

## Retailer own-label goods

1. This appendix reviews the numerous specific concerns that have been raised during this investigation on the competitive impact of grocery retailers' sales of own-label products.
2. We begin by explaining the context of own-label products in the UK and note that there are a number of factors that contribute to own-label sales success. We review the important competitive concerns that have been raised by the BBG with reference to own-label products—in particular, copycat packaging, the impact on competition between retailers and the role of grocery retailers and buyer power. We then develop our views on the concerns that have been raised from a number of market features that we observe and consider are relevant to the issue of own-label products. Finally, we note some observations of potential pro-competitive aspects of own-label products.

### The importance of own-label goods to consumers and retailers

3. In 2006, sales of own-label food and drink products in the UK were an estimated £30.0 billion, representing more than one-third of total food and drink sales.<sup>1</sup> This is the highest proportion of own-label sales in Western Europe, which as a global region experiences the highest proportion of own-label sales out of total grocery sales.<sup>2</sup> The UK also differs from the rest of Europe in that growth in own-label sales

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<sup>1</sup>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 BBG, Asda, and the Boston Consulting Group, *The Relentless Advance of Private Label: Strategies to compete* estimate the share of own-label products to be around 40 per cent of total UK grocery sales (the IGD estimates non-tobacco grocery sales to be £101.7 billion in 2006).

<sup>2</sup>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.

has been led by the major grocery retailers, not the LADs which tend to have a higher proportion of own-label sales than other grocery retailers.

4. Sales of own-label food and drink, as a proportion of total food and drink sales in the UK, vary by retailer. M&S food and drink sales are 100 per cent own-label compared with around 50 per cent for Tesco, Sainsbury's and Waitrose.<sup>3</sup> As already noted, 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. Netto sells around 300 major brands across most categories in addition to its own-label products.
  
5. Convenience stores are generally likely to have a smaller proportion of own-label sales compared with the major grocery retailers, and independent convenience stores sell almost entirely branded products. However, a number of symbol group convenience store retailers, such as Spar, will offer own-label products and own-label manufacturers can sell in-house brands to wholesalers serving independent convenience stores. These tertiary branded products allow smaller retail outlets to offer customers an alternative to the primary branded product which fulfil many of the same functions as an own-label product, from a consumer's perspective.<sup>4</sup>
  
6. Consumer research indicates that around 20 per cent of shoppers choose their grocery retailer on the basis of own-label ranges.<sup>5</sup> Around 40 per cent of shoppers buy value own-label brands, 34 per cent buy standard own-label brands and 20 per

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<sup>3</sup>Mintel, *Own-label food and drink intelligence*, October 2006. Sainsbury's said that one of its typical large supermarkets would sell approximately 34,000 products, around half of which would be own-label (see: [www.sainsburys.co.uk/shoppingandservices/FAQs/sainsburys\\_faqs/foodandgroceries.htm#1](http://www.sainsburys.co.uk/shoppingandservices/FAQs/sainsburys_faqs/foodandgroceries.htm#1)).

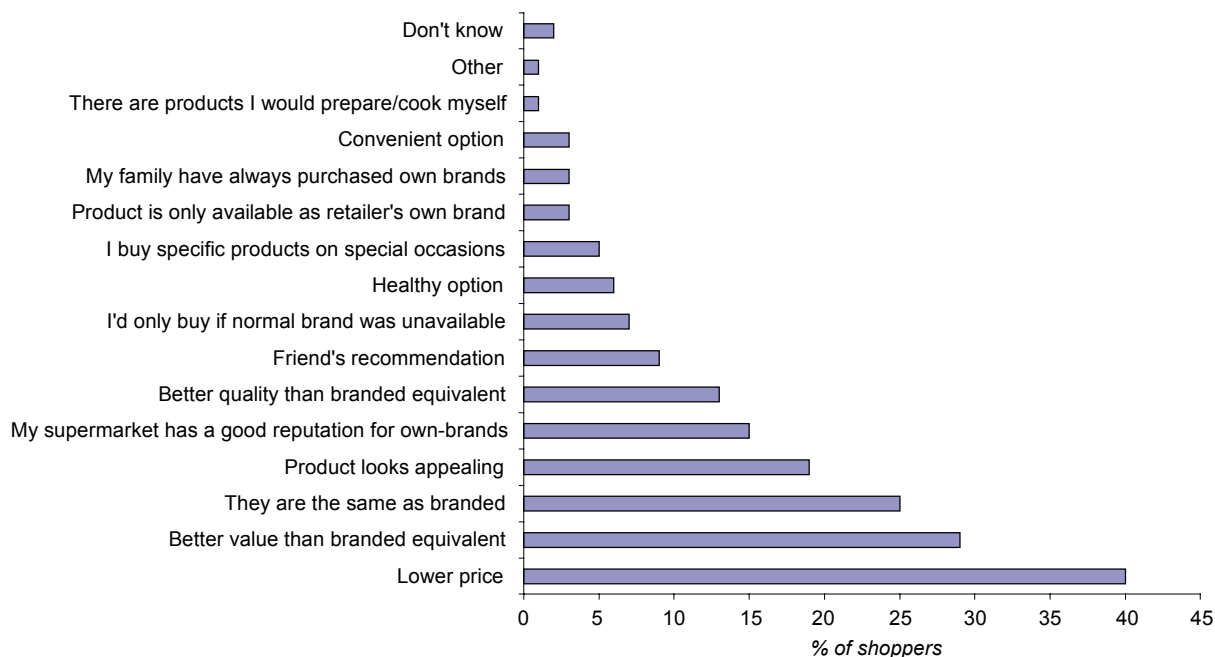
<sup>4</sup>The BBG has noted that a distinction can be drawn between an own-label product sold by a retailer and a tertiary product sold by an independent convenience store. A tertiary product needs to compete for shelf-space and consumer demand with the same information available to other branded manufacturers. Arguably, own-label products have the benefit of the retailer's intimate knowledge of other branded products to assist in launching own-label products. However, this distinction is less relevant in the current context of product alternatives from a consumer perspective.

<sup>5</sup>IGD, *Shoppportunities*, 2005. Asda also told us that its customers had strong preferences for either own-label or branded products and it would lose customers if it did not meet the preferences of its customers.

cent buy premium own-label brands.<sup>6</sup> 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 1). However, it should be noted that some own-label brands can be more expensive than branded competitors in the same product category.

FIGURE 1

**Shopper reasons for purchasing own-label products**



Source: IGD, *Shoppportunities*, 2005.

- 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 with 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

<sup>6</sup>IGD, *Shoppportunities*, 2005.

sales in yogurt, cooking sauces, sweeteners, crisps and snacks, sugar, and still and sparkling bottled water.<sup>7</sup>

8. The extent of own-label penetration in different food categories has also varied over time. For example, between 2001 and 2005 own-label yogurt declined from 21 to 5 per cent of total sales, and own-label sweet biscuits declined from 33 to 18 per cent of total sales. Conversely, own-label products in cheese, chilled pasta and pot desserts all increased their share of total sales by more than ten percentage points between 2001 and 2005.<sup>8</sup>
  
9. The share of own-label sales within a product category can be explained by a number of factors, including the following:<sup>9</sup>
  - (a) Higher perceived quality for branded products compared with 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 with own-label sales.
  - (c) Where consumer trust in a branded product is low, or where the difference in trust attributed to 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 consumers

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<sup>7</sup>Mintel, *Own-label food and drink intelligence*, October 2006.

<sup>8</sup>Mintel, *Own-label food and drink intelligence*, October 2006. Out of the 36 product categories that were reviewed by Mintel, own-label sales had decreased for 19 categories, increased for 15 categories and remained stable for 2 categories.

<sup>9</sup>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.

believe that own-label products are produced by the manufacturer of the branded product.<sup>10</sup>

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

### **Competition concerns in the sale of own-label products by grocery retailers**

10. Concerns regarding the competitive impact of the sale of own-label products by grocery retailers fall into three main areas: copycat packaging, the impact on competition between grocery retailers, and grocery retailers as customers and competitors of brand manufacturers. We discuss each of these issues, in turn, in paragraphs 11 to 32.

#### ***Copycat packaging***

11. Copycat packaging of own-label products is a concern that has been raised on the competitive impact of own-label products.<sup>11</sup> In particular, copycat packaging might induce consumers to purchase own-label products under a mistaken belief or transpose the reputation of a branded product to the own-label good. Similar packaging can lead consumers to think that the own-label product is the same as the branded version, or that it is produced by the same company, or that it is of similar quality. This practice could distort competition between the retailer and suppliers or between retailers.<sup>12</sup>
12. Further, the BBG states that these factors lead to reduced profits for manufacturers and ultimately fewer innovations. Profit is affected by copycat packaging as own-label obtains a consequential larger market share, legal costs are incurred to pursue the

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<sup>10</sup>The BBG also refers to consumer research conducted by Europanel, which it said showed that similar packaging resulted in a 55 per cent increase in an own-label share compared with the situation where the own-label product had dissimilar packaging to a rival branded product.

<sup>11</sup>This behaviour consists of selling own-label products with packaging which closely resembles the packaging of a rival branded product.

<sup>12</sup>P Dobson, *The Competition Effects of Look-alike Products*, University of Nottingham, 1998.

infringement, a dilution of its distinctive brand occurs and other costs are incurred to rectify consumer confusion.

13. Research shows that up to 25 per cent of consumers consider own-label products to be the same as branded products.<sup>13</sup> The BBG also told us of a number of studies conducted in the 1990s that show that 6 to 21 per cent of consumers have bought an own-label copycat product by mistake and 35 to 50 per cent of consumers believed that a copycat product was made by the manufacturer of the rival branded product.
14. However, 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'.<sup>14</sup>
15. 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 a range of products to identify what is needed to make a Tesco own-label product an attractive and successful proposition. We did not see any 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 is considered a 'red herring' in the conclusions of the document which state that '... it is more about good,

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<sup>13</sup>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.

<sup>14</sup>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. The BBG suggests that confusion is allowed and directly encouraged by retailers through in-store displays and buyer power.

expressive design than copycatting’ and that ‘it’s important that Tesco does differentiate its products from the brand to aid customer decision making’.

16. In relation to the issue of copycat packaging, Tesco states that existing legislation on trademarks and copyright adequately addresses retailer behaviour in this area. However, the BBG submits that it would not be commercially practical for a manufacturer to sue a retailer that is a major customer. There was also concern expressed that copyright and trademark legislation is insufficient to address copycat packaging issues. This is a well-developed area of consumer protection law and we note that we have not considered the issue of copycat packaging outside the context of competition law.
17. 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’.<sup>15</sup>
18. Asda has suggested that the introduction of shelf-ready packaging and retail-ready packaging is providing suppliers with greater opportunities to distinguish their products from others.
19. In paragraph 9 we note the importance of packaging and its similarity to branded products is stated to be a key driver of own-label success. However, that study also identified five other primary drivers and seven secondary drivers. These results suggest 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. Therefore, any negative effect on competition is unlikely to be a result of copycat packaging.

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<sup>15</sup>CC, *Cott Beverages Limited and Macaw (Holdings) Limited*, 28 April 2006, paragraph 4.51. We note that the BBG considers that this decision is of limited value in the general context of copycat packaging.

### ***Impact of own-label sales on competition between grocery retailers***

20. Concerns have also been raised regarding the potential for own-label products to reduce consumers' ability to compare the offer of different retailers and thus price competition is softened between retail chains.
21. This concern is based on a view that only branded goods can be readily compared across retailers. However, there is some evidence to suggest that own-label goods can be compared between retailers.<sup>16</sup>
22. Loyalty for an own-label product indicates a deliberate selection of the product over an alternative branded or own-label product. A positive association has been found to exist between store loyalty and own-label purchasing.<sup>17</sup> Consumers in the UK are said to be 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.
23. We note that in the CC's assessment of the merger between two manufacturers of own-label carbonated soft drinks it was submitted that price competition in the category was being driven by own-label products. Specifically, intense retailer competition existed between own-label products because it was a known value item that would bring customers into a store.<sup>18</sup>
24. We note that Asda told us that it devoted considerable resources to ensure that its own-label products were competitive with those of other similar grocery retailers.

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<sup>16</sup>The BBG has submitted that because products are technically different, in most instances, the consumer is being misled into believing that the products are comparable.

<sup>17</sup>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.

<sup>18</sup>The BBG considered that this reference was of limited value in the context of own-label sales between grocery retailers.

25. Morrisons viewed the grocery market as increasingly concentrated by primary and own-label brands, at the expense of secondary and tertiary brands and for the benefit of consumer choice. Morrisons considered that own label has provided better competition for the brands, than tertiary brands, because they are generally better marketed, better packaged and challenge the ability of the brands to dictate prices. Secondary brands tend not to have the marketing support of the brand leaders and find it difficult to compete against own-label products. Own-label products acquire the well-known reputation of the retailer, which promotes sales over less well-known secondary and tertiary brand reputations. However, where tertiary brands gain popularity, they can become known brands to customers who will then expect them to be stocked. In this context, the tenure of the secondary and tertiary brands is a function of a competitive marketplace.
  
26. Tesco told us that the own-label format allowed it to challenge the market power of branded goods manufacturers and reduce category prices for the benefit of consumers.
  
27. 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. While the specification of own-label products is likely to vary between retailers, consumers are still able to make comparisons between the own-label products of different grocery retailers. Consumers are able to take into account price and, following their initial purchase, their experience of the different quality of own-label products offered in a particular category by different grocery retailers.

## ***Grocery retailers as customers and competitors***

28. It has been suggested that major grocery retailers control an increasingly significant proportion of the grocery market and shelf display space. This means that the retailers are vital commercial customers for branded manufacturers. However, at the same time these grocery retailers compete with branded manufacturers through their own-label ranges. The BBG has suggested that major grocery retailers also hold a third role as supplier of shelf space to branded manufacturers. In this sense, it has been argued that major grocery retailers are customers of and competitors to branded goods suppliers.
29. In these roles the retailers are considered to enjoy significant competitive advantages through their ability to control branded product manufacturers' access to the grocery market, consumer pricing, rates of sale (through shelf position and size) and in-store communications and promotions. However, Asda told us that retailers do not enjoy significant advantages over branded suppliers through control of route to market, as a retailer's ability to leverage its position in this sense is severely curtailed by its need to respond to customer demand.
30. The BBG told us that as a customer of the supplier, a retailer could demand access to branded manufacturers' marketing plans and new product plans (six months or more before launch).<sup>19</sup>
31. The BBG also stated that buyer power was derived in part from the own-label sales of the retailer and increased by having the ability to replace a branded product on its shelves with its competing own-label equivalent. The ability to control all the in-store marketing mechanisms also added to the retailers' buyer power. We were told by the

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<sup>19</sup>This advantage is considered by the BBG to allow own-label products to be strategically promoted at the time of the new product launch, developed faster than they would otherwise, improved to match or mimic the performance of the new branded product, stocked on shelves to capitalize on the promotions for the branded product launch; given shelf space over branded products.

BBG that this would affect the ability of branded manufacturers to compete. The impact of these practices was noted by the BBG in previous European Commission merger decisions where it was suggested that increasing buyer power through own-label products may 'spiral'. That is, as retailers gain greater power they can demand further concessions and increase their power. In turn, the power of the retailer is expected to lead to a higher concentration of own-label goods.

32. It has been argued by the BBG that the multiple role of the retailer, along with the general tendency of own-label goods to benefit from brand owners' investments, reduce the ability of brand owners to realize a full return on their investment into innovation. This reduced return leads to lower levels of future investment into new products. Further, it is suggested that the replacement of secondary and tertiary brands with own-label products reduces overall levels of innovation (as the profits that would have been going to the branded manufacturer are instead being captured by the retailers' own-label goods).

### **Relevant market features**

33. To assist with identifying the prevalence of the range of concerns above, we have looked for market features that might express the outcomes of the concerns that have been raised. Specifically we have looked for trends that might show own-label products to be performing at the expense of branded products and reduced innovation from branded product companies that might reflect falling investment in R&D.

### ***Trends in own-label sales***

34. If grocery retailers possess a decisive advantage in competing with branded manufacturers, we might expect to see a trend towards an increasing share of sales

for own-label products. The sale of own-label products as a share of total grocery sales has increased substantially since their widespread introduction in the 1960s.

35. As set out in paragraphs 6 and 7, at a product category level, there are quite different levels of own-label penetration within different categories. In addition, the research undertaken by Mintel shows that over time own-label sales as a share of total sales have increased and decreased in different product categories. If growth was consistent across the range of different product categories, it might suggest that retailers have some means to be able to manipulate competition. However, it seems that any advantages that grocery retailers have in selling their own-label products are not sufficient to ensure growth at the expense of branded products. We also note that it may be in a retailer's best interest to promote growth of a branded label at the expense of its own label. In some instances the performance of a category of product may benefit from increased sales of branded product.
36. It has been suggested that while primary brand manufacturers may be able to withstand a retailer advantage in selling its own-label products, secondary and tertiary brands may be more vulnerable. Specifically, secondary and tertiary brands are more likely to be replaced by own-label brands. As noted above, own-label shares of categories have increased and decreased over time. On this basis it seems that this suggestion is not proven by the research at this time.
37. In contrast, Tesco told us that own-label products provided an important route to market that helped smaller suppliers to access customers at a lower risk and reduced cost than that associated with developing its own branded supply. Tesco considered that the development of smaller suppliers ultimately led to greater consumer choice.

38. The BBG told us that buyer power was derived from own-label sales and retailer control over the provision of shelf space, and this gave a retailer a decisive competitive advantage. However, the movement of own-label shares of categories suggest that buyer power, should it currently be exercised, is not leading to a higher concentration of own-label goods within categories. Instead, the research states that there are a number of factors that influence the market share of own-label products. We consider buyer power in more detail in the context of the grocery supply chain in Section 8 of the main report.
39. In paragraph 9, we set out a number of factors that research indicates influence the share of own-label sales within a product category.<sup>20</sup> The movement in the share of sales by own-label products in different product categories is consistent with there being a number of different factors driving branded and own-label sales. Some of these factors are capable of being exclusively influenced by the branded product manufacturer and some are capable of being influenced by the grocery retailer. This research supports the view that the sale of own-label products by grocery retailers does not provide them with a decisive advantage over branded product manufacturers. A decisive advantage is more likely to occur where a retailer exercises control over the factors to the extent that a branded manufacturer holds little influence over the performance of their products.

### ***Innovation in own-label products***

40. According to Mintel, it is the own-label manufacturer that is the innovator in some product categories (such as fresh pasta and ethnic takeaway food).<sup>21</sup> More general information from the Mintel Global New Product Database (see Figure 2) indicates

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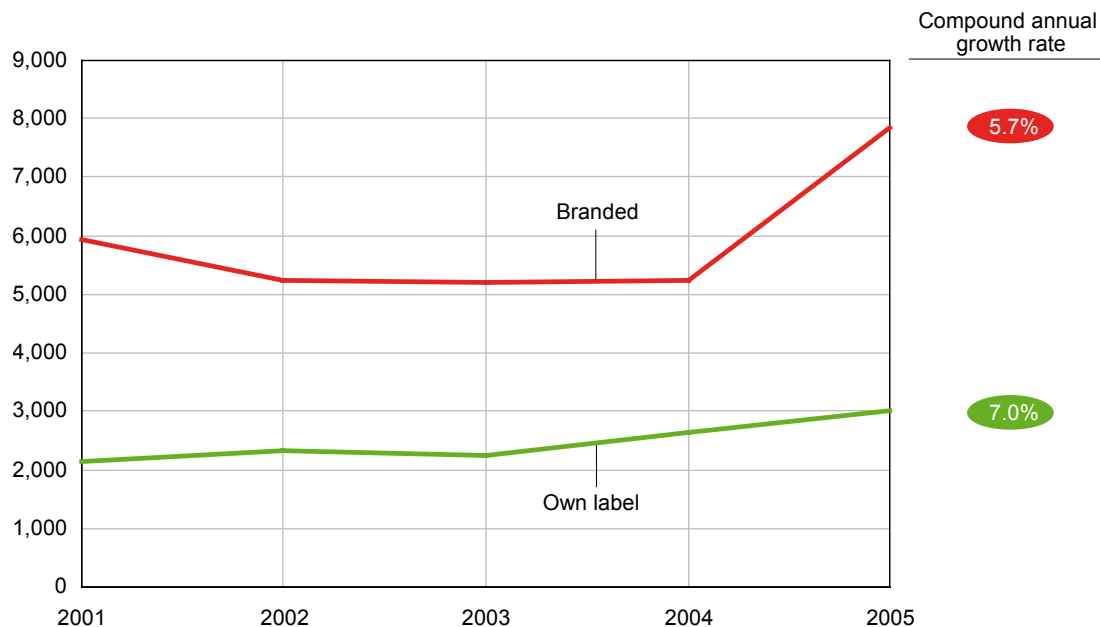
<sup>20</sup>The BBG considered that these factors are outweighed by the power that retailers retain over in-store marketing and access to private information.

<sup>21</sup>Asda also suggested that own-label products were the innovation leader in chilled food and prepared produce generally.

that the number of yearly new product launches in the UK has increased for both branded and unbranded goods from 2001 to 2005.

FIGURE 2

**Number of new grocery product launches annually in the UK**



Source: Mintel Global New Product Database.

41. Asda noted that in circumstances where branded supplier viability is not under threat, additional competition from own label might be expected to drive higher levels of innovation. However, the Mintel report points out that in many sectors own-label products still play the role of innovation follower. In particular, own-label products will generally introduce an own-label variety for any new branded product that proves successful.
  
42. We are aware that some suppliers are becoming more careful about releasing commercially-sensitive information about new products to retailers. It seems that these suppliers have identified an advantage in limiting the sensitive information that is provided to retailers, and is consistent with what we expect would be normal commercial practice surrounding the R&D of new products. We note that we have not attempted to ascertain if additional R&D would be undertaken in own-label products if

the existing information flows between manufacturers and retailers were different. However, in the wider context of supply chain practices (discussed in Appendix 8.10), we consider that current levels of innovation or investment are unlikely to be maintained where the practices that we observe continue to be carried out to the extent that is currently the case.

43. As noted in paragraph 31, it has been argued that the presence of own-label products may reduce investment into innovation by branded product manufacturers. We have previously published, in our working paper on buyer power, an assessment of 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 than they did five years ago, while 14 per cent stated that they spent less.<sup>22</sup>
- 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)<sup>23</sup> 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 to 0.5 per cent of turnover between 1995 and 2002.

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<sup>22</sup>The BBG considered 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 was a matter for concern. It also noted that the major reason for this decline in expenditure among those firms surveyed was the squeezing of margins and insufficient money to invest (77 per cent). The decline in expenditure had in turn caused insufficient returns on investment due to retailers demanding low prices.

<sup>23</sup>Available at [www.ciaa.be/documents/news\\_events/Data\\_&\\_Trends\\_2005.pdf](http://www.ciaa.be/documents/news_events/Data_&_Trends_2005.pdf).

44. The indicators that we have reviewed show levels of expenditure on R&D consistent with what we would expect to see. However, the BBG was strongly of the view that innovation activity needed to be examined at the product category level, not aggregate industry level. In particular, innovation levels should be evaluated where there are a number of branded competitors in contrast to product categories with a single brand leader and own-label product.
45. A recent report by Mintel says that competition and innovation is taking place in several product categories, and market shares are continually shifting between own-label and branded products.<sup>24</sup> For example, 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'. In the yogurt category, the report suggests that a stronger performance by branded producers such as Danone and Müller led to the share of own-label products falling from 21 to 5 per cent between 2001 and 2005. This low level of own-label share stimulated own-label innovation activity by Tesco, and led to the introduction of the 'inner goodness' range (including a cholesterol-lowering drink and yogurt).

### **Potentially beneficial effects of own-label products**

46. We consider it possible that own-label products may have a beneficial effect on competition, in addition to the negative effects that have been identified in this appendix. For example, the stratification of own-label products may have increased consumer choice and competition by developing category ranges of basics, healthy, kids, organic and premium.
47. The Boston Consulting Group reports that the growth of private label has served as a catalyst for companies to re-evaluate how they can create and sustain competitive

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<sup>24</sup>Mintel, *Own-label Food and Drink*, Market Intelligence, October 2006.

advantage over own-label and other brands. It is also noted that there are many marketing strategies that allow branded manufacturers to compete with own-label products.<sup>25</sup>

48. The four largest grocery retailers told us that the provision of own-label products was in response to consumer demand. We were told that they would attempt to source own-label product lines for a variety of reasons, the most common answers being where they found a lack of choice, price competition, or innovation within a product category. In regard to price, each of the four largest grocery retailers sets its basic own-label price as the lowest on display.

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<sup>25</sup>Boston Consulting Group, *The Relentless Advance of Private Label: Strategies to Compete*, April 2007.