

THE MARKET POWER OF PRIVATE LABELS – RETAILER’S BRAND AND INDUSTRY EFFECT

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ABSTRACT

In the rapidly changing international business environment of today, a company’s brand can be the key feature for a retailer to distinguish itself from other competitors and to compete with manufacturers. In fact, the dynamics of competition between these players and private labels (PL) brand power can be an important element. The main purpose of this research is to measure and explain the PL’s market power across different retailers and categories through the use of the price’s differential between national brands (NB) and PLs, using a proxy for an Lerner’s index (L) of each category. Assuming a Cournot behavior of oligopoly competitors, $L=H/\varepsilon$ (H = Herfindahl concentration index and ε = elasticity of demand), the retailer market power depends simultaneously of supply characteristics (concentration) and demand characteristics (elasticity). The logic beyond this approach is that the higher the consumer’s satisfaction and brand awareness of a product related to a brand, the higher the consumer’s willingness to pay. As the willingness to pay to a PL product increases, the differential between NBs product and PLs decreases, implying a higher PL market power.

We adapt the model developed by Suits (1984) and Kennedy (1985). Our predictions are that the market power of a PL’s product will be influenced by the retailer’s image as also the customers’ perception regarding the product category’s characteristics (e.g., number and concentration of manufacturers). In order to have a more detailed analysis, we separated the effect that “retailers” and “product-categories” have on product’s price differential, obtaining “pure” retailer and “pure” category’s price’s margins, after removing product-category’s effect on retailer’s market power and retailer’s effect on category’s market power. To decompose individual product price’s differential into retailers and categories, we run cross-sectional regressions of individual price’s differential on retailers and category dummies for each product, obtaining this way the estimated retailer and category effects.

The study – with primary and secondary information for 40 product’s categories, during 5 quarters (from 2009 to 2010’s first trimester), from 5 biggest grocery retailers operating in Portugal that represent about 85% of total market share, revealed that private labels’ market power differ significantly across product categories but not across retailers. These results seem to suggest that PLs are seen by consumers as the being similar across different retailers. Customers do not differentiate them, at least in what regards to their willingness to pay for the same PL product from different retailers (assuming that market prices reflect the consumer’s willingness to pay for a product). This might be related with a high retailer’s competitiveness in the market and ineffective differentiation strategies. In addition, the PLs market power differs significantly across products’ categories, meaning that products’ characteristics are a determinant factor on PLs success. Previous research has suggested that consumer’s perception of quality influences greatly the market power of a brand. This is why categories that are historically characterized by little product innovation and where the level of processing is low and technology cheap are more likely to have a higher PL’s market power, since NBs cannot differentiate their product’s quality from PLs. However, in categories where consumers typically demand high levels of quality, one of the strategies retailers might be taking in order to increase the PLs market power is to set a price close to the NB. An interesting additional finding is that although the PL’s market power across product’s categories on the global has been quite constant, for individual categories it has been very volatile. This is an important and relevant result, particularly for competition authorities since it shows that NBs are not struggling with an increase in PLs market power throughout time. These results also suggest that categories’ PLs market power may not yet be sustainable over time; creating a challenge for retailers’ own-brand management.

References available upon request