Working paper on the competitive effects of own-label goods

Introduction

1. The nature of competition between branded and own-label goods has been raised with the CC as a potential competition concern. This issue was discussed in the working paper on supply chain practices published with Emerging Thinking, and this paper takes this analysis forward by analysing additional data from public reports, parties' submissions and parties' internal documents.

2. This paper, first, provides a general discussion of the sale of own-label products by grocery retailers in the United Kingdom and then considers the specific concerns that have been raised regarding the competitive impact of grocery retailers' sales of own-label products.

Sales of own-label products by grocery retailers

3. Own-label products have formed an increasingly important part of grocery retailers' consumer offer since the 1960s.[1] In 2006, sales of own-label food and drink products were an estimated £30.0 billion, representing more than one-third of total food and drink sales.[2] The share of own-label sales in the UK is amongst

[1] Own-label products may have been first introduced in the UK as early as 1900, but started to be widely available in the 1960s and 1970s (see O.Consuegra, *Own labels in the United Kingdom: A source of competitive advantage in retail business*, pensamiento & gestion, 21, Universidad del Norte, 114-161, 2006.

[2] Own-label food and drink sales in 2006 were estimated at £30.0 billion in Mintel, *Own-label food and drink intelligence*, (October 2006), while total food and drink sales in 2006 were estimated at £82.6 billion in IGD, 2006. The British Brands Group estimates the share of own-label products in total UK grocery sales (not just food and drink) at 43 per cent.

the highest in Western Europe, which is itself the most developed region in terms of own-label sales as a share of total grocery sales.[3]

4. While elsewhere in Western Europe, Limited Assortment Discounters (LADs) have been a major driving factor behind the growth of own-label products with higher shares of own-label sales than other grocery retailers, in the UK, where LADs are less prominent, growth in own-label sales has been led by the major grocery retailers.

5. Sales of own-label food and drink in the UK as a proportion of total food and drink sales varies by retailer. M&S food and drink sales are almost 100 per cent own-label compared to around 50 per cent for Tesco, Sainsbury's and Waitrose.[4] The LADs in the UK also have a high proportion of own-label sales. Aldi sells own-label products almost exclusively, Lidl predominantly stocks own-label products, but also stocks the leading brands in a number of core categories, while Netto sells many of the major brands across most categories in addition to its own-label products.

6. Convenience stores are likely to have a smaller proportion of own-label sales compared to the major grocery retailers. A number of symbol group convenience store retailers, such as Spar, will, however, offer own-label products.

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[3] See J Steenkamp, I Geyskens, K Gielens and O Koll, *A global study into drivers of private label success*, report commissioned by AIM, the European Brands Association, 2004, for cross-country comparisons and explanations of the prominence of own-label products. In general terms, the authors consider that a country's level of own-label sales can, in large part, be explained by a number of national-cultural characteristics, including the extent of class or status consciousness which will be associated with greater sales of branded products, the economic-institutional environment, where economic performance will be associated with greater sales of own-label products, and the retail environment, where high retail concentration, a presence of international retailers, and the presence of LADs will all be associated with greater sales of own-label products.

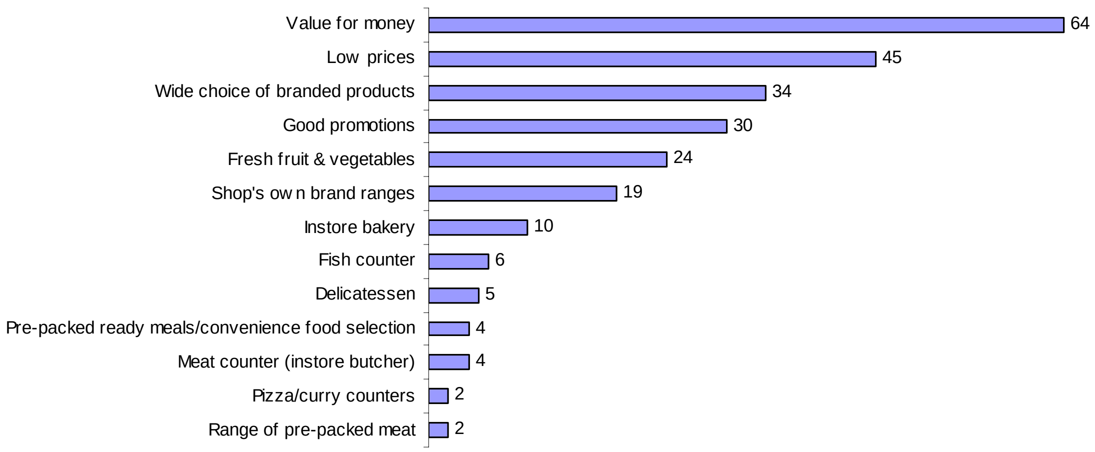
[4] Mintel, *Own-label food and drink intelligence*, October 2006, p37. Sainsbury's says that one of its typical large supermarkets would sell approximately 34,000 products around half of which would be own-label (see http://www.sainsburys.co.uk/shoppingandservices/FAQs/sainsburys_faqs/foodandgroceries.htm#1).

Independent non-affiliated convenience stores sell almost entirely branded products. However, own-label manufacturers can have in-house brands that are used for sales to wholesalers serving independent non-affiliated convenience stores. These tertiary branded products allow these smaller retail outlets to offer customers an alternative to the primary branded product that fulfils many of the same functions as an own-label product.

7. Consumer research indicates the importance that is attached to own-label ranges in the choice of grocery retailer (see Figure 1). Around 40 per cent of shoppers buy value own-label brands, 34 per cent buy standard own-label brands and 20 per cent buy premium own-label brands.[5]

FIGURE 1

Shopper reasons for choice of main supermarket



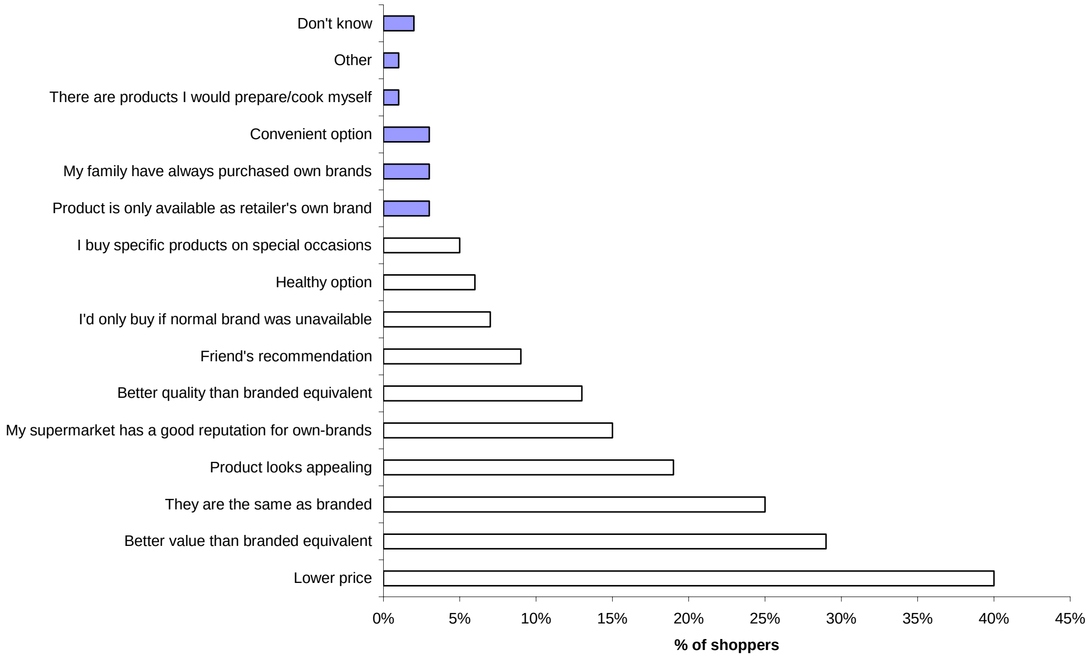
Source: IGD Consumer Research 2003.

[5] IGD, Shopportunities, 2005.

8. Consistent with the number of consumers purchasing value own-label products, 40 per cent of shoppers cite lower price as the primary motivation for purchasing own-label products (see Figure 2).

FIGURE 2

Shopper reasons for purchasing own-label products



Source: IGD Shopportunities, 2005.

9. The penetration of own-label products in the UK varies across product categories. In general terms, own-label products are less prominent in personal care compared to food and beverages and household care. Even within food and drink, there is substantial variation. For example, sales of own-label products are more than 80 per cent of total sales in ready meals, fresh pasta, chilled pizza, canned vegetables and fruit juice. However, sales of own-label

products are less than 20 per cent of total sales in yoghurt, cooking sauces, sweeteners, crisps and snacks, sugar, and still and sparkling bottled water.[6]

10. The extent of own-label penetration in different food categories has also varied over time. For example, between 2001 and 2005 own-label yoghurt declined from 21 per cent to 5 per cent of total sales, and own-label sweet biscuits declined from 33 per cent to 18 per cent of total sales. On the other hand, own-label products in cheese, chilled pasta and pot deserts all increased their share of total sales by more than 10 percentage points between 2001 and 2005.[7]

11. A recent study[8] found that the share of own-label sales within a product category can be explained by a number of factors, including the following:

(a) Higher perceived quality for branded products compared to own-label products will restrict the share of own-label sales.

(b) The more important a product in terms of performance risk (ie the consequences to the consumer of the product failing), the greater the share of branded product sales compared to own-label sales.

(c) Where consumer trust in a branded product is low or where the size of any gap in the level of trust between the branded and own-label product is small, then the share of own-label sales will be higher.

(d) Promotions, innovation and advertising by branded manufacturers are significant barriers to own-label sales.

(e) Own-label sales are stimulated when consumers cannot tell an own-label product from a branded product due to similarity in packaging and when

[6] Mintel, *Own-label food and drink intelligence*, October 2006, p37.
[7] Mintel, *Own-label food and drink intelligence*, October 2006, p37.
[8] See J Steenkamp, I Geyskens, K Gielens and O Koll, *A global study into drivers of private label success*, report commissioned by AIM, the European Brands Association, 2004.

consumers believe that own-label products and produced by the manufacturer of the branded product.

(f) Own-label products have a greater share of sales where consumers consider that making good quality products is not difficult.

12. The same study found a positive association between store loyalty and own-label purchasing. Consumers in the UK were, in general, evenly divided between those exhibiting store loyalty and those exhibiting brand loyalty. This contrasted with France, where consumers had a greater tendency to exhibit store loyalty, and Germany, Italy and Spain, where consumers had a greater tendency to exhibit brand loyalty.

Competition concerns in relation to the sale of own-label products by grocery retailers

13. Concerns regarding the competitive impact of the sale of own-label products by grocery retailers fall into three main areas:

(a) grocery retailers' ability to exploit their position as both customers and competitors of the manufacturers of branded products;

(b) the use of copycat packaging in relation to own-label products; and

(c) the potential for growth in own-label sales to soften competition between grocery retailers.

14. We discuss each of these issues in turn below.

Grocery retailers as competitors and customers of branded manufacturers

15. One of the concerns that has been raised[9] is that control by major grocery retailers over an increasingly significant proportion of the grocery market means that they are vital commercial customers for branded manufacturers. However, at the same time, these grocery retailers also compete with branded manufacturers through their own-label ranges.

16. It has been argued that major grocery retailers, in their capacity as both customers of, and competitors to, branded goods suppliers, enjoy significant advantages through their ability to:

(a) control branded product manufacturers' access to market, consumer pricing, rates of sale (through shelf allocation) and in-store communications and promotions; and

(b) demand access to branded manufacturers' marketing plans and new product plans (typically six months or more before launch), thus allowing own-label products to be developed using this foreknowledge.

17. It has also been argued that these advantages, along with the tendency of own-label goods to free-ride on brand owners' investments, reduce the ability of brand owners to invest, and that the replacement of secondary and tertiary brands with own-label products reduces overall levels of innovation.

18. In assessing these concerns, we have considered a range of evidence including:

- trends in own-label sales in different product categories;

[9] See A Gorrie, *Competition between branded and and private label goods. Do competition concerns arise when a customer is also a competitor?*, European Competition Law Review, Issue 5, 2006.

- research on the drivers of own-label success compared to branded products;
- investment in research and development by food and drink manufacturers; and
- the presence of innovation in own-label grocery products.

19. In the event that the advantages that grocery retailers potentially possess in relation to their use of own-label products in competition with branded products were decisive, we might expect to see a uniform trend towards an increasing share of sales for own-label products compared to branded products. As noted in paragraph 3, the sale of own-label products as a share of total grocery sales has increased substantially since their widespread introduction in the 1960s. However, it is not clear that the own-label products share of grocery sales will continue to increase. While research commissioned in 2004 for AIM, the European Brands Association[10], suggested that own-label products' share of sales may have reached a ceiling in the UK, other research[11] could imply further growth.

20. More specifically, however, as set out in paragraphs 8 and 10, at a product category level there are quite different levels of own-label penetration, and over time, own-label sales as a share of total sales have both increased and decreased in different product categories. This suggests that the advantages that own-label products provide to grocery retailers are not always sufficient to ensure growth in own-label sales at the expense of branded products.

[10] J Steenkamp et al, p.35.
[11] See A Gorrie, *Competition between branded and private label goods. Do competition concerns arise when a customer is also a competitor?*, European Competition Law Review, Issue 5, 2006. This article quotes industry research predicting 25 per cent growth in expenditure on own-label products to £48.7 billion in 2010 although it is not clear whether this prediction includes expenditure on non-grocery products as well as grocery products.

21. It has suggested that while primary brands may be able to withstand the pressure that grocery retailers are able to bring to bear through their use of own-label products, secondary and tertiary brands may be more vulnerable, leading to their replacement by own-label brands. We are interested in reviewing evidence regarding the number of competing brands in different product categories and how this has changed over time.

22. In paragraph 11, we set out a number of factors that research indicates influence the share of own-label sales within a product category. The movement in own-label share of sales in different product categories is consistent with there being a number of different factors driving branded and own-label sales, some of which are capable of being influenced by the branded product manufacturer and some of which are capable of being influenced by the grocery retailer. As such, this research does not give support to the view that the sale of own-label products by grocery retailers provides them with a decisive advantage over branded product manufacturers.

23. As noted above, it has been argued that the presence of own-label products may be depressing incentives for investment and innovation by branded product manufacturers. We have previously published in our working paper on buyer power (published with Emerging Thinking) an assessment of research and development (R&D) expenditure among grocery suppliers based on a range of sources.

- ONS statistics on R&D expenditure in the agriculture and food production industries do not indicate any significant or broad-based decline in R&D expenditure in the period since 1996.

- The survey of suppliers to grocery retailers conducted on behalf of the CC by GfK found that 80 per cent of suppliers had made an investment in some form of product or process development during the past two years. Of these, 43 per cent stated that they currently spent more on such investments that they did five years ago, while 14 per cent stated that they spent less.
- A ratio of R&D expenditure to sales, based on the DTI R&D Scoreboard, for 13 leading food and drink manufacturers has shown a significant upward trend over the period 1998-99 to 2004-05.
- A report from the Confederation of Food and Drink Industries of the EU (CIAA)[12] states that R&D intensity in the UK food sector is above the EU average, and that R&D expenditure has increased from 0.3 per cent to 0.5 per cent of turnover between 1995 and 2002.

24. The BBG has submitted that it considers that the finding of the GfK survey that 14 per cent of suppliers are spending less on R&D than they did five years ago is a matter for concern, and notes that the major reason among these firms for this decline in expenditure is the squeezing of margins and insufficient money to invest (77 per cent), which in turn has caused insufficient returns on investment due to retailers demanding low prices.

25. The BBG also suggests that innovation activity needs to be examined at the product category level, and in particular, through comparing innovation in those product categories where there are a number of branded competitors compared to those product categories where there is only a brand leader and own-label products.

[12] Available at www.ciaa.be/documents/news_events/Data_&_Trends_2005.pdf.

26. A recent report by Mintel[13] describes competition in innovation taking place in several product categories, with market shares shifting between own-label and branded products. In the cheese category, the own-label share of sales fell from 70 per cent in 2002 to 63 per cent in 2004 due to brands such as Cathedral City introducing innovations such as "zip lock bags" and "Dip & Go".

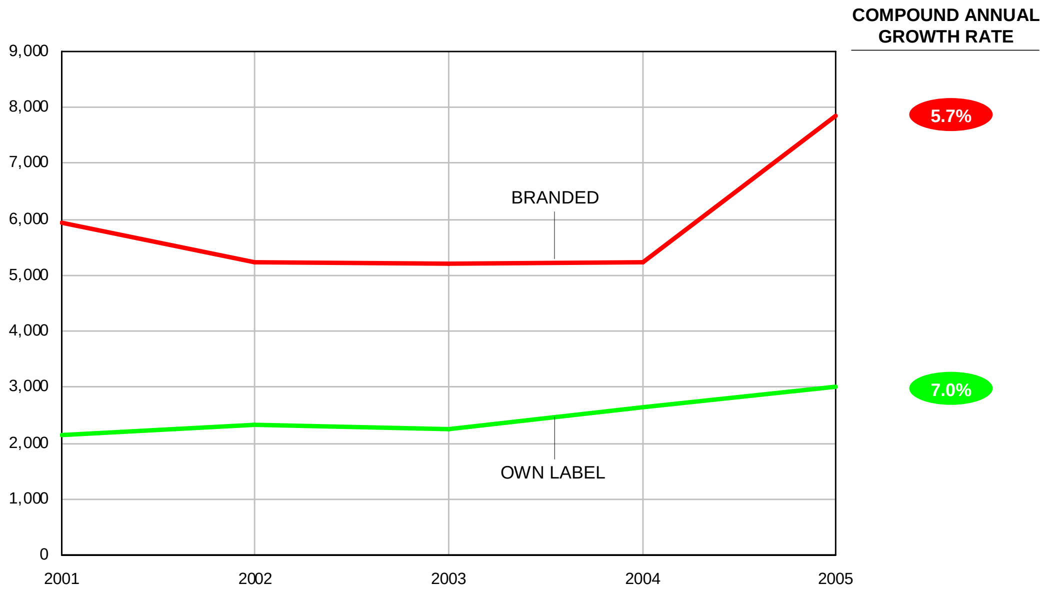
27. In yoghurt, the report suggests that a stronger performance by branded producers such as Danone and Muller led to the share of own-label products falling from 21 per cent to 5 per cent between 2001 and 2005, which in turn stimulated own-label innovation activity by Tesco, leading to the introduction of the "inner goodness" range (including a cholesterol-lowering drink and yoghurt).

28. More generally, in some product categories, according to Mintel, it is the own-label manufacturer which is the innovator (such as in fresh pasta). More general information from the Mintel Global New Product Database (reproduced in Figure 3) indicates that the number of yearly new product launches in the UK has increased for both branded and unbranded goods from 2001 to 2005.

[13] Mintel, *Own-label Food and Drink,* Market Intelligence, October 2006.

FIGURE 3

Number of new grocery product launches annually in the UK



Source: Mintel Global New Product Database

29. However, the Mintel report also points out that in many sectors own-label products still play the role of innovation follower, by introducing an own-label variety of any new branded product which proves successful. The extent to which own-label manufacturers are capable of bringing copycat products to the market faster than competing manufacturers of branded products is not clear. We have not seen any empirical evidence or specific examples in relation to this matter, and remain open to submissions on this point.

30. We would also welcome further submissions more generally that provide evidence regarding the relationship between innovation and competition for own-label and branded products.

Copycat packaging

31. As set out in paragraph 13, copycat packaging[14] of own-label products is another concern that has been raised regarding the competitive impact of own-label products. In particular, the concern is that copycat packaging induces consumers to purchase own-label products in the belief either that these products are the same as the branded version, or that the own-label product is produced by the same company that produces the branded product, or finally, that the own-label product is of similar quality as the branded version. This distorts competition between the retailer and suppliers, but could also distort competition between retailers.[15]

32. The BBG has told us of a number of studies conducted in the 1990s by market research organisations where a significant proportion of consumers in each study (between 6 per cent and 21 per cent) indicated that they have bought an own-label copycat product by mistake in the past. Other research studies conducted in the 1990s and quoted by the BBG show that 35-50 per cent of consumers believed that a copycat product was made by the manufacturer of the rival branded product. The BBG also refers to consumer research conducted by Europanel, which it says shows that similar packaging results in a 55 per cent increase in a own-label share compared to the situation where the own-label product has dissimilar packaging to a rival branded product.

[14] This behaviour consists of selling own-label products with packaging which closely resembles the packaging of a rival branded product. See BBG submission para.24.
[15] See P Dobson, *The Competition Effects of Look-alike Products*, University of Nottingham, 1998.

33. A review in 1999 of more than a dozen different studies of consumer confusion between own-label and branded products concludes that the 'evidence for confusion is therefore inconclusive. While some degree of association appears to be drawn from packaging, evidence of outright confusion and mistaken purchase is less clear'.[16]

34. In terms of the importance of packaging in explaining the success of own-label products compared to branded products, the study on drivers of private label success referred to in paragraph 11 identifies similarity in packaging between branded and own-label products as a key driver of own-label success. However, the study also identified five other primary drivers and seven secondary drivers. The results of this study appear consistent with a view that given the repeat purchases involved with many grocery products, packaging on its own is unlikely to provide a sustained basis for the success of an own-label product when competing with a branded product.

35. We have examined two customer research reports produced for Tesco by independent research companies. The purpose of the first report was to identify customer attitudes and usage of [✂] products to identify what is needed to make a Tesco own-label [✂] product an attractive and successful proposition. We did not see here references to copycat packaging, unfair use of information on new products or marketing plans from competitors. The objective of the second report was to explore customer requirements for the packaging design of Tesco's 'standard' brand. In this document there is a detailed discussion of copycat packaging (eg in relation to children's acceptance of the products) but the issue

[16] S Burt and S Davis, *Follow my leader? Lookalike retailer brands in non-manufacturer-dominated product markets in the UK*, The International Review of Retail, Distribution and Consumer Research, 9:2, April 1999, pp163-185.

is considered a “red herring” in the conclusions of the document which state that “[…] it is more about good, expressive design than copycatting” and that “it’s important that Tesco does differentiate its products from the brand to aid customer decision making”.

36. Finally, we note that the CC when considering whether own-label soft drinks were part of the same economic market as branded soft drinks stated that it did not consider that ‘attempts at similar packaging compensate for […] advertising and branding issues’.[17]

Impact of own-label sales on competition between grocery retailers

37. Finally, as set out in paragraph 13, concerns have been raised regarding the potential for own-label products to reduce consumers’ ability to compare the offer of different retailers and thus soften price competition between retail chains.

38. This concern is based on a view that only branded goods can be readily compared across retailers. It is not, however, clear that this is the case. While the specification of own-label products is likely to vary between retailers, consumers are still likely to be able to make comparisons between the own-label products of different grocery retailers taking into account both price and, following any initial purchases, their experience of the different quality of own-label products offered in a particular category by different grocery retailers.

[17] CC, *Cott Beverages Limited and Macaw (Holdings) Limited*, 28 April 2006, par 4.51.

39. We note that in the CC's assessment of the merger between two manufacturers of own-label carbonated soft drinks (CSDs), one of the parties, Cott Beverages Limited, submitted that the 'price differential [between own-label and branded CSDs] has come about as a result of retailers relentlessly driving down the price of own-label, particularly in the 2-litre CSD category, as part of the process of retail price competition and the entry of hard discounters (for example, Aldi, Lidl and Netto)'. It went on to say that that 'to a large extent the price gap [between own-label and branded CSDs] is a result of intense retailer competition [in own-label CSDs], motivated by the fact this is a KVI'.[18]

40. This assessment of competition between grocery retailers in relation to an own-label product indicates that the introduction of own-label products does not necessarily lead to a softening of competition between grocery retailers in relation to that product.

Potential pro-competitive effects of grocery retailers' sales of own-label products

41. We consider it possible that own-label products may also have a beneficial effect on competition in addition to any negative effects that might be identified. For example, the stratification of own-label products into basics, healthy, kids, organic and premium ranges may have increased consumer choice and competition.

42. The four largest grocery retailers told us[19] that the provision of own-label products was a response to consumer demand. We were told that they would

[18] CC, *Cott Beverages Limited and Macaw (Holdings) Limited*, 28 April 2006, par 4.48.
[19] Responses to question 62 of the Main Party Questionnaire.

attempt to source own-label product lines for a variety of reasons, the most common answers being where they found a lack of:

(a) choice within a product category;

(b) price competition between brands; or

(c) innovation in the category.

43. Each of the four largest grocery retailers sets its basic own-label prices as the lowest on display. Tesco told us that that own-label products provide an important route to market that helps smaller suppliers to access customers at a lower risk and reduced cost than that associated with developing a branded supply.[20]

44. In its response to Emerging Thinking, Tesco stated that own-label products, in addition to challenging the market power of branded goods manufacturers and reducing price for the benefit of consumers also provide an important route to the market for smaller suppliers thereby increasing consumer choice. Furthermore, in relation to the issue of copycat packaging, Tesco states that these issues are addressed by the existing legislation on trademarks and copyright.

[20] Tesco's response to the Main Party Questionnaire.