National Brand Manufacturers as Producers of Premium Private Labels: Factors encouraging production

Bachelor Thesis Marketing

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Abstract

Private labels (PLs), also known as store brands, have had an increased presence in many packaged consumer goods markets. The increased incidence of private labels in the packaged consumer goods markets has had an unfavorable effect on national brand market share, which poses a problem to national brand manufacturers (NBMs). In light of the intense competition in the packaged consumer goods market pertaining to high private label market share, approximately 50% of NBMs in the US now produce PLs, while having their national brands compete simultaneously with them.

Given the high incidence of NBMs producing PLs, the marketing literature related to the production of PLs has received limited attention. Academics have shown that the reasons to produce PLs by NBMs are centered on economic, competitive and relational reasons. Nevertheless, given the increased presence of Premium PLs used strategically by retailers to further intensify competition, the marketing literature does not assess the production of Premium PLs, and therefore requires attention.

This thesis shows that the reasons for NBMs to produce Premium PLs vary in effect as compared to PLs. The effects are stronger for economic and competitive reasons due to higher overall profits and increased competition in middle and high market segments, but the relational reason of producing a Premium PL is weaker, given the control of the retailer over the Premium PL.
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Chapter 1 | Introduction

1.1 Problem Background

The subject of private labels (PLs) has become a popular research area in the marketing literature due to their influence on the retailing environment. PLs, also known as store brands, have had an increased presence in many packaged consumer goods markets, with shares ranging from 16% in the USA to as high as 45% in Switzerland (AC Nielsen, 2005, p. 9). Europe is currently the most developed PL region, with a market share of 32% and a growth rate of 4%, while countries in the emerging markets show low market shares of 2% but a leading growth of 11%. The growth in the USA and Europe can be substantiated by an increase in retailer concentration, along with several other factors that have advocated a structural change in the grocery channel that consists of manufacturers, retailers and consumers (Messinger & Narasimhan, 1995).

The increased incidence of private labels in the packaged consumer goods markets has had an unfavorable effect on national brand market share (Kumar & Steenkamp, 2007). For example, when considering market share changes for manufacturer brands and PLs in Germany from 1999-2005, PL market share increased by 50%, while national brand market shares experienced negative rates; 8% market share loss for leading national brands, and a 15%-30% loss for second-tier national brands (Kumar & Steenkamp, 2007, p. 50). The sale of PLs is a threat to the sales and margins of other brands in shared product categories, and therefore a threat to national brand manufacturers (Nandan & Dickinson, 1994).

In light of the threat to national brand manufacturers posed by PLs, academics have centered on the issue of PLs from the perspective of retailers, manufacturers and consumers (Gómez & Rubio Benito, 2008). While roughly 28% of articles focus on the perspective of the manufacturer (Gómez & Rubio Benito, 2008), the literature on why NBMs produce PLs, while having PLs compete with their national brands, remains anecdotal as shown in (Verhoef, Nijssen, & Sloot, 2002; Oubiña, Rubio, & Yagüe, 2006; Gomez-Arias & Bello-Acebron, 2008; Tarziján, 2007; Gómez & Rubio Benito, 2008).

The incentive for NBMs to produce PLs has been explained by reasons grounded on economic, relational and competitive goals (Verhoef, Nijssen, & Sloot, 2002). In this connection, some academics have advanced this framework by distinguishing manufacturer segments that produce PLs in terms of their characteristics (Gómez & Rubio Benito, 2008).
While these papers aim to explain the rationale behind PL production, they give similar reasons drawn from previous work and fail to give an integrated overview of what factors drive NBMs to produce PLs. Furthermore, the existence of varying advises towards the production of PLs can be further explained by some studies discussing PLs in the traditional sense (Gómez & Rubio Benito, 2008), and others incorporating the increasing role of Premium PLs (Oubiña, Rubio, & Yagüe, 2006; Verhoef, Nijssen, & Sloot, 2002).

As the production of Premium PLs has been advocated in the literature as beneficial for NBMs (Oubiña, Rubio, & Yagüe, 2006; Gomez-Arias & Bello-Acebron, 2008) this thesis will assess this proposition in detail by considering a two-fold objective.

Firstly, this thesis will identify what factors influence the production of PLs by NBMs by investigating the PL production literature. Secondly, the characteristics of PLs and Premium PLs will be discussed, which will then lead to a discussion of how the effect of these factors can vary for Premium PLs, therefore providing insight to the nature of the PL production in the marketing literature.

1.2 Problem Statement

The problem statement of this thesis is formulated in the following manner:

“What factors drive a national brand manufacturer to produce premium private labels for a retailer?”

1.3 Research Questions

The problem statement in this thesis will be answered by focusing on the following research questions, which will then lead to the conceptual framework of this study:

1. What factors drive a national brand manufacturer to produce a private label for a retailer?
2. How do standard private labels and premium private labels differ in characteristics?
3. How do the factors in research question 1 differ in effect for premium private labels?

1.4 Academic and Managerial Relevance

1.4.1 Academic Relevance

Investigating the factors that drive NBMs to produce premium private labels has its relevance in the current academic literature.
Firstly, there is a small amount of research focusing solely in the production of PLs by NBMs (Tarzijan, 2006). While there is increasing interest in this field, the role of Premium PLs is important to assess, given that much of the literature discusses PLs in their traditional sense (Gomez & Benito, 2006; Tarzijan, 2006). Secondly, while the drivers behind the production of PLs are discussed in much of the academic literature pertaining to PL production, some papers take specific drivers while other papers do not. This is why there exist sentiments of the literature being anecdotal (Tarzijan, 2002), given that many of these papers attempt to investigate the same question, including papers that are more recent (Gomez-Arias & Bello-Acebron, 2008). Thirdly, given the nature of PLs and Premium PLs taken into consideration in different papers, they provide contradictory propositions towards the production of PLs in general (Oubiña et al, 2006; Gomez et al. 2006). By investigating the difference in the characteristics of PLs and Premium PLs, this would give a more parsimonious avenue for future research of empirical nature.

1.4.2 Managerial Relevance

The managerial relevance of this thesis would benefit NBMs that question the use of a Premium PL, given the various reasons to produce them. As opposed to empirical literature, this thesis does not go into depth with the underlying properties of the factors. However, it does take into consideration how each factor affects each other from previous empirical analysis that is not integrated, therefore providing a more realistic picture of the problem. Additionally, future research can establish the generalizability of the proposed hypotheses of these factors, and therefore measure the salience of each factor as a driver for NBMS to produce Premium PLs.
Chapter 2 | What factors influence a NBMs incentive to produce private labels?

This chapter will focus on answering the first research question of this thesis: ‘What factors drive a national brand manufacturer to produce private labels for a retailer?’ This chapter will discuss the incentive to produce private labels by a NBM, followed by the economic, competitive and relational factors that drive this incentive. The conclusion of this chapter will provide a conceptual framework that summarizes the theories given in the related literature, which is required to answer the problem statement.

2.1 Incentives to produce private labels by NBMs

Private labels, hereafter denoted as PLs, are defined as products owned and branded by organizations whose primary economic commitment is distribution rather than production (Richardsson, Dick, & Jain, 1994). The incentive of NBMs to produce PLs clearly exists as evidenced by Quelch & Harding (1996), reporting that more than 50% of US NBMs produce PLs for retailers, even though PLs can threaten their national brands.

In order to understand why NBMs have an incentive to produce PLs in the first place, this section will discuss the nature of competition in the grocery channel, and the strategic options available to NBMs.

2.1.1 Intense competition in the packaged consumer goods market

NBMs and retailers are both members of the grocery channel and interact together to bring final products to consumers. This channel is defined by empirical research as a channel of vertical strategic interaction between NBMs and retailers (Amrouche & Zaccour, 2007, p. 649). The packaged consumer goods market, which includes food & drink, personal hygiene and cleaning products, is said to be a very competitive market (Corsten & Kumar, 2005). For example, refrigerated food has the highest incidences of PL market share (AC Nielsen, 2005) and therefore NBMs competing in this market are faced with increased pressure to fend off the threat that PLs can have on their national brands (AC Nielsen, 2005). For this reason, this thesis investigates PL production in terms of this market.

In order to understand why NBMs produce PLs, it is necessary to discuss some aspects of how competition is created in the grocery channel. Firstly, an increase in retailer concentration creates increased competition for NBMs to merchandise their products, which
has established business practices like the use of slotting allowances and high rent concessions for retailers (Corsten & Kumar, 2005). Secondly, the shelf space of a retailer has become increasingly scarce, as high proliferation of national brands, along with the increased presence of PLs further increase competition for shelf-space allocation (Amrouche & Zaccour, 2007). Thirdly, the competition is characterized as intense, because the packaged consumer goods market consists of a large variety of commodity products (Oubiña, Rubio, & Yagüe, 2006).

Retailers appropriate value from NBMs by using PLs to negotiate lower wholesale prices for national brands, and increase the amount of rent concessions paid by NBMs for shelf-space allocation (Messinger & Narasimhan, 1995). In this respect, the presence of PLs in the market increases the scarcity of the retailer’s shelf-space by favorably allocating shelf-space to PLs, which further enhances the negotiating power of the retailer (Corstjens & Lal, 2000). Because retailers use PLs strategically towards national brands, this has caused traditional NBMs to consider the potential threat of PLs in their branding strategy (Verhoef, Nijssen, & Sloot, 2002).

2.1.2 Strategic options open to NBMs

Having discussed the intense competition experienced in the grocery channel for packaged consumer goods, NBMs look to remain competitive in their markets. One option for NBMs to remain competitive is the production of PLs (Verhoef, Nijssen, & Sloot, 2002), even though this role has been conventionally assumed by independent manufacturers. Furthermore, what is more interesting is that leading NBMs also produce PL, even though PLs can compete with their national brands (Verhoef et al. 2002; Gomez-Arias & Bello-Acebron, 2008).

According to Verhoef et al. (2002), NBMs that do not produce PLs are those who pursue a differentiation strategy because of their strong brand equity, and the ability to provide technical differentiation to their products. Additionally, some NBMs pursue a “wait and see” strategy, and finally there are NBMs who simply choose not to produce PLs. The case for NBMs that do produce PLs consists of non concrete reasons, as witnessed in empirical studies (Verhoef et al. 2002; Gomez et al. 2006).

NBMs therefore produce PLs for a mixed set of reasons, which are defined in previous literature as being that of economic, competitive and relational reasons (Hoch & Banerji, 1993). These set of reasons do not appear to suit a specific competitive strategy by definition, nevertheless, the combination of these reasons are in effect what drives NBMs to produce
PLs. It can therefore be concluded that NBMs competing in the packaged consumer goods market produce PLs with the general aim to increase profitability by conditioning the benefits and costs to economic, competitive and relational reasons. The PL production literature has followed this rationale previously (Gomez et al. 2006), and therefore suits the objective of this chapter. The next section will therefore consider the factors that drive NBMs to produce PLs by assessing the costs and benefits of this decision in relation to the economic, competitive and relational reasons.

2.2 Economic factors to produce PLs

This section will discuss the factors related to the economic reason for NBMs to produce PLs. It has been shown that economic reasons for the production of PLs alone explains the variability of NBMs deciding to produce PLs (Gomez-Arias & Bello-Acebron, 2008), and therefore are considered in this study.

2.2.1 Idle Capacity

Capacity is defined as the maximum level of value-added activity that an operation, or process, or facility is capable of over a period of time (Slack, Nigel, & Johnston, 2007). Idle capacity is associated with fixed costs and costs of staff that is not engaged in direct productive work, and therefore motivates companies to plan their capacity in order to meet demand levels, and to optimize profitability (Slack, Nigel, & Johnston, 2007).

Idle capacity in the PL production literature has been mentioned as a factor that drives NBMs to produce PLs (Oubiña, Rubio, & Yagüe, 2006). The reason why idle capacity is an important consideration for NBMs is because it can be costly (Bergès-Sennou, 2006). NBMs are characterized as having high fixed costs relative to variable costs for the production and marketing of their national brands (Verhoef, Nijssen, & Sloot, 2002), which in effect characterize the majority of their costs as sunken costs (Bhimani, Horngren, & Datar, 2008). These costs are covered by spreading them over the amount of units produced during the period in which they are incurred. Idle capacity for NBMs increases the unit cost of their products because there are fewer units to allocate the costs to, and therefore NBMs have to either increase the unit sales price of their national brands, or decrease costs in other areas like customer service. Furthermore, idle capacity risks under-pricing of the national brands, higher inventory costs and lower service levels to their customers (Tarziján, 2007). For this reason, producing PLs can offer NBMs the opportunity to eliminate idle capacity, and therefore lower unit costs for their national brands and the PLs in relation to other NBMs. It
has been shown that NBMs can have higher profits derived from both national brands and PLs, as compared to only deriving profits from their national brands alone (Mills, 1999). It can therefore be concluded that NBMs with existing or increasing idle capacity have higher incentives to produce PLs. This effect can be summarized in the following hypothesis.

**H1: Idle capacity has a positive effect on the incentive of a NBM to produce PLs**

### 2.2.2 Economies of scale (EOS)

Economies of scale is another factor behind the economic reason of PL production by NBMs. EOS is a key success factor for NBMs to compete in maturing industries, and is defined as proportionate increases in the amounts of inputs employed in a production process that result in lower unit costs, and is usually associated with manufacturing (Slack, Nigel, & Johnston, 2007). EOS are said to be exploited given a level of capacity of manufacturing operations and unit costs, and this optimization is refered to from a strategic point of view as the Minimum Efficient Plant Size (MEPS) (Slack, Nigel, & Johnston, 2007).

Most NBMs can be characterised as having achieved their MEPS to exploit EOS, which provide them with competitive unit marginal costs for their products due to the scale of their operations (Oubiña, Rubio, & Yagüe, 2006). Nevertheless, NBMs continue to strive to achieve EOS whenever possible given the competitive and maturity stage of the packaged consumer goods market (Tarziján, 2007). NBMs experiencing difficulties at increasing EOS, or NBMs that are closely falling back on their MEPS, would be inclined to produce PLs, and therefore it is advisable for any NBM to produce PLs for whatever level of retailer concentration for this purpose (Tarziján, 2007). The effect of EOS on the incentive of a NBM to produce PLs can therefore be summarised in the following hypothesis.

**H2: Achieving economies of scale has a positive effect on the incentive of a NBM to produce PLs**

### 2.3 Competitive factors to produce PLs

Having discussed the economic factors that drive NBMS to produce PLs, this section now discusses the competitive factors related to the production of PLs. Given the nature of how PLs compete with national brands, NBMs are also known to produce PLs for competitive reasons.
2.3.1 The Quality gap

NBMs competing in the consumer packaged goods market need to differentiate their national brands from competition (Verhoef, Nijssen, & Sloot, 2002). They do this by means of positioning their brands in relation to competing brands. Positioning is defined as the perceptual distance between two brands, where brands positioned closer to each other exhibit a higher cross-price sensitivity (Sayman, Hoch, & Raju, 2002). National brands are therefore said to be positioned by following a price-quality dimension.

Given that previous research relate national brands with having a level of brand equity (Sethuraman & Cole, 1999), this thesis considers NBMs as having that of middle and high quality dimension in terms of positioning, due to the nature of their traditional competitive strategies (Verhoef, Nijssen, & Sloot, 2002), and because low quality products are usually associated with independent or second-tier manufacturers.

PLs in shared product categories with national brands are said to cannibalize the latter’s market share by means of their positioning (Geyskens, Gielens, & Gijsbrechts, 2009). Given a PL that is positioned closely to a national brand, the cross-price sensitivity created in the product category would compromise the national brand by means of being relatively cheaper (Sayman, Hoch, & Raju, 2002). For this reason, a national brand’s positioning difference, usually mentioned as the “quality gap” in the PL production literature is an important factor for NBMs considering to produce PLs for reasons to remain competitive (Mills, 1999). This effect is summarised in the following hypothesis.

H3: The Quality gap between NBs and PLs has a negative effect on the incentive of a NBM to produce a PL

2.3.2 NBM Market Share

The level of market share for national brands is a determinant of profitability in mature markets characterised of having intense competition (Slack, Nigel, & Johnston, 2007). Given the cannibalization effect that PLs have on national brands, this is also a factor to consider in relation to competitive reasons to produce PLs.

It has been shown that NBMs produce brands of lower equity in order to foreclose competition in market segments to protect their most valuable national brands. These brands are referred to as “Value Flankers” or “Fighter Brands” (Verhoef, Nijssen, & Sloot, 2002). Since NBMs usually do not introduce these brands to compete against PLs directly because
of relations with the retailer (Verhoef, Nijssen, & Sloot, 2002), NBMs produce PLs to reduce competition from both PLs and national brands (Verhoef, Nijssen, & Sloot, 2002).

Empirical studies have discussed two reasons for NBMs to produce PLs to cannibalize the market share of competing brands. Firstly, NBMs that cannot remain competitive in product categories can produce PLs to reduce competition from other national brands (Gómez & Rubio Benito, 2008). Secondly, NBMs wanting to enter a new product category do not have to take into consideration the negative effects of producing PLs, given that they have no market share to suffer a cannibalization effect (Gómez & Rubio Benito, 2008).

Regardless of these reasons, the common factor that determines the drive for NBMs to produce PLs can be considered a low market share level. The following hypothesis summarized this effect

H4: The market share of a NBM has a negative effect on the incentive of the NBM to produce PLs

2.4 Relational factors to produce PLs

This section discusses the factors related to the relational reasons NBMs produce PLs.

2.4.1 NBM bargaining power

It has been shown previously that NBMs produce PLs for relational reasons, which have shown to benefit NBMs both economically and strategically (Verhoef et al. 2002). Given the little information on channel relationships (Geykens, Steenkamp & Kumar, 1999), along with the difficulties in establishing collaborative relationship between channel members in the packaged consumer goods market (Corsten & Kumar, 2005), it can be mentioned in this thesis that the antecedents for relational reasons to produce PLs stems from the level of retail concentration in the packaged consumer goods market (Tarziján, 2007).

Firstly, the level of retail concentration is said to have increased the bargaining power of retailer’s vis-à-vis NBMs, and has been shown to have a positive correlation with PL market share in packaged consumer goods product categories (Tarziján, 2007). As a retailer’s bargaining power can negotiate unfavorable wholesale prices on national brands from a NBM’s perspective, the extent of collaboration by part of a NBM can be explained by a low bargaining power of a NBM (Gomez-Arias & Bello-Acebron, 2008). When NBMs and retailers negotiate wholesale prices for the merchandising of national brands, the retailer determines this value by the incremental sales that it provides in relation to the retailer PLs.
(Scott Morton & Zettelmeyer, 2004). For this reason, a NBM of low bargaining power for negotiating national brand wholesale prices has a national brand that provides low value to consumers (Richardsson, Dick, & Jain, 1994). NBMs with national brands could therefore produce PLs to improve the relationship with the retailer, given that a PL would in any case compromise the value-added of their national brands to product categories, and further increase the bargaining power of the retailer (Corstjens & Lal, 2000).

Secondly, given the current retailer concentration rates of USA and Europe, along with the increasing penetration of PLs (ACNielsen, 2005), a long-term orientation with the retailer has shown to have good results towards NBMs. This effort has shown that NBMs can avoid simultaneous brand promotions in their product categories, while can contribute with a NBM’s competitive strategy (Dunne & Narasimhan, 1999; Verhoef et al. 2002).

Although skepticism from the NBM usually compromises the viability of the relationship (Corsten & Kumar, 2005), we can still substantiate that relational reasons towards the retailer will always be economic and strategic in nature by referring to how channels of vertical strategic interaction are approached in the literature (Amrouche & Zaccour, 2007). Given that a low bargaining power of a NBM can create an incentive to collaborate with the retailer by producing PLs, the following hypothesis can summarise the effect of this factor.

\[ H5: \text{NBM bargaining power has a negative effect on the incentive of a NBM to produce PLs} \]

### 2.5 Conclusion

Having discussed the factors related to economic, competitive and relational reasons for NBMs to produce PLs, this chapter is concluded by highlighting the anecdotal marketing literature pertaining to the production of PLs and the possible effects they have on the incentive of NBMS to produce PLs. Although the interaction effects of these factors are noteworthy, this thesis considers the independent effects of these factors only to provide a conceptual framework for the next chapters. This conceptual framework is presented here.
Figure 1: Factors influencing the incentive of a NBM to produce PLs

- Economic Factors
  - H1: Idle capacity (+)
  - H2: Economies of Scale (+)

- Competitive Factors
  - H3: Quality Gap (-)
  - H4: NBM Market Share (-)

- Relational Factors
  - H5: NBM Bargaining Power (-)

Standard PL production by NBM
Chapter 3 | Characteristics of standard and premium private labels

This chapter will focus on answering the second research question of this thesis: *How do standard private labels and premium private labels differ in characteristics?* This chapter discusses the product characteristics in the packaged consumer goods market that are important from a consumer perspective, and then discusses the differences between standard and premium PLs by means of those characteristics. The conclusion of this chapter will therefore provide an answer to the second research question, which will serve to answer the third research question by taking into consideration the factors discussed in chapter 2.

3.1 Product Characteristics in the packaged consumer goods market

The packaged consumer goods market, as noted in chapter 2, is one of intense competition between brands, and in which products of commodity status dominate the market. It has been shown that some retailers in the UK display a range of 40,000 product lines in this market (Vazquez, Bruce, & Studd, 2003) This presents a great challenge for NBMs and their national brands to compete for the consumer’s attention. In connection, a study has also shown than the rate of unplanned purchases can be as high as 51% for products in this market (Phillips & Bradshaw, 1993). Due to the nature of the grocery environment, it has been shown that the characteristics of price, perceived quality and perceived value are salient features of products related to positive consumer choice (Sheinin & Wagner, 2003). These characteristics are briefly discussed in this section.

Firstly, packaged consumer goods categories are said to be characterized of having commodity products, which establish a low level of involvement for consumers. Consumer involvement is defined as a person’s perceived relevance towards the object based on their inherent needs, values and interests (Solomon, Barmossy, Askegaard, & Hogg, 2006). Given this definition, they have been shown to rely on price as a simple decision rule to choose amongst alternatives (Sheinin & Wagner, 2003).

Secondly, the perceived quality of packaged products requires consumers to look for salient cues for product attributes. Cues refer to both extrinsic and intrinsic, where the former relates to product attributes such as the package and the information of product ingredients, and the latter refers to the actual ingredients and composition of the product.
Thirdly, given the definition of positioning in chapter 2, the price-quality dimension associated with a product determines its perceived value for consumers, along with symbolic associations of more abstract features like brand image.

3.2 Product Characteristics of PLs

Having discussed the importance of price, perceived quality and perceived value as salient characteristics in packaged consumer goods categories, this section will discuss these characteristics for PLs.

3.2.1 Price of Standard PL

The price of a PL is considered to be competitive against other brands in shared product categories, and is generally priced lower than that of national brands (AC Nielsen, 2005). The lower price of a PL can be justified by retailers not adhering to nation-wide promotion for their brands (Hoch & Banerji, 1993), and therefore the marginal costs of PLs are lower than those of most other brands.

In the context of the packaged consumer goods market, PLs have been accepted favorably by consumers, since it has been shown that consumers place more importance on price in low involvement categories because of the little perceived differences in non-price extrinsic cues (Richardsson, Dick, & Jain, 1994). It can therefore be concluded that the price of a PL is competitive against other brands in the same product category for their lower marginal costs of production.

3.2.2 Perceived quality of PLs

The Perceived quality of PLs can be stated as lower that competing national brands. It has been shown that although the package of a PL is similar to that of national brands due to the positioning initiatives of the retailer, they cannot justify a price premium for an increased perception of quality by controlling the package. This limits the PL as a high market segment alternative, while national brands can be positioned both in middle and high market segment categories. For this reason, NBMs pursuing a differentiation strategy comprise of higher quality brands (Verhoef, Nijssen, & Sloot, 2002).

Secondly, PLs have the consumer’s perception of being choice alternatives to national brands, and therefore generally assume them to be of lower quality due to the product association to the PL brand.

3.2.3 Value of Standard PL
One of the key selling points as mentioned is the traditional promotion of PLs as having good value for money (Zielke & Dobbelstein, 2007). PLs provide good value for money to price-conscious segments of the market as compared to national brands (Livesey & Lennon, 2007). This value is however limited to solely the price-conscious segment of the market due to the brand image associated with PLs and their traditional role as cheaper alternatives to national brands. Nevertheless this value proposition captures both consumers that perceive the quality of the PL as acceptable, and those consumers that perceived the quality as bad, but by assessing the gains and losses, they earn value from their purchase (Richardsson, Dick, & Jain, 1994). Therefore, PLs have good value for money orientation and are limited to lower and middle market segments.

3.3 Characteristics of Premium PLs

Having discussed PLs and their characteristics, Premium PLs are defined as PLs that are at the top end of the market, and deliver quality equal to that close to leading national brands while typically still selling for a slightly lower price (Geyskens, Gielens, & Gijsbrechts, 2009).

3.3.1 Price of Premium PLs

The price of a Premium PL is considered to be higher than the price of a national brand, but slightly lower than those of leading national brands (Geyskens, Gielens, & Gijsbrechts, 2009). The increased price of Premium PLs can be explained by a higher contribution margin that is charged to consumers. As Premium PLs are usually of innovative design (Huang & Huddleston, 2009), they can have increased sales prices that can compromise the price premium of national brands, which can be justified by consumers associating a higher price with an extrinsic cue to quality (Anselmsson, Johansson, & Persson, 2007).

3.3.2 Perceived quality of Premium PLs

The perceived quality of a premium PL is considered to be its most salient feature. Premium PLs are usually positioned as high quality products that sometimes have higher quality than national brands (Huang & Huddleston, 2009) (Richardsson, Dick, & Jain, 1994) (Geyskens, Gielens, & Gijsbrechts, 2009). It has been shown that retailers sometimes provide superior quality in terms of intrinsic cues by surpassing the minimum quality standard (MQS) imposed by the European Union (Codron, Giraud-Héraud, & Soler, 2005). Additionally, retailers are known to seek certification of well known quality associations like Fairtrade to increase the package extrinsic cues (Schoormans & Robben, 1997). For this reason, it is
expected that premium PLs have a salient perceived quality dimension from a consumers perspective.

### 3.3.3. Perceived Value of Premium PLs

The value provided by Premium PLs to consumers from their price and perceived quality characteristics can be due to a retailer’s strategy to price the premium PL slightly lower than leading national brands (Geyskens, Gielens, & Gijsbrechts, 2009). Due to the nature of the packaged consumer goods market, consumers derive value from the equivalent characteristics of extrinsic cues between the packaging of the premium PL and the national brand, and therefore a lower price can justify good value for money in this sense.

### 3.4 Conclusion

Having discussed the product characteristics that are important for the consumer packaged goods market, and the salient characteristics of both PLs and Premium PLs, this section will discuss their differences and conclude this chapter.

Firstly, in terms of price, standard and Premium PLs belong in different market segments and do not interact with one another in terms of cross-price elasticity. In this sense, it can therefore be established that they compete against national brands according to the price level of the market segment.

Secondly, in terms of perceived quality, Premium PLs can be positioned at almost any quality level as compared to Standard PLs, which are said to be restricted to middle and lower market segments. The perceived quality level of Premium PLs is said to be determined by the quality that is closest to the leading national brand, due to the associated equity of the brand being more favorable than any PL product.

Thirdly, in terms of value, it is surprising to find that both PLs offer good value for money in their respective market segments. This is because of the general quality proximity to that of national brands, and the slightly lower price that they have in their relation.

In conclusion, since standard and Premium PLs are positioned at different market segments, it has important implications for retailers, as discussed in much of the literature on PLs (Corstjens & Lal, 2000). The next chapter will answer the question how these different characteristics affect NBM’s, incentive to produce Premium PLs.
Chapter 4 | What factors influence a NBMs incentive to produce private labels?

This chapter will focus on answering the third research question of this thesis: *How do the factors in research question 1 differ in effect for premium private labels?* This chapter will discuss each factor related to the economic, competitive and relational reasons to produce PLs in chapter 2, and consider the effects for the characteristics of Premium PLs discussed in chapter 3. The conclusion of this chapter will discuss the findings and discuss the implications they have for NBMs.

4.1 Economic reasons to produce Premium Private Labels

4.1.1 Idle Capacity

Idle capacity has a positive effect on the incentive of NBMs to produce PLs. This effect can be proposed to be positive and stronger in the context of a Premium PLs.

Firstly, idle capacity can also be eliminated by producing Premium PLs, and therefore NBMs would not have to worry about increasing the prices of their national brands, or reduce customer service levels. Secondly, Premium PLs comprise a higher sales price, which gives them a higher contribution margin than that of PLs. Thirdly, the absence of nation-wide advertisement and promotional costs for Premium PLs also characterize them as products with lower marginal costs than national brands (Bhimani, Horngren, & Datar, 2008).

For these reasons, NBMs would be able to increase overall profitability by producing Premium PLs and national brands, as compared to PLs and national brands together (Mills, 1999). It can therefore be concluded that idle capacity has a positive effect on a NBMs incentive to produce Premium PLs, and this effect can be stronger than for Standard PLs. This can be summarized in the following hypothesis.

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H1b: \text{Idle capacity has a positive effect on a NBMs incentive to produce Premium PLs, and is stronger than the effect of producing Standard PLs.}
\]

4.1.2 Economies of Scale (EOS)

Achieving economies of scale has a positive effect on the incentive of a NBM to produce PLs. This effect can be proposed to be positive and of equivalent strength in the context of a Premium PL.
It can be stated here that price, perceived quality and value do not have an important role in terms of NBMs achieving EOS. Firstly, while price plays an important factor to the profitability of the PL in consideration, it does not have a direct effect to the capacity and unit cost relation of exploiting economies of scale (Tarziján, 2007). Secondly, while the perceived quality of Premium PLs requires the use of investment in packaging and non-price extrinsic cues, these characteristics do not influence the benefits gained in terms of exploiting economies of scale. For this reason, the following hypothesis can be provided.

H2b: *Economies of scope has a positive effect on a NBMs incentive to produce Premium PLs, and is equivalent to the effect of producing Standard PLs.*

### 4.2 Competitive reasons to produce Premium PLs

#### 4.2.1 The Quality gap

The Quality gap has a negative effect on the incentive to produce a PL. This effect can be proposed to be negative and weaker in the context of a Premium PL.

Premium PLs, due to the high perceived quality of their extrinsic cues, would entail competition in the middle and higher segments of the market, and would limit the ability of a differentiation strategy for NBMs. This would create a cannibalization effect on market share of national brands positioned in these segments, compromising the high advertisement and promotion investments made by NBMs, and the value as perceived by consumers (Sayman, Hoch, & Raju, 2002).

In this connection, since only leading NBMs can pursue a differentiation strategy through continuous improvements towards the quality of national brands (Verhoef, Nijssen, & Sloot, 2002), most NBMs would be foreclosed from pursuing a differentiation strategy for their brands, and would have to accept the cannibalization of their market share due to the intense competition created by the introduction of a Premium PL.

Therefore, in light of no strategic options available to NBMs to compete against the Premium PL, they are inclined to either suffer the cannibalization effect of market share, or consider producing the Premium PL in order to appropriate the profits that are left in the product category. For this reason, it can be concluded that the quality gap effect on the incentive of a NBM to produce a Premium PL is weaker than it is in the context of a Standard PL, and the following hypothesis is provided.
H3b: *The quality gap has a negative effect on the incentive of a NBM to produce a PPL, and is weaker than the effect of producing PLs.*

### 4.2.2 NBM Market Share

NBM Market share has a negative effect on the incentive of the NBM to produce PLs. This effect is proposed to be negative and stronger in the context of Premium PLs.

Having discussed how low or decreasing market share leads some NBMs to produce PLs to reduce competition for their national brands, the characteristics of Premium PLs intensifies competition not only in the middle market segments, but the higher market segment of the product category.

Firstly, the extrinsic cues of the Premium PL would signal perceived quality, and would allow less-price conscious consumers to consider the product as an actual choice among competing brands. Secondly, the higher sales price would also act as a salient feature of perceived quality, but would also allow for a higher level of cross-price elasticity in the product category (Mills, 1999). Thirdly, the value perceived by consumers would therefore offer them with an option to consider a premium product at better value for money. These characteristics would therefore allow for the cannibalization effect to take place not only in middle market segments, but would also cause this effect in the higher market segments, which would have these Premium PLs competing incrementally toward the leading incumbent national brand.

For NBMs struggling to remain competitive in the product category, they could produce a Premium PL and have them cannibalize the market share of more competitive national brands. Additionally, the retailer can also provide benefits in terms of merchandising their less competitive national brands.

NBMs wanting to enter a product category would find this option appealing, since they would not suffer from the cannibalization effect of the Premium PL, and would therefore enter the category by being able to introduce their national brands accordingly.

For this reason, it can be concluded that a NBMs market share in the product category is negatively related to the incentive to produce a Premium PLs, and the effect would be stronger, given the lower or non-existent cannibalization effect that the Premium PL would have on their national brands. The following hypothesis summarizes this effect.
H4b: NBM market share has a negative effect on the incentive to produce a Premium PL, and is stronger in the context of Premium PLs.

4.3 Relational reasons to produce Premium PLs

4.3.1 NBM Bargaining Power

The bargaining power of a NBM has a negative effect on the incentive of the NBM to produce a PL. This effect is proposed to be negative, and have a weaker effect in the context of Premium PLs.

As discussed in chapter 2, NBMs negotiate wholesale prices for their national brands with the retailer according to the incremental sales the national brand provides on top of the retailers capabilities to produce PLs (Gomez-Arias & Bello-Acebron, 2008). In the context of a Premium PL being produced by a NBM, the perceived value of the national brand in the product category would be compromised by the value of the Premium PL, and therefore the incremental sales that the national brand provides to the retailer.

Given that the relational motives to produce a PL for a retailer entail both possible economic and strategic benefits to the NBM, it can be stated here that the cannibalization of their national brands is a sufficient reason to rule out these benefits by the loss of bargaining power. This is because a Premium PL would create intense competition in middle and higher market segments, therefore compromising any NBMs differentiation strategy (Sayman, Hoch, & Raju, 2002). The extent of this effect has already been discussed in terms of Premium PLs, and therefore can be considerable.

While there has been discussion about the capabilities of a NBM to provide technical insights for a retailer as a salient reason for NBMs to establish a collaborative relationship, it is the control of the Premium PL that offsets any economic or strategic benefit in this context, given that the retailer has an incentive to position the Premium PL as close as possible to that of leading national brands in terms of value, which is that of a higher quality, and a slightly lower price. For this reason, the bargaining power of a NBM alone cannot explain the relational reason to produce PL, and therefore it can be concluded that given the control of the retailer in the positioning of the Premium PL, the effect of the incentive to produce a Premium PL is weaker than that of producing a Standard PL. This can be summarized in the following hypothesis.
H5b: *NBM bargaining power has a negative effect on the incentive to produce a Premium PL, and the effect is weaker for Premium PLs.*

### 4.4 Conclusion

The findings derived in this thesis provide some managerial implications associated with the production of Premium PLs for NBMs. Firstly, it can be stated that there exists differences in terms of economic, competitive and relational reasons for NBMs to produce Premium PLs as opposed to PLs.

Firstly, the economic reasons to produce Premium PLs are good for NBMs. NBMs considering the production of PLs should benefit more economically by producing Premium PLs. The main determinant of this benefit is the higher contribution margins that Premium PLs have when producing them simultaneously with national brands. The higher contribution margins in the sales price would offer better overall profits to the NBM than producing PLs.

Secondly, the competitive reasons to produce Premium PLs differ according to the competitive position of the NBM. Regarding NBMs that are not competitive in the product category, the production of a Premium PLs would cause a cannibalization effect in middle and higher market segments, therefore compromising the differentiation strategies of more competitive NBMs. Additionally, NBMs of a lower competitive position can derive profits from higher market segments, which are usually not accessible due to the positioning of their national brands in lower market segments, which can contribute to increased overall profitability from the category. Regarding NBMs who want to facilitate market entry into middle and higher market segments, the production of a Premium PL would decrease competition in the product category, especially if competition is induced by leading NBMs.

Thirdly, the relational reasons to produce Premium PLs are not good for NBMs. The fact that the retailer has control of the positioning of the Premium PL would compromise economic and strategic benefits that can be derived from collaborating with the retailer. While no more insight can be provided from these findings, it can be stated that retailers that strive to decrease the bargaining power of NBMs would do so respectively by the use of the Premium PL.
Chapter 5 | Conclusion

This chapter will answer the problem statement of this thesis: What factors drive a national brand manufacturer to produce premium private labels for a retailer? In order to answer the problem statement, the conceptual framework derived from the research questions in the previous chapters is presented, and the effects of the factors are presented. Afterwards, these effects will be discussed to provide their implications towards the academic and managerial relevance of the thesis. The chapter will conclude by providing suggestions for future research.

5.1 Conclusion

This thesis identified the factors that drive NBMs to produce PLs. These factors are idle capacity, economies of scale, the quality gap, NBM market share and NBM bargaining power. Secondly, the characteristics of PLs and Premium PLs of price, perceived quality and perceived value were discussed and compared. By following this structure to answer the problem statement, it can be concluded that the identified factors that drive NBMs to produce PLs differ in effect for Premium PLs, and are stronger for economic and competitive reasons, while weaker for relational reasons. Having answered the problem statement, the conceptual framework of this thesis summarizes the findings, and is presented in figure 2.

Figure 2 Conceptual Framework of the Thesis

5.2 Discussion

The findings of this thesis have both academic and managerial relevance, and are discussed in this section. By approaching the PL production in terms of both standard PLs and Premium PLs, the answer to the problem statement gives insight to why previous PL production literature presents contradictory findings, in terms of the advisability of NBMs to produce PLs.

The conceptual framework of the thesis provides insight on anecdotal literature by focusing on the relationship factors have with each other. While Gomez-Arias et al (2008) propose that NBMs of all competitive levels can produce Premium PLs solely by the quality gap factor in this conceptual framework, they do not consider how this decision would affect a leading NBMs’ bargaining power, by not considering the relational factors that drive the NBM to
collaborate with the retailer. In this connection, Oubiña et al. (2008) show that leading NBMs produce standard PLs in order to control and increase the NBM’s bargaining power, but do not take into consideration how Premium PLs would perhaps affect the NBM’s decision to produce PLs, and therefore cause harm to the generalization of the proposition. The conclusions of these papers can therefore be stated as anecdotal; given that they derive insights about the reasons NBMs produce PLs, without taking all motives for PL production into consideration.

5.3 Limitations

In order to establish a meaningful analysis in this thesis, limitations had to be made.

The first limitation deals with the depth of analysis, given that the factors identified in chapter 2 have been considered from the small amount of research in the PL production literature. For example, while the relational factor of NBM bargaining power is adequate given the PL production literature, there exists a short-term and a long-term perspective of collaboration. NBMs can produce PLs to improve relations with the retailer in the short-term, or produce PLs to produce a sustainable competitive advantage by partnering with the retailer.

Secondly, as the scope of this thesis was to establish a framework to be tested, the results of interaction effects cannot be discussed in detail. For example, the factor NBM bargaining power could very well lead to a stronger effect if combined with low NBM market share and a low distance in the Quality gap. Nevertheless, it was shown that the PL production literature suggested strong effects for the NBM market share and NBM bargaining power factors.

5.4 Suggestions

Future research should naturally focus on empirical analyses of these factors to test the proposed hypotheses and interaction effects. This would assist on the scarce nature of PL production that is found in the marketing literature. Additionally, more research should be conducted on the relational reasons to produce PLs given that these reasons would give more beneficial insights to PL production than for example competitive and economic reasons, which can be explained by overall profits and the cannibalization effect of market share. The reasons for long-term collaboration with a retailer specifically by a leading NBM could provide significant insights to sustain competitive advantage in light of PL competition.
Bibliography


