

Impact of New Product Development of Store Brands on Branded Manufacturers in the U.S. Grocery Industry.

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Store brands of U.S. packaged food products have made considerable strides in the last 20 years. Readily available technology has enabled manufacturers and retailers to understand consumer trends and buying habits and quickly offer private label substitutes. U.S. consumers recognizing value are more willing to buy private label, and the level of penetration is approaching once lofty European share levels. This has branded manufacturers looking harder at NPD as a weapon to fend off private label and grow category share. This paper will explore the process of new product development in private label and the role private label plays for manufacturers, retailers, consumers and brands. Further a research proposal will be outlined to determine the impact of private label growth on branded NPD strategies.

I. Introduction

The proportion of private label (PL) food products on U. S. supermarket shelves has been growing steadily for the last twenty years at the expense of national brands (NB) until it is now on average across categories about 16% of total supermarket sales (PLMA 2006). In the past year, more than 41% of consumers bought PL (PLMA 2007). There is only a finite amount of shelf space in supermarkets, so as retailers have allocated more shelf space to their own brands, it has become more difficult for manufacturers to get distribution for both existing and new products (Amrouche & Zaccour, 2007). This is expected to continue for the foreseeable future, presenting manufacturers with a dilemma about the best way to compete with their own customers (Amrouche & Zaccour, 2007). Our study will evaluate the moderating factors that govern the extent to which this trend will continue and provide strategic direction for NB marketers on how to deal with it.

Several additional factors have further intensified competitive pressure on manufacturers. The U.S. food market has become increasingly open to foreign firms due to lowering of trade barriers, for example the North American Free Trade Agreement (NAFTA) with Canada and Mexico. The trend towards elimination of trade barriers globally will continue as virtually every country has an interest in the World Trade Organization (WTO). At the same time the U.S. market is attractive to foreign firms because of its size and diversity. Technology has speeded up and automated communications and fostered development of websites that offer 24 hour availability of every conceivable form of merchandise on a worldwide basis. All of these influences have

intensified competition for food marketers in a mature market where total demand is increasing only in proportion to population growth, no more than 3% in dollar volume annually.

Additionally, structural changes in the industry due to improved methods of communication, gathering and analysis of check-out scanner data, and automation of inventory control have made it possible for supermarkets to measure the sales and profit contribution of every stock keeping unit (SKU) in the store on a daily basis. Due to this new-found capability, during the last twenty years the balance of power in food industry distribution channels has shifted from the manufacturer towards the retailer. This is a powerful illustration of the old adage, "Knowledge is Power." Whereas previously only large manufacturers like Procter & Gamble (P&G) or market research firms like A.C. Nielsen had the capability to collate and analyze checkout scanner data, now retailers can do it. They have gone further and turned access to checkout data into a profit center. Wal-Mart used to give scanner data to Nielsen who charged them for analyzing it. Now, they sell it to them. Also, since they have better data sooner than P&G, they have been able to negotiate deals which take into account the savings that P&G can obtain in manufacturing efficiency because of access to Wal-Mart inventory information. The result of this shift in power is that, in order to get distribution, manufacturers now have to convince retailers that a new product introduction will generate at least as much profit as the product it will displace.

Since it is impossible to forecast exactly the potential demand for a new product, retailers also demand a "slotting allowance" which may run as high as \$40,000 per store, before agreeing to carry a new product (Desiraju, 2001). Some manufacturers have claimed that this is a restraint of trade and particularly a barrier to entry for small manufacturers. Several Congressional committees have pondered whether or not to outlaw the practice, so far without any result. It is evident, however, that retailers' own new brands have a competitive pricing advantage in not having to carry the added cost of a slotting allowance.

Branded packaged food products have been marketed in the U.S. for more than 100 years by manufacturers who were much quicker than grocery stores and supermarkets to see the benefits of branding to marketing strategy. However, with their new-found sophistication in marketing, retailers have also come to realize that branding their own food products is a good way to differentiate themselves from other retailers. (Tarnowski, 2007) In this respect, European food retailers such as Sainsbury in the U.K., and Ahold in the Netherlands have been much quicker to adopt a branding strategy for their own label packaged goods. It is estimated that on average, the proportion of private label in U.S. supermarkets is around 16%, while in Europe it averages around 40% and in the UK chain, Sainsbury's, it is as high as 65% (Harcar et al., 2006; PLMA 2006). Loblaw's President's Choice PL line is so popular that it is licensed to non-competing retailers and is distributed internationally. Wal-Mart, the largest food retailer in the U.S. has its Great Value brand, and Target has its Archer Farms label.

Perhaps one of the most disappointing revelations of recent studies is that the heavy users of PL products are middle and upper middle income consumers (PLMA 2006).

The proportion of relatively affluent consumers who shop at discount stores but who also demand quality has increased (Nunes, Johnson & Breene, 2004). Astute retailers like Target have based their marketing strategy on catering to this segment and Wal-Mart is trying to follow suit. The most brand-loyal consumers tend to be lower income and ethnic minorities.

Few food retailers possess their own manufacturing operations. Exceptions include Kroger which supplies around 4,300 SKUs from 41 manufacturing plants for distribution to its own and other stores. Retailer and wholesaler-sponsored co-ops also have limited manufacturing capabilities. Most depend upon contract manufacturers who produce and package PL products to their specifications. In some cases, manufacturers of branded products also produce private label products. (Table 1) This may seem paradoxical behavior when private label products are directly in competition with them. However, they do it when it allows them to reduce their cost of goods although the profit margins for manufacturers on private label products are typically about half that of branded products. There are also competitive advantages to supplying PL products that will be discussed later.

Table 1 - Wal-Mart Share of Consumer Package Goods Companies' 2004 Sales

Company	Global Sales (\$ millions)	% Sales to Wal-Mart
Procter & Gamble	56,741	16
General Mills	11,244	16
Kellogg	9,614	14
Kraft	32,168	14

Source: Kumar & Steenkamp, Brand Versus Brand (2007)

The conventional wisdom is that failure rates of new food products are typically around 90%. Scholarly studies have shown that it actually varies from 33 – 50%, depending upon the uniqueness of the product and the nature of the product category (Crawford & Di Benedetto, 2008). One of the factors that increases the likelihood of failure is the similarity of the new product to others already on the market.(Crawford & Di Benedetto, 2008). In this respect, PLs are mostly “me-too” products. However, they will always be guaranteed distribution, an advantage not enjoyed by national brands. As the proportion of private label grows, manufacturers will be competing for less and less shelf-space in order to get distribution and will be pressed to introduce new products that are well-differentiated from PL products.

Store brands are priced lower than equivalent national brands by about 20 – 30% (Mendez 2008, Tortola 2007). Until recently, they relied mostly on price to differentiate themselves and did not apply the same marketing methods as those used by national brands. However, that has changed (Bell 2008). Consolidation in manufacturing has led some marketing managers to cross over into the retail side of the business. The result is that PL products have improved in product and packaging quality and now compare favorably with NBs. It follows that as private label grows, manufacturers will be forced to develop more innovative products in order to get distribution and maintain their market share.

It should also be mentioned that the cross –category average proportion of store brands does not reveal the complete competitive picture since it varies widely by product category. For example, in 2006 the average PL market share of milk was 58.7 %. For packaged frozen entrees it was 2.4% and for chewing gum only 0.7% (Table 2).

Table 2 – Retail Grocery Market Share of U.S. Private Label Food Products

Category	PL % Share of Market	PL % Annual Growth
Top Ten High Share		
Milk	58.7	+ 5.8
Butter	45.5	+20.1
Frozen Vegetables	45.5	- 1.0
Frozen Seafood	38.2	+6.2
Natural Cheese	36.1	+ 7.1
Snack Nuts	29.6	+ 25.6
Pickles/Relish	28.3	-1.8
Frozen poultry	24.3	+6.1
Bottled Water	21.1	+10.1
Pasta	20.1	-6.2
Top Ten Low Share		
Baby Food	0.4	+47.1
Gum	0.7	-5.5
Chocolate	1.2	+ 9.1
Frozen Dinners	2.4	-5.2
Granola Bars	3.8	+0.3
Salty Snacks	4.7	- 3.5
Prozen Appetizers	4.9	+13.8
Candy	5.7	+7.2
Carbonated Beverages	6.4	+ 6.0
Dressings/Deli	8.1	+ 8.0

Source: Stagnito (2005)

The food industry is often referred to as a “low-tech” industry. However, this is not an accurate description. For example, today’s food industry is actually based upon extremely “high-tech” developments in animal and crop husbandry, food preservation systems, and ingenious high speed packaging systems which are based upon basic scientific discoveries in biology, chemistry, genetic engineering, mathematical modeling, microbiology, nanotechnology, nutrition, physics, physiology, and process engineering. All of this is not apparent to the consumer of the finished product, but without it our current global food distribution system would not exist. National brand manufacturers possess more of the technological know-how required to produce truly innovative new products than do retailers or the contract manufacturers who supply the bulk of the private label trade and who tend to be technology followers. This, along with their marketing expertise and

financial strengths, provide the national brand manufacturers with their most significant competitive edge in developing new products.

II. Literature Review

An extensive literature has developed during the past twenty years, much of it from European scholars, about the relationship between private label and national brands. It covers analyses of the economic basis and nature of consumer buying preferences for PL products and the strategic alternatives available to retailers and manufacturers in dealing with them (Amrouche & Zaccour, 2007; Ashley, 1998; Batra & Sinha, 2000, Bronnenberg et al, 2007; Kumar, 2007). This paper is concerned mostly with the impact of this relationship on new product development practices, and so we review the literature from that standpoint.

As PL market share increases, most researchers conclude that manufacturers should develop more innovative products that are well-differentiated from PLs (Ashley, 1998), Kumar & Steenkamp, 2007). Prior research has indicated that failure rates of new products that are similar to existing products are higher than those that are well differentiated (Crawford & Di Benedetto, 2008). Also, various researchers have suggested that the leading brand in a category can use contract packing to reduce unit manufacturing cost and assist a PL product to fulfill the role of a lower quality flanker NB (Wu and Wang, 2005). As manufacturers lose market share to PLs, it is reasonable to suppose that they will increase their rate of new product launches in order to compensate for the loss. In fact new food and beverage product introductions have continued to increase for the last twenty years. This is undoubtedly due to the stage of the U.S. food industry life cycle which is mature and intensely competitive. However, the number of new product introductions seems greatly disproportionate to the market need. For example, the total number of new packaged food products introduced annually has been more than 10,000 for the past ten years (Table 3). A recent report in *Industry Week* stated that consumer packaged goods companies increased new product introductions by 25% over the last three years and a similar increase is forecast for 2008 (*Industry Week*, Feb 28, 2008). The average U.S supermarket carries 30–40,000 stock keeping units (SKUs), while a Wal-Mart Supercenter may stock 100,000, of which around 40,000 are of food products. An SKU can be a different package size of the same brand. Also, many of the products taking up shelf space such as bread, milk, meat, and vegetables are staples that have been in distribution for centuries. According to Marketing Intelligence, Ltd., retail chains are offered around 200 new SKUs each week of which at least 70% are rejected by buying committees. Of those that are accepted, it is often at the store manager's discretion if they will be stocked in his store. On average, as we have said, 16% of the existing stock is private label (Adkawski & Bari, 2004). It is extremely unlikely that a new NB food product being introduced will obtain distribution, let alone become a success. Many of these products may only be seasonal or intended for regional rather than national or international distribution. Nevertheless, the difficulties in new product development faced by national food marketers are apparent and likely to get worse.

Table 3 : New Packaged Food Product Introductions

Year	1989	1990	1991	1992	1993	1994	1995	1996	1997
Total	8420	10641	9866	9770	10320	13451	13397	14596	13840
Top 20 Firms	1549	1713	1718	1566	1562	1562	1935	1377	1430

Source: Marketing Intelligence Service, Ltd., 2000

Most scholars who have studied the dilemma of marketers faced with the prospect of intensifying competition with their retailer and wholesaler customers have advised them to develop value-added products that carry benefits for the target market that cannot be matched by PL. (Harcar et al, 2006; Herstein & Gamliel, 2006; and Kumar & Steenkamp, 2007) They have also suggested that the technology base of NB products should be protected by patent applications or maintenance of trade secrets. (Kumar & Steenkamp, 2007) They have also advocated greater use of advertising to build brand equity and customer loyalty rather than trade promotions which favor a sales or short-term strategy. (Kumar, 2007) Retailers favor promotions because they defray the cost of local advertising and often include allowances that go to their bottom line (Abraham & Lodish, 1990). At the same time research has shown that only 16% of trade promotions actually provide incremental profit to manufacturers (Abraham & Lodish, 1990). All of these suggestions play to the strengths of manufacturers which are in marketing and manufacturing expertise and research and development capability (Lewis, 2006). However, in order to accomplish this they will also have to wean their customers off of their current reliance on trade promotions, which will not be easy (Abraham & Lodish, 1990). If manufacturers follow these strategic recommendations, one would expect the ratio of unique new products to incremental new products to increase.

If, as seems likely, the increased marketing competence of retailers leads them to develop PL line extensions within each category, this will bring them even more directly into competition with NBs (Anonymous, 2007). The large manufacturers, such as P&G, General Mills, and Kraft have recently extended their new product development activities to worldwide external R&D networks including consultants, universities, and contract suppliers (Huston & Sakkab, 2006). Providing they have sufficient resources, the large chains such as Wal-Mart, Safeway, Target and Costco could do the same to compensate for their lack of NPD infrastructure. The British retailers, Tesco and Sainsbury have their own PL premium brands, as have Loblaws in Canada (Anonymous, 2007). In the U.S., Food Lion has launched a food product line differentiated by quality (Daniel, 2007). While this trend may grow in the short term, and despite the fact that Kroger has been able to do so for many years, it is unlikely that retailers would be able to or even want to sustain a heavy NPD program or make the significant investment in plant and equipment required. Some scholars have estimated an optimum ratio of PL as about 50% overall of market share (Kumar & Steenkamp). However, this issue is best looked at on a category basis rather than cross-category as most researchers have done. For example, the PL market share of

commodity type products such as bread, milk, butter and eggs already exceeds 50% (Table 2, Wellman, 2003). It seems likely that there is an inverse relationship between PL market share and product degree of innovativeness (Lewis, 2006). However, if the U.S. market develops in the same way as has European markets, this picture may be changing. For example, Tesco in the U.K., Loblaw in Canada, and Food Lion are already marketing premium PL brands. In fact, Food Lion is using a three tier approach of marketing generic, flanker and premium products

The conventional wisdom in the food industry is that it is difficult to compete as the third or lower market share brand. If market share grows as expected to European or Canadian levels, PL will become at least the third brand in most categories, making it extremely difficult for firms with lower market share to maintain distribution (Harcar et al, 2006; Herrstein & Gamliel, 2006; Ward et al., 2002; Wu & Wang, 2003). Also, consumers like variety in food products but supermarkets are continually pruning their assortment of brands with respect to volume and profit per square foot of shelf space . Consequently it is to be expected that the average number of NBs per store will decline as the marginal market share competitors drop out.

III. Research Questions

1. As PL market share increases, how will this affect the number of NB new product launches?
2. As PL market share increases, how will this affect the success rates of new NB products?
3. As PL market share increases, how will this affect the ratio of radical to incrementally new NB products?
4. As PL market share increases, will retailers introduce less incrementally new and more unique products?
5. As PL market share increases, will this squeeze out tertiary NBs?

IV. Hypotheses

- H1: As PL market share increases, the number of new NB market launches will increase.
H2: As PL market share increases, the ratio of NB unique product market launches will increase
H3: As PL market share increases, the ratio of PL unique new product introductions will increase
H4: As PL market share increases, the success rate of NB new product introductions will increase
H5: As PL market share increases, the number of NB brands will decrease.

V. Methodology

It is proposed to conduct a survey of retailers, private label contract manufacturers and national brand manufacturers in order to determine the current role that PL plays in their NPD strategy and future plans with respect to new product development (NPD)

Data will be collected via a self-administered questionnaire using a random sample collected from regional, national, and large NB manufacturers, PLMA members, and retailers with respect to five high market share and five low market share categories of PL products.

Measures will be developed regarding:

- current and planned role of PL in retailer, contract manufacturers and NB manufacturers strategy, e.g. retailer increase in profit contribution per square foot of shelf space; contract manufacturers into proprietary technology; NB manufacturers to reduce unit manufacturing cost and increase pressure on competition
- current and planned NPD practices of Retailers, Dedicated PL Mfrs, and NB Mfrs.
- current and planned brand strategy of retailers, e.g. me-too in direct competition with NB, or differentiated from them.

It is proposed to carry out analysis of the data in order to determine relationships between variables using Correlation Analysis and Regression Analysis. We will also conduct Factor Analysis in order to determine if there are combinations of variables that influence relationships. Regression analysis will be used to model the relationships between variables.

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