brands is Heinz. Although Heinz has refused to manufacture its core product (ketchup) for any other brand, the company took advantage of its huge industrial capacity and knowledge and started to produce packaged soups for retail brands,

becoming responsible for 80 percent of the packaged soups sold under private label brands (Ward, Shimshack, Perloff, & Harris, 2002). The other national brand is Kimberly Clark. Kimberly Clark has decided to produce one of its core products (diapers) for private label brands, in order to improve its assets use, and this allowed Kimberly Clark to obtain the benefit of exclusive shelf placement in some of the most important retailers, where it has been for years the only national brand in the diaper category (Gruver et al., 2011).

In respect to A and B Brands, it seems that A Brands will have a brighter future and an easier coexistence with private label than B Brands. Indeed, both consumers and retailers need A Brands. There are a lot of strong motives why retailers need A Brands and must keep them on their shelves. A Brands are the price/quality anchor of the whole product category, and mainstream private label prices are often directly linked to the prices of the A Brand. In fact, A Brand's price level is a key determinant of retailers' profit pool, since any price adjustment of an A Brand (upward or downward) will likely lead to a fluctuation of the price of the product category. Moreover, these brands can be instrumentally used by retailers for communicating "bad news", and thus help them to convert an apparent problem into an opportunity. For example, if the price of raw materials increases, this can be a major problem for private labels, as raw materials represent a substantial part of a private label products' RRP. However, retailers can raise the RRP price of the A Brands, using these brands to prepare consumers for the new and higher prices of the product category. Furthermore, even when both prices increase, private labels will always remain cheaper, still offering a potential price saving to consumers.

A Brands are particularly important for consumers because they work as price benchmarks, allowing them to analyze the price attractiveness of different retail chains (inter-store competition). Additionally, A Brands enjoy a superior reputation and represent social status for the consumers who buy them. Usually they present the more innovative and differentiating products, satisfying even consumers' higher functional needs. Actually, the higher the perceived risk associated to a purchase, the higher the A Brands share tends to be (Erdem, Zhao, & Valenzuela, 2004).

All these facts help to explain why, despite private label competition, the market share of the A Brands in the majority of the product categories remained constant (or even increased), being B Brands the ones who suffered more with the growth of private labels. To face this threat, B Brands can choose between two distinct lines of action. On the one hand, these “not so strong” brands can try to deeply explore, or even create, a niche market, and thus to become an A Brand in this niche. On the other hand, these brands may choose to produce for private labels and achieve important scale advantages, becoming a private label “specialist”. Actually, this last scenario might increase the competition between private label suppliers and lead to a tough battle for scale consolidation. Despite of all the difficulties, some of these B Brands managed to accomplish both strategies at the same time. This is the case of the Spanish brand “Gullon”. This B Brand on the biscuits segment managed to create a niche market (the healthy biscuits market) and, simultaneously, to obtain a significant scale advantage (by producing its basic biscuits for private label brands).

3.3. Consumer attitudes toward private labels

In respect to consumer attitudes toward private labels, as already mentioned, the higher the perceived risk in a given product category, the lower the chance that consumers will choose a private label brand. However, we should highlight that the perceived risk can be expressed in several forms: functional risk (private label products do not function like the ones offered by the national brand); financial risk (consumer believes that even if the private label is cheaper than the correspondent national brand, the quality difference between both is so significant that it will still be a waste of money); and social risk (when a private label brand is not well accepted in a given social circle) (Pandya & Joshi, 2011).

However, all the perceived risks may be diluted if the retailer is able to turn its private label into a trustworthy or desirable brand for any product category. In order to reach these high levels of brand trust and recognition, a retailer should have on its own brand portfolio premium and even innovative products. These products will reinforce the quality image of its full range of private label products. Nevertheless, it is important to highlight that if the retailers’ private label achieves a high reputation, consumers are likely to respond very negatively to what they might perceive as imitations and, therefore, private labels are forced to consistently innovate.

4. Case Study: Pingo Doce brand

Pingo Doce brand belongs to a major Portuguese economic group named Jerónimo Martins. Jerónimo Martins, besides having a powerful distribution chain (in Portugal, Poland and Colombia) is also the biggest Portuguese manufacturer of Fast Moving Consumer Goods (FMCG), through a joint venture with Unilever group, a group that owns strong brands in different product categories. Hence, Jerónimo Martins must be particularly careful with the balance between national brands and its private label brands.

The Portuguese economy is still facing tough times and, according to Nielsen SanTrends (2014), private label accounted for 34.7 percent of all FMCG sold in 2013. Nevertheless, mostly because of the strong promotional campaigns implemented by national brands during this year, national brands earned market share and boosted their sales for the first time since 2009. Regarding promotional campaigns, it is important to highlight that Pingo Doce retail chain is now using sales promotions very intensively. In fact, and according to Jerónimo Martins financial report (2013), during the year of 2013, despite a growth of 3.6 percent on the Like for Like (LFL)[1] global sales, the private label share on those sales dropped 3.8 percent, indicating that most of the 2013 growth was achieved due to national brands.

We believe that the main long term goal of Pingo Doce is to enhance the credibility and the appeal of its own brand, and the social status that it transmits to consumers. In order to achieve these challenging purposes, besides high quality requirements in all the products offered by Pingo Doce umbrella brand, and competitive RRPs, Jerónimo Martins group is implementing additional measures, which will be analyzed bellow.

First of all, whenever Pingo Doce brand presents products with a premium packaging, these products have a truly premium quality, enhancing consumer trust and the overall quality perception of Pingo Doce brand’s products. Actually it is quite tempting for a brand to adopt a premium packaging and the corresponding premium price, for a product that “is not that premium” and, thus, does not have significantly higher production costs, and by doing so to achieve a higher direct profit. However, the entrance of Pingo Doce brand in more premium segments has not as a main goal to improve the short run profits. Although premium product categories typically present

[1]Like for like sales is a comparison between this year’s sales and last year’s sales, for a given company, taking into consideration only those activities that effectly occured during both time periods. Like for like sales is a method of evaluation that tries to exclude any effects of expansion, acquisition or any other extraordinary event that artificially increases a company's sales.

higher gross margins, we believe that Jerónimo Martins main purpose is to use premium categories to increase the appeal of all Pingo Doce brand products.

At the same time, Pingo Doce brand is diversifying and improving the packaging and the nutritional profile of its healthy products range, named Pura Vida. By doing so, Jerónimo Martins is trying to communicate the idea that it has strong health concerns, and this can favorably influence consumers' perceptions of all the products offered by Pingo Doce umbrella brand.

The second strategy used by Jerónimo Martins is a bit more risky and its ROI (return on investment) might be slow, but if successful, the reward can be very significant. This strategy involves highlighting the name of the retailer, even for highly emotional and status associated product categories, as it is the case of wines. In fact, usually retailers choose to create a specific brand for this category (e.g. the wines of Sonae group are sold under a different label called Contemporal), or even to give a greater emphasis to the producer´s name, together with a specific tagline (like e.g."Sabores de Portugal"/ "Portuguese Flavors", the tagline used by Auchan Portugal).

Therefore, for emotional and status associated product categories like wine, the most obvious approach is to avoid highlighting the private label in the packaging. However, if retailers highlight their own brands in these categories and are able to offer high quality products, an appealing packaging, highly competitive prices and an effective communication, they can also achieve several benefits. In fact, we believe that by using this strategy Jerónimo Martins may be giving up some profit in this product category in the short run, since the majority of the wine consumers prefer to buy (and to show) a wine that is not associated to a private label, but will be able to increase its results in the long run.

Indeed, it is not a coincidence that the wines labeled with Pingo Doce brand are achieving international medals (9 of them just in 2013), while they keep a truly competitive price. And even if Jerónimo Martins group is temporarily lowering its profit margins in the wine category, we may consider that this is part of a plan to enhance the reputation of the whole Pingo Doce umbrella brand.

In conclusion, by using these strategies, we expect Pingo Doce brand to improve brand loyalty (and consequently the loyalty to the retail chain) and to effectively reach niche markets (for example through the healthy products line). Furthermore, Pingo Doce will be able to achieve an even more important advantage: to be perceived by consumers as a truly appealing and trustworthy brand. Thus, the drop in this private label's market share, which occurred for the first time in many years, should not be seen as a negative or unexpected fact, because private labels' market shares do not have a "golden number", and in the meantime, the group's profits are growing and the brand image is improving.

5. Limitations

The main limitation of this study is related with the absence of accurate data concerning the changes in Pingo Doce brand's market share for the different product segments, namely for the premium and wine segments. Actually, in order to write this case study we used mainly secondary data from Jerónimo Martins financial reports of 2012 and 2013, together with Nielsen reports concerning the actual retail and private label context in Portugal.

Another limitation that we can highlight is the global approach used in this work, since we did not focus in any private label product category in particular and tried to analyze the global context of private label brands in today's modern distribution. However, we believe that in future research a more focused approach would be interesting, since private labels' shares and strategies can dramatically change from one market and one product category to the other.

6. Managerial Implications

We truly believe that this study can help managers of national brands to better understand how they should "play" the private label's "game". In this working paper we tried to give illustrative examples and highlighted a few effective strategies used by national brands and their implications for managers of "A Brands" and "B Brands". On the other hand, Pingo Doce brand case study may help managers to better understand the strategy and positioning of an important Portuguese private label, and adapt and improve their own strategies accordingly.

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