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## 12 Pricing of national brands versus store brands: market power components, findings and research opportunities

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### **Abstract**

Among the most important activities for supermarket retailers is the creation and marketing of store brands, also known as private label brands. Given the increasing quality-equivalence between national brands and store brands, they have become direct competitors, and pricing decisions should take this into account. In most cases, national brands still possess some degree of pricing and market power over store brands. In this chapter, we define three components of market power for national brands versus store brands: (1) price premium; (2) volume premium; and (3) margin premium. Our chapter proceeds along the following lines. First, we delineate the factors that are the most important drivers of the three components of premium. Second, we discuss managerial implications about key success factors in the pricing of national brands and store brands. A key contribution of this chapter is that we incorporate emerging insights from the marketing literature on the pricing and market power of national brands versus store brands. Finally, we conclude by offering important future research directions.

### **1. Introduction**

#### *1.1 Importance of store brands*

One of the most important activities for supermarket retailers is the creation and marketing of store brands, also known as own labels, distributor-owned brands or private labels. Although store brands have been around for about a century, despite some exceptions (such as Marks & Spencer's St Michael brand), store brands were seen as poor cousins to the manufacturer brands, with a small market share that was considered unlikely to become significant. Recently, store brands have enjoyed tremendous success at the expense of national brands. For example, in an analysis of over 225 categories during the period 1987 to 1994, Hoch and Lodish (2001) found that the average annual share of sales for store brands increased by 1.12 percent, while the average shares of the top three national brands in each category fell by 0.20 percent. According to the Private Label Manufacturers' Association (PLMA), store brands now account for one in every five items sold in US supermarkets and represent nearly a \$50 billion segment of the retailing business (Hansen et al., 2006). This trend has also occurred in international markets. A striking example is Germany, Europe's largest and the world's third-largest economy. Over the last three decades, store brand share tripled from 12 percent to 34 percent. Worldwide, the six largest retailers obtain between 24 percent and 50 percent of their revenue from store brands, while the tenth-largest retailer, Aldi, stocks its stores almost exclusively with store brands (Kumar and Steenkamp, 2007, p. 3).

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No longer are store brands only for recessionary times, to be discarded once the economy has picked up again (Lamey et al., 2007). Although traditionally store brands were perceived to be low-quality brands and inexpensive versions of generics, they have made great strides in quality in recent years (Quelch and Harding, 1996; Dunne and Narasimhan, 1999). Increasingly, retailers are differentiating themselves and building customer loyalty by offering quality products that are unavailable elsewhere, for example through multi-tiered offerings such as premium versus value store brands (Zimmerman et al., 2007). For instance, *Consumer Reports* magazine ranked Winn-Dixie's chocolate ice cream ahead of Breyers, Wal-Mart's Sam's Choice better than Tide detergent, and Kroger's potato chips tastier than Ruffles and Pringles. At the 2005 annual Christmas wine Oscars in the UK, Tesco Premier Cru, at less than £15 a bottle, was named the best non-vintage champagne. It beat in blind taste tests famous names such as Taittinger and Lanson that can cost twice as much. A German study across 50 consumer product categories (reported in Kapferer, 2003) found that in over half of these categories, the hard discounter store brands (e.g. Aldi, Lidl) rivaled or exceeded the quality of manufacturer brands. A US study (Apelbaum et al., 2003) reports that the average quality of store brands exceeds the average quality of national brands in 22 out of 78 categories. In sum, store brands are becoming largely quality-equivalent to national brands (Soberman and Parker, 2006), although national brand manufacturers have been slow to face up to this new market reality in their planning and marketing decisions (Kumar and Steenkamp, 2007).

From a strategic pricing perspective, three sets of players are affected by store brands and interact to create their net impact: (i) the retailers, (ii) the manufacturers, and (iii) the consumers. For the retailers, store brands typically provide greater (percentage) margins (Hoch and Banerji, 1993; Sayman et al., 2002; Narasimhan and Wilcox, 1998; Pauwels and Srinivasan, 2004). Since store brands by definition can be exclusively sold by the retailer that carries them, many retailers attempt to use this exclusivity to differentiate themselves from the competition (Ailawadi et al., 2008; Walters and Rinne, 1986). Moreover, store brands change the retailer–national brand manufacturer interaction from one of cooperation to one of competition for consumer dollars (Chintagunta et al., 2002). Retailer performance is linked to all the brands in the category (Raju, 1992; Sayman et al., 2002), and, as such, this changing competitive environment may induce reconsideration of how store brands and national brands should be priced. Indeed, categories with larger store brand share tend to get more retailer pricing attention with more extensive use of demand-based pricing rather than past-price dependence and higher-category profits (Nijs et al., 2007; Srinivasan et al., 2008).

For the national brand manufacturers, the growing competitive element in the manufacturer–retailer relationship may change the strategic interaction between the two parties (Mills, 1995; Steiner, 2004). For example, national brand manufacturers may increasingly respond to store brands with changes in regular prices (Hauser and Shugan, 1983) and with changes in price promotions (Lal, 1990; Quelch and Harding, 1996). The advent of 'premium' store brands adds quality competition to the picture and brings the fight from lower-tier national brand to premium-tier national brands (Kumar and Steenkamp, 2007; Pauwels and Srinivasan, 2004). Therefore national brands increasingly find themselves in a battle for market share with their own customers: retailers.

The responses of consumers define the demand side. Store brands often make it more affordable to buy into the category, and thus may increase primary demand, creating

room for win–win scenarios among entrant and incumbent brands (Hauser and Shugan, 1983). Alternatively, the introduction of store brands may result in brand switching, drawing buyers away from the existing brands (Dekimpe et al., 1997; Srinivasan et al., 2000). Moreover, long-term price sensitivity may change due to the different competitive market structure over time.

Given the increasing quality-equivalence between national brands and store brands, they have become direct competitors, and their pricing decisions should take this into account. In most cases, national brands still possess some degree of market power over store brands. In this chapter, we identify the components of such power: (1) price premium, (2) volume premium, and (3) margin premium. We discuss the main drivers of these components and their implications for retailers and national brand manufacturers. To this end, we draw upon the extant literature in marketing and economics on national brands versus store brands.

## **2. Framework for pricing national brands versus store brands**

In industrial economics, a brand is said to have market power when it is able to charge prices exceeding marginal costs (Besanko and Braeutigam, 2005). In a perfectly competitive market, price equals marginal costs, and brands have no market power. However, producers of differentiated products (and monopolists) will, in general, be able to charge prices that exceed marginal costs, and, hence, have market power. In the context of the packaged goods industry, the relative market power of retailers versus manufacturers determines how total channel profit is split between the two (e.g. Kadiyali et al., 2000).

Market power of national brands can arise from a variety of sources. Two natural dimensions are the ability to outprice and outsell the store brand, and can be measured as the price and volume premium, respectively (Ailawadi and Harlam, 2004).

### *2.1 Price premium*

We define the price premium<sup>1</sup> as the difference in price between a specific national brand and a corresponding specific store brand offered by the retailer:

$$\text{Price premium}_{NB} = \text{Price}_{NB} - \text{Price}_{SB} \quad (12.1)$$

### *2.2 Volume premium*

We define the volume premium as the difference in the volume between a specific national brand<sup>2</sup> and a corresponding specific store brand offered by the retailer:

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<sup>1</sup> This metric is based on the price premium charged in the market and is not the same as the price premium metric commonly used in the literature. The latter is defined as the maximum price consumers will pay for a national brand relative to a store brand expressed as the proportionate price differential that consumers report that they are willing to pay for a national brand over a private label, and is usually obtained from survey data (Sethuraman and Cole, 1999).

<sup>2</sup> Moreover, it is important to note that typically, only leading national brands in a category command a volume premium over the private label good. For the other national brands in the category, the situation could vary on a case-by-case basis, and the volume premium could well be negative for specific national brands.

$$Volume\ premium_{NB} = Volume_{NB} - Volume_{SB} \quad (12.2)$$

Both retailers and manufacturers consider the likely impact of their pricing decisions on volume premiums, although the many complexities are not yet well understood (Sayman and Raju, 2007).

### 2.3 Margin premium

Ultimately, retailers and manufacturers should make pricing decisions that optimize their overall profits (Kumar and Steenkamp, 2007; Raju et al., 1995a).

$$\begin{aligned} Retailer\ margin\ premium_{NB} &= Retailer\ profit\ contribution_{NB} \\ &\quad - Retailer\ profit\ contribution_{SB} \end{aligned} \quad (12.3)$$

$$\begin{aligned} Manufacturer\ margin\ premium_{NB} &= Mfr\ profit\ contribution_{NB} \\ &\quad - Mfr\ profit\ contribution_{SB} \end{aligned} \quad (12.4)$$

Evidently, the key to price premiums, volume premiums and margin premiums is the price/quality positioning of store brands, in relation to the quality and price of national brands (Sayman and Raju, 2007). Table 12.1 provides a scheme to understand the extent to which three main types of prevalent private label brands, generic private labels, copycat private labels and premium private labels differ in terms of their characteristics from national brands.

Examples of premium-tier (lower-tier) store brands are Sam's Choice (Great Value) and Archer Farms (Market Pantry) at Wal-Mart and Target, respectively. The most common strategy is an imitation or copycat strategy, accounting for more than 50 percent of the store brand introductions (Scott Morton and Zettelmeyer, 2004).

### 2.4 Illustrative numerical example

To illustrate the problem of pricing store brands versus national brands, we consider the fictional numerical example of a store brand entering a category in a retail store with two incumbent national brands with retail prices of \$2.00 and \$3.00 and wholesale prices of \$1.50 and \$2.00, respectively. In this market, the retailer sells 300 units of each brand, yielding category revenues of \$1500 and a margin of \$450. The retailer considers introducing a store brand that falls into one of the following three categories:

- (a) a generic store brand,  $SB_1$ , at a price of \$1.50; i.e. lower than any other brand;
- (b) a copycat store brand  $SB_2$  at a price of \$2.50; i.e. right in between the national brand prices;
- (c) a premium store brand,  $SB_3$ , at a price of \$3.00; i.e. at the highest end of the market.

Because of the different quality of the ingredients, these store brand options also differ in wholesale price: \$0.90 for the generic brand, \$1.25 for the copycat brand and \$1.80 for the premium store brand. How will these options impact short-term retailer revenues, manufacturer revenues and category margin? We start from a very simple formal model

*Table 12.1 Price premium, volume premium and margin premium of national brand versus store brand*

Examples	Characteristics	Illustrative papers	Price premium	Volume premium	Margin premium
Generic store brands	No brand name products Example – generic sugar	Steenkamp and Kumar (2007)	Large; sell 20%–50% below national brand	Moderate to high, depending on price sensitivity of potential customers	High; they have a very low price and suffer from low margins relative to national brands
Copycat brands	Me-too brand copying a strong brand leader Example – Walgreens Shampoo	Pauwels and Srinivasan (2004) Soberman and Parker (2006) Sayman et al. (2002)	Moderate; 5%–25% below national brand	Moderate to low, depending on the copycat execution and the loyalty for the emulated brand	Moderate; their cost structure is similar to imitated national brands
Premium store brands	Premium store brand offered as best products on market Example – Archer Farms (Target)	Corstjens and Lal (2000) Steenkamp and Kumar (2007)	Zero or even negative; sometimes priced higher than national brands	Moderate to high, depending on the retailer's ability to convince consumers of premium-tier status	Moderate to low; critically depends on sales success given similar retail and wholesale price

to derive the initial effect on sales and margin. Consider the Hotelling competitive positioning model in which consumers are uniformly distributed in their ideal points for quality/price positions (e.g. Lilien et al., 1992, p. 233). Figure 12.1 visualizes our pre-entry situation, in whom the incumbent national brands split the current number of shoppers for whom the buying utility exceeds the price of second-tier national brand  $NB_1$ . All shoppers to the left of this point  $X_1$  do not buy in the category (i.e. the 'outside good'), while all customers to the right of point  $X_2$  prefer the premium national brand  $NB_2$ . As usual in this model, we assume complete information (i.e. full consumer awareness/knowledge of all brands and perceived quality equals objective quality).

What happens when a store brand gets introduced into this market? When the retailer enters with the generic store brand  $SB_1$ , it expands the category by moving  $X_1$  to the left (from  $X_1$  to  $X_1'$ ). Moreover, it steals share from  $NB_1$ , not from  $NB_2$ . In contrast, entering with the copycat  $SB_2$  does not expand the category. Instead, the introduction steals share from both  $NB_1$  and  $NB_2$ . Finally, premium-tier brand  $SB_3$  competes directly with the premium national brand  $NB_2$  and steals share from it. Table 12.2 calculates how the three options differently impact key performance indicators for retailers, consumers and manufacturers.

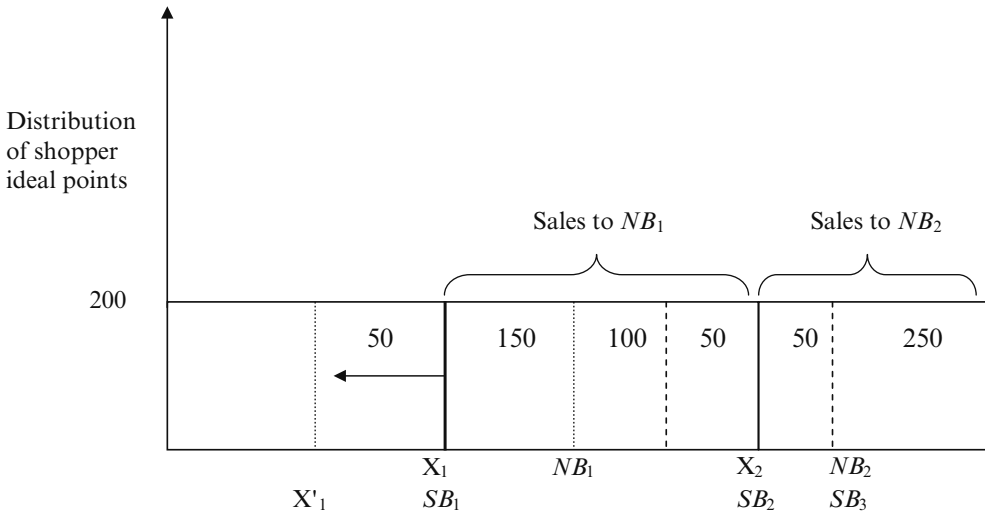


Figure 12.1 Simple model of sales of national brands versus store brands

**2.4.1 Retailer's perspective** When the generic store brand  $SB_1$  is introduced, it obtains 200 customers and a healthy margin of \$120. For the total category, demand grows from 600 to 650, and retailer gross margin increases from \$450 to \$495. In contrast, the copycat store brand does not expand category demand and obtains a smaller customer base (100), but with a higher store brand margin of \$125. Category margin grows to \$500. Finally, the premium store brand does not expand demand but obtains a customer base of 150 and obtains the highest store brand margin (\$180). However, retailer category margin increases only to \$480. Thus it appears that in this case, the copycat store brand strategy yields the highest contribution to retailer profits. The important point is that this revelation of the optimal store brand strategy for the retailer requires a category management perspective; it would not derive from a simple assessment of the sales and margin contribution of the store brand itself. Indeed, the generic store brand is the clear winner in terms of store brand sales and category traffic, while the premium option yields the highest margin from the store brand itself.

**2.4.2 Consumer's perspective** From the consumer's perspective, the average price before the introduction is \$2.50. This average price stays the same for the copycat and premium store brand options but lowers to \$2.30 with the introduction of the generic store brand. Thus price-sensitive shoppers, in particular those that now become new-category customers, benefit from the generic store brand introduction, leading to category expansion. No such benefit occurs for the copycat brand and, in our example, for the premium store brand. We return later to possible store loyalty effects of high-quality store brands.

**2.4.3 Manufacturer's perspective** Store brand entry hurts the sales of at least one national brand in our example, with the extent of the damage depending on store brand price/quality positioning. Would supplying the store brand overcome the margin loss for

Table 12.2 *Illustrative example on pricing of national versus store brands*

Variable	Retailers			Manufacturers	
	Store brands			National brands	
	$SB_1$	$SB_2$	$SB_3$	$NB_1$	$NB_2$
Retail price	\$1.50	\$2.50	\$3.00	\$2.00	\$3.00
Wholesale price	\$0.90	\$1.25	\$1.80	\$1.50	\$2.00
Manufacturer cost	\$0.70	\$1.00	\$1.50	\$1.00	\$1.50
<i>Before introduction</i>					
Sales				300	300
Manufacturer revenue				\$450	\$600
Retailer revenue				\$600	\$900
Retailer margin				\$150	\$300
Category sales = 600, retailer category revenues = \$1500, retailer category margin = <b>\$450</b>					
<i>After introduction of <math>SB_1</math> (generic store brand)</i>					
Sales	200			150	300
Manufacturer revenue	\$180			\$225	\$600
Retailer revenue	\$300			\$300	\$900
Retailer margin	\$120			\$75	\$300
Category sales = 650, retailer category revenues = \$1500, retailer category margin = <b>\$495</b>					
<i>After introduction of <math>SB_2</math> (copycat store brand)</i>					
Sales		100		250	250
Manufacturer revenue		\$125		\$375	\$500
Retailer revenue		\$250		\$500	\$750
Retailer margin		\$125		\$125	\$250
Category sales = 600, retailer category revenues = \$1500, retailer category margin = <b>\$500</b>					
<i>After introduction of <math>SB_3</math> (Premium store brand)</i>					
Sales			150	300	150
Manufacturer revenue			\$270	\$450	\$300
Retailer revenue			\$450	\$600	\$450
Retailer margin			\$180	\$150	\$150
Category sales = 600 retailer category revenues = \$1500, retailer category margin = <b>\$480</b>					

the national brand manufacturer? This appears unlikely given the competitive nature of the store brand procurement market (Kumar and Steenkamp, 2007). In all of our scenarios, the manufacturer margin on the national brand remains higher than that for the store brand (which is \$40, \$25 and \$45). Table 12.3 shows the components of price premium, volume premium and retailer margin premium of each national brand over the three store brand options.

Even in this stylized example, the observed scenarios are relatively complex: national brands may have positive or negative price premium, volume premium and margin premium over a store brand. And, of course, actual markets involve several issues that further influence the impact of store brands, including (1) varying retailer success in bridging the gap between perceived versus objective store brand quality, (2) consumer

Table 12.3 Illustrative example on pricing of national versus store brands

Examples	Price Premium	Volume Premium	Margin Premium
<i>After introduction of SB<sub>1</sub> (generic store brand)</i>			
Second-tier national brand ( $NB_1$ )	\$0.50	-50	-\$45
Premium-tier national brand ( $NB_2$ )	\$1.50	100	\$180
<i>After introduction of SB<sub>2</sub> (copycat store brand)</i>			
Second-tier national brand ( $NB_1$ )	-\$0.50	150	\$0
Premium-tier national brand ( $NB_2$ )	\$0.50	150	\$125
<i>After introduction of SB<sub>3</sub> (premium store brand)</i>			
Second-tier national brand ( $NB_1$ )	-\$1.00	150	-\$30
Premium-tier national brand ( $NB_2$ )	\$0.00	0	-\$30

involvement with and perceived risk in the category and (3) national brand manufacturers' reaction in terms of product, price and advertising. We next turn to these drivers of the premium components.

### 3. Findings on pricing of national brands versus store brands

Despite the high and increasing importance of store brands for both retailers and manufacturers, we have seen relatively little academic research on pricing of national brands versus store brands. This is probably because of the mindset of both marketing academicians and executives in manufacturer companies, who tend to consider store brands as inferior goods and hence focus on competition between national brands (Kumar and Steenkamp, 2007). As a result, we believe it is too early to give exact recommendations on how to price national brands versus store brands. However, as argued, this decision will depend on the three components of market power. The last two decades have yielded influential articles on the importance, presence and drivers of the three premiums mentioned, as shown in Table 12.4.

Table 12.5 shows how the various drivers influence price, volume and margin premiums, and also offers some generalizations on these effects in the last column. Clearly, this is an area where more research is needed to make specific predictions on pricing, so we conclude in Section 4 with suggestions for future research.

#### 3.1 Price premium

**3.1.1 Importance** The price premium of a national brand over a store brand is of major importance to both manufacturers and retailers (Hoch and Banerji, 1993). In the absence of pricing mistakes, it reflects consumer willingness to pay for the different brands. For manufacturers, keeping consumer prices high is a main objective. Consider the typical economics of a S&P500 company (Kumar and Steenkamp, 2007): 19.2 percent of all revenues are needed to cover fixed costs, 68.3 percent to cover variables costs, leaving a profit margin of 12.5 percent. All other things equal, a price increase of 2 percent would



Table 12.4 *Illustrative papers on price, volume and margin premiums*

Paper – authors/ year of study	Substantive issue	Data	Key contribution
<i>1. Price premium</i>			
Raju et al. (1995a)	Decision to introduce a store brand into a category	IRI data on 438 product categories	Store brands are more likely to be introduced in categories where the price competition is low, and when the number of national brands is high.
Raju et al. (1995b)	Price differential of national brands	Numerical simulations of data	Results show that a store brand can obtain a high market share even with a low price differential when the cross-price sensitivity is high.
Hoch and Lodish (2001)	Optimal price gap	Two consumer studies and two in-market pricing tests	Most retailers would improve profits by maintaining national brand pricing and closing the gap by raising store brand prices.
Sethuraman and Cole (1999)	Factors influencing the price premium	Random survey of 350 households	Perceived quality differential is the most important driver of price premiums.
Apelbaum et al. (2003)	Extent to which quality premiums drive price premiums	<i>Consumer Reports</i> data for 78 product categories	For 75% of the categories considered, the average quality of national brands was higher than that of store brands, and price premiums for national brands prevail regardless of their command of quality premium or not.
Sayman et al. (2002)	Retailer's store brand positioning problem	Data from 19 product categories	In categories with high-quality store brands, the store brand and the leading national brand compete more intensely with each other than with the secondary national brand.
<i>2. Volume premium</i>			
Hoch and Banerji (1993)	Cross-category differences in private label share	185 grocery categories	Six variables (quality relative to national brands, quality variability, category revenue, percentage gross margins, number of national brand manufacturers, and national advertising expenses) explain 70% of the variance in market shares.
Dhar and Hoch (1997)	Store brand penetration variations across retailers	34 food categories for 106 major chains	Store brand penetration increases with retailer size, commitment to quality, category expertise, the use of own name on the store brands, breadth of store brand offerings, premium store brand offerings, and promotional support for the store brand.

Table 12.4 (continued)

Paper – authors/ year of study	Substantive issue	Data	Key contribution
Hansen et al. (2006)	Drivers of store brand purchase across categories	10 food and non-food product categories	Household-level traits which are no-category-specific explain variation in store brand shares across categories.
Cotterill et al. (2000)	Factors that drive market shares of private label brands	143 food categories in 59 geographic markets	Feature and display promotions are more effective than price cuts for private labels to gain share from national brands.
Deleersnyder et al. (2005)	Factors that drive national brand success	400 brands in 6 stores in 3 countries	Large price gaps benefit both manufacturers and retailers since they signal that the brands are targeted at different consumers/ purchase occasions.
Erdem et al. (2004)	Factors that drive store brand shares	Scanner data for 3 countries (UK, USA, and Spain)	Quality uncertainty is the key determinant of store brand market share across countries, more important than price sensitivity.
<i>3. Margin premium</i>			
Ailawadi and Harlam (2004)	The effect of store brand share on margins of the retailer	Retail data from a grocery and a drug retail chain for multiple categories	Retailers' percentage margin on store brands is higher than on national brands, even though dollar margin per unit may be lower for store brands.
Pauwels and Srinivasan (2004)	Impact of store brand entry on retailer margins	Data from 4 food and non- food categories with store brand entry	Store brand entry raises retailers' margins due to high unit margins on the store brand as well as on the national brands.
Ailawadi et al. (2008)	Impact of store brand use on store loyalty	Consumer hand- scan panel: all categories	Store brand use and store loyalty (share of wallet) have an inverted U-shaped relationship.

thus raise profits by 16 percent, and vice versa. Evidently, the net effect will depend on the resulting volume changes, and manufacturers need to understand both own and cross-price elasticities in the market, including that of their brand with the store brand. For retailers, the price premium, also known as the price gap between a national brand and the store brand, is a key driver of the gross dollar margin from the store brand, but also of the total category's profit to the retailer. Papers in economics have argued that the magnitude of the ratio of national brand to store brand prices can be used to measure the markup of the retailer (Scherer and Ross, 1990; Carlton and Perloff, 1994; Barsky et al., 2001).

*3.1.2 Presence* In all studied countries, even those leading in store brand quality and penetration, a price premium still exists between national brands and store brands

Table 12.5 *Generalizations on drivers of price premiums, volume premiums and margin premiums*

Premium components	Drivers	Illustrative papers	Generalization
A. Price premium	Perceived quality	Sethuraman and Cole (1999); Hoch and Banerji (1993); Apelbaum et al. (2003)	Brands with higher perceived quality command higher price premiums.
	Innovation	Pauwels and Srinivasan (2004); Steiner (2004)	Innovative national brands command higher price premiums.
	Imagery/feelings	Wills and Mueller (1989); Connor and Peterson (1992)	Brands high on imagery command higher price premiums.
	Promotional activity	Cotterill et al. (2000)	Higher price promotional activity in a category leads to lower price premiums.
	Category characteristics	Ailawadi et al. (2008); Steenkamp and Dekimpe (1997)	Category characteristics are related to price premiums.
	Retailer store brand strategy	Meza and Sudhir (2002); Soberman and Parker (2006)	Price premiums of national are largest vs generic store brands, followed by copy-cat brands and least vs premium store brands.
	B. Volume premium	Prices of national vs private labels	Dhar and Hoch (1997); Hoch and Lodish (2001); Geyskens et al. (2007)
Availability of brands		Srinivasan et al. (2004); Ailawadi et al. (2008); Kumar and Steenkamp (2007)	Availability of popular national brands drives volume premiums.
Usage occasions		Pauwels and Joshi (2007)	Volume premium depends on usage occasions.
C. Margin premium	Wholesale prices	Ailawadi (2001); Sethuraman (2006); Ailawadi and Harlam (2004)	Higher wholesale prices of national brands result in lower margin premiums.

Table 12.5 (continued)

Premium components	Drivers	Illustrative papers	Generalization
	Price premiums	Pauwels and Srinivasan (2004); Kumar and Steenkamp (2007)	Factors that drive the price drive premium of the national brand will margin premiums.
	Brand switching patterns	Pauwels et al. (2007); Rangan and Bell (2002)	Retailer gross margin depends on the switching patterns among brands.
	Category expansion and store traffic	Bronnenberg and Mahajan (2001)	Category expansion and store traffic effects of enhanced retailer profitability for store brands.
	Store image	Corstjens and Lal (2000)	Store brands enhance store image and retailer margins.

in general (Pauwels and Srinivasan, 2004; Dhar and Hoch, 1997). Based on IRI (Information Resources Inc.) pricing data, the current price premiums across all US retailers between national and store brands is about 25–30 percent (Hoch and Lodish, 2001). Kumar and Steenkamp (2007) report an average price premium of 37 percent in situations where the store brand is quality-equivalent with the national brand. Moreover, Apelbaum et al. (2003) report a 29 percent price premium in categories where average store brand quality exceeds average national brand quality and a 50 percent price premium in other categories. However, this price premium appears under siege. For instance, a recent survey by AC Nielsen (2005) revealed that only 29 percent of US consumers agree that manufacturer brands are worth the price premium. Several driving forces may explain why the price premium has been going down over time (Kumar and Steenkamp, 2007).

*3.1.3 Drivers of price premium* In general, consumers compare the price of a product to the utility they derive from buying and consuming it. This utility may have both rational and emotional components, also known as performance perceptions and judgments versus imagery and feeling in the customer-based brand equity framework (Keller, 1993). Research has shown that the range of acceptable prices depends on the product characteristics such as brand familiarity (Monroe, 1976) and on customer perceptions of price and value (Raju et al., 1995b).

**DRIVER 1: PERCEIVED QUALITY** Branded and private label versions of a product cannot be identical, as that would violate the law of one price (Barsky et al., 2001). Despite the increasing quality-equivalence of national brands and store brands in general, certain national brands do succeed in maintaining superior perceived quality. Perceived quality of the national brand versus the store brand is a key driver of the price premium because

most consumers care more about quality than about price (Steenkamp, 1989; Sethuraman and Cole, 1999; Hoch and Banerji, 1993). French data revealed that in categories where manufacturer quality exceeds store brand quality, the price premium for national brands is 56 percent; in quality-equivalent categories, it is 37 percent; and in categories where store brand quality is higher, the price premium is 21 percent (Kumar and Steenkamp, 2007). In the USA, the numbers are similar: quality-equivalence yields a 37 percent price premium for national brands, and a 1 percent quality gap results in a 5 percent price gap (Apelbaum et al., 2003). Therefore both national brand manufacturers and retailers should carefully monitor the perceived quality of their brands. In fact, empirical evidence suggests that as store brands improve their quality, national brands lose some of the pricing power, and the price premium they command relative to the store brand decreases (Rao and Monroe, 1996). If the manufacturer fails to convince consumers of its higher quality, it is tough to justify a high price premium. Likewise, if the retailer fails to convince quality-sensitive consumers of its high store brand quality, it is left with only the price-sensitive buyers and consequently has to charge a lower price for its store brand. This is especially true when consumers believe it is only fair that the store brand charges them less because it costs less to the retailer, for instance because of the lower quality of the ingredients. Interestingly, though, quality is not the full story: US consumers perceive store brands to be quality-equivalent in 33 percent of cases, but are only willing to pay the same price in 5 percent of all cases (AC Nielsen, 2005).

**DRIVER 2: INNOVATION** Besides enhanced quality, national brands may also contain desirable new features that are not (yet) present in store brands. For instance, Pauwels and Srinivasan (2004) find that, faced with store brand entry and resulting price competition at the low end of the market, some manufacturers take the high road and introduce innovative, higher-priced SKUs (stock-keeping units). In contrast, due to their reliance on low prices, store brands are not typically engaged in expensive product innovations, and thus score low on innovativeness (Steiner, 2004). As such, a highly innovative national brand will clearly stand out and be able to command a higher price premium (Deleersnyder et al., 2007). In contrast, categories with few national brand innovations allow the store brand to easily close the quality and price gap (Hoch and Banerji, 1993).

**DRIVER 3: IMAGERY/FEELINGS** The emotional components of product utility are known under many labels: brand feelings, image, emotional bond, love, engagement, etc. National brand manufacturers use their large advertising budgets and brand-building experience to create and sustain these elements of brand equity. Specifically, research has found that advertising has a positive effect on the price of national brands relative to store brands (Wills and Mueller, 1989; Connor and Peterson, 1992). Kumar and Steenkamp (2007) report that the typical price premium for brand image is 23 percent. In France, categories high on imagery obtain an average price premium of 61 percent compared to only 38 percent in categories low on imagery. However, creative marketing can and has achieved high image in such categories as baked beans and paper towels (ibid.). While such imagery used to be generated by television advertising, future success may be more readily obtained through such new communication channels as videogame marketing, 'underground marketing' (e.g. Red Bull giving free samples to trendsetting people and bars, but refusing them to others), word-of-mouth marketing, Internet

community marketing (e.g. Trusov et al., 2007), and the like. Manufacturers appear to have a substantial advantage over retailers in this regard. Once retailers move beyond simple copycat strategies for their store brands, they may find creative ways to build their own imagery components, instead of merely attempting to demote the imagery of national brands.

**DRIVER 4: PROMOTIONAL ACTIVITY** While non-price-oriented promotions by national brands may benefit their price premium, price-oriented promotions appear 'fast but faulty'. In the short run, price promotions may enable national brands to keep price-sensitive consumers from trying store brands (e.g. Lal, 1990) and thus help sustain their price premium at regular levels. In the long run, however, price promotions may teach consumers to 'lie in wait' for deals (Mela et al., 1997) and focus on price instead of quality as a buying criterion (Kalwani and Yim, 1992; Wathieu et al., 2004). Moreover, price promotional activity in a category not only lowers prices but is also a more effective way for store brands to gain share from national brands (Cotterill et al., 2000).

**DRIVER 5: CATEGORY CHARACTERISTICS** Despite increasing quality and consumer acceptance of store brands, willingness to pay for them still varies substantially by category (Steenkamp and Dekimpe, 1997; Ailawadi et al., 2008). The first author of this chapter analyzed a European dataset where the price premium of the store brand versus the leading national brand varied from virtually zero (e.g. aluminum foil and canned vegetables) to over 80 percent (e.g. shampoo and bodymilk). These variations in price premium were associated with consumer involvement with the category: the price premium is higher for categories that connect to consumers' ego and self-image (Assael, 1998), with higher hedonic value (Holbrook and Hirschman, 1982), and with a higher social expressive or sign value (McCracken, 1986). Other important characteristics may include the risk and credence nature of the product category.

**DRIVER 6: RETAILER SIZE AND STRATEGY** First, retail consolidation reduces the price premium of national brands (Cotterill et al., 2000). Second, we know that the price premium of national brands depends on the store brand strategy of the retailer. Kumar and Steenkamp (2007) show that 'generic store brands' and 'value innovators' have a large discount (20–50 percent), 'copycat' brands have a moderate discount (5–25 percent) compared to brand leaders, while 'premium store brands' are priced close to or higher than the brand leaders. Recent research suggests that when it comes to copycat store brands, retailers may behave non-optimally by increasing the price of the national brand imitated by the store brand and by maintaining a high price differential between the copycat store brand and the national brand (Meza and Sudhir, 2002; Soberman and Parker, 2006). Importantly, 'despite all the buzz surrounding premium store brands, we should not forget that traditional store brands – generics and copycats – are still the dominant types of store brands around the world' (Kumar and Steenkamp, 2007, p. 29). Even so-called 'premium' store brands are typically not 'premium-price' (priced above leading manufacturer brands) but 'premium-lite', i.e. of similar/higher quality than manufacturer brands but at a lower price. Moreover, even truly premium-price retailer brands are still necessarily mass-market, and consequently may be priced below a niche manufacturer brand. Increasingly, retailers maintain a portfolio of store brands similar to Tesco's

three-tier strategy (Buckley, 2005): low-priced Tesco Value (lowest price: 34 percent of its store brand volume), Tesco (standard quality: 61 percent of its store brand volume), and Tesco's Finest (highest quality: 5 percent of its store brand volume).

### 3.2 *Volume premium*

**3.2.1 *Importance*** Because manufacturers face substantial fixed costs (on average, 19 percent of revenues at full capacity), it is very important to keep volumes up and, thus, keep factories running. Higher volumes also mean better bargaining power with suppliers and with retailers, who prefer to stock and promote leading manufacturer brands (e.g. Pauwels, 2007). Retailers care about volume for similar scale and scope reasons, and several studies have investigated factors that lead to successful store brands (Hoch and Banerji, 1993; Dhar and Hoch, 1997; Hoch et al., 2002).

**3.2.2 *Presence*** In the USA, the leading national brand typically still has a volume premium over the store brand, but this is no longer true in several categories and in several European countries. Kumar and Steenkamp (2007) project a store brand share of 40–50 percent: increasing retailer consolidation and globalization will increase current store brand shares, but after a certain point, higher store brand share will turn off consumers looking for choice and will not be beneficial to the retailer (Ailawadi et al., 2008). Still, an expected store brand share of 40–50 percent implies a substantial loss of volume premium, as has been demonstrated across 225 consumer-packaged goods categories in Hoch et al. (2002), who find that store brands capture most of the category growth and steal away share, especially from the smaller national brands.

**3.2.3 *Drivers of volume premium*** Evidently, the volume premium may be affected by the same drivers as those identified for price premium. Additional drivers include prices, availability and usage occasions as detailed below.

**DRIVER 1: PRICES OF NATIONAL BRAND AND STORE BRAND** The relation between the price gap and store brand sales depends on whether one considers within-category effects (over time) versus cross-category relations (Raju et al., 1995b; Sayman and Raju, 1997). Focusing on within-category effects, research finds that a 10 percent change in the price gap fraction results in a 0.8 percent change in the store brand share (Dhar and Hoch, 1997). In contrast, cross-category comparisons find a higher store brand share with a smaller price gap (Mills, 1995; Sethuraman, 1992), apparently because store brand popularity in a category allows the retailer to price it close to the national brands (Raju et al., 1995b). Moreover, Dhar and Hoch (1997) argue that a high price differential leads (some) consumers to infer that the store brand has substantially lower quality, outweighing the positive direct price effect. The situation gets more complex in the presence of compromise, similarity and attraction effects (e.g. Geyskens et al., 2007).

**DRIVER 2: AVAILABILITY** Distribution is a key driver of store brand share and growth (Dhar and Hoch, 1997; Kumar and Steenkamp, 2007; Sayman and Raju, 2007). Indeed, European store brands may derive their strength from championing by large, consolidated retailers (Hoch and Banerji, 1993) versus smaller manufacturers. However, even

the largest retailer is not the only game in town and thus typically fails to obtain the quasi-universal availability of popular national brands. This provides an important edge to national brands, which they should strive to maintain. In principle, retailers could overcome this advantage by either licensing their store brands to other retailers (e.g. President's Choice) or creating such a strong preference for their store brands that most consumers will seek them out at the expense of other retailers. With a few notable exceptions, either scenario appears unlikely. Licensing to competitors reduces the differentiation a retailer achieves with its store brand, and price-sensitive shoppers tend to look intelligently for deals wherever they are and thus are 'loyal' to store brands in general rather than to the store brand of a specific retailer (Ailawadi et al., 2008). Related to the retailer distribution strength, research has shown that the higher the retailer's private label share in a category, the lower the revenue benefits a national brand obtains from its own promotions (Srinivasan et al., 2002; 2004).

**DRIVER 3: RETAILER POSITIONING** Dhar and Hoch (1997) find that store brand penetration increases with retailer commitment to quality, category expertise, the use of own name on the store brands, premium store brand offerings and promotional support for the store brand.

**DRIVER 4: USAGE OCCASIONS** As long as consumers associate certain usage occasions with certain brands, the volume premium also depends on the frequency of such usage occasions. For one snack category, Pauwels and Joshi (2007) find that 'entertaining friends' and 'afternoon lift' occasions were associated with the national brand. However, the typical 'store brands for myself, national brands for conspicuous consumption' attitude is not set in stone, as consumers in some countries (such as Germany, the UK and the Netherlands) proudly display their smart, best-value shopping (Kumar and Steenkamp, 2007). Even in the USA, only 6 percent of consumers feel uncomfortable serving store brands in their homes (AC Nielsen, 2005). Therefore, to safeguard their volume premium, manufacturers may strive to 'set the agenda' in terms of usage occasions and their link to the national brand.

### 3.3 *Margin premium*

**3.3.1 Importance** The manufacturer margin premium is especially important if a given manufacturer is (or is considering) supplying both national brands and store brands (Kumar and Steenkamp, 2007). The retailer margin premium is obviously relevant to retailers, as they want to carry the optimal assortment of brands to maximize their overall profitability. Moreover, national brand manufacturers need the retailer's cooperation for a host of activities that affect the national brand's performance: sufficient and appropriately located shelf space, promotional pass-through, launch and promotion of new products, etc. Negotiations on such activities are easier when the manufacturer can demonstrate and quantify the contribution of these activities to the retailer's profitability.

**3.3.2 Presence** Little is known about the margin premium for national brand manufacturers, mostly because they do not spread the word that they are also producing store brands (Kumar and Steenkamp, 2007). Therefore the presence and drivers of this



manufacturer margin premium are a key topic for future research. In contrast, it is now well documented that store brands give retailers a better percentage margin than national brand manufacturers do (Ailawadi and Harlam, 2004; Handy, 1985; Hoch and Banerji, 1993). Sethuraman (2006) reports that the average retailer's margin from store brands is about 34 percent compared to the margin of 24 percent that retailers obtain from national brands. However, virtually unanswered is the more relevant question about how much each brand contributes to the category's gross margin and to retailer overall profitability (Ailawadi and Harlam, 2004; Ailawadi et al., 2008). Several factors need to be considered to determine each brand's margin contribution to the retailer, and our numerical example in Section 2 and recent research demonstrates that the margin premium may substantially vary depending on several drivers.

### 3.3.3 *Drivers of margin premium*

**DRIVER 1: WHOLESALE PRICES** Wholesale prices are almost always lower for store brands, even compared to small national brands (e.g. Sethuraman, 2006; Ailawadi and Harlam, 2004). The key reasons are the competitive nature of the store brand procurement market and the much lower marketing and advertising costs faced by store brands as compared to national brand manufacturers. As to the competitive nature of the market, most store brand suppliers are fairly small companies, especially compared to their retail customers. They specialize in a few product categories, product differentiation is virtually absent, optimal scale of production is low, and they sell their products to powerful, well-informed, professional retail buyers. Furthermore, the marketing and advertising costs are much higher for national brands, as they are building consumer-based brand equity (Keller, 1993) by creating and maintaining awareness, relevance and differentiation in consumers' minds.

**DRIVER 2: RETAIL PRICES** As long as national brands sell at higher retail prices than store brands, their unit dollar margins may be higher even if their percentage margins are lower than the store brands'. Indeed, real-life cases (e.g. Rangan and Bell, 2002) and our numerical example illustrate the situations in which the dollar margins of the store brand are lower than those of at least one national brand: the generic store brand has only a \$0.60 margin as compared to \$1.00 for the premium national brand. Evidently, retail prices depend both on the pricing decisions of the retailer and on consumer willingness to pay for a brand. Often, the dollar margin on the store brand is higher than on that of second-tier national brands – especially if the retailer decides to drop its retail prices in the face of store brand growth (Pauwels and Srinivasan, 2004). Likewise, factors that drive the price premium of the national brand, such as innovation and advertising, will help maintain retail prices and thus dollar margins. On the other hand, the dollar margin benefit erodes with successful retailer efforts to increase willingness to pay for the store brand. Moreover, retailers may further reduce their store brand costs in terms of logistics, rental, overhead, marketing, personnel, etc. 'Value innovator' store brands like Aldi's are especially successful in lowering process costs by passing on shopping functions to the consumer and focusing on a limited assortment to compensate for lower dollar margin with high turnover and supply chain negotiating power (Kumar and Steenkamp, 2007).

**DRIVER 3: BRAND SWITCHING PATTERNS** Given the tradeoffs in dollar margins, retailer gross margin in the category will critically depend on the switching patterns among brands. Every purchase going from a higher dollar-margin national brand to the store brand will actually reduce retailer gross margin (and related measures such as profit per square foot). Such a situation creates an interesting dilemma for the retailer: if the store brand does not expand category consumption, its sales growth at the expense of national brands may lower total category retail margin. This realization induced HEB Foods managers to consider cheaper sourcing and to reposition the store brand against a low-margin instead of a high-margin national brand (Rangan and Bell, 2002). More generally, both retailers and manufacturers influence these brand-switching patterns. Retailers often emulate a specific national brand (e.g. the brand leader as recommended in Sayman et al., 2002) and promote direct comparison by shelf placement, displays, features, etc. Manufacturers choose to get closer to or further away from the store brand by introducing new products with similar or very different features from those of the store brand (Pauwels et al., 2007) and by pricing their brand closer to or further away from the store brand (Pauwels and Srinivasan, 2004).

**DRIVER 4: CATEGORY EXPANSION AND STORE TRAFFIC** Besides inducing brand switching within the category, store brands may also induce shoppers to buy in the category or even to come into the store – thus enhancing retailer store profitability. Traditionally, popular and expensive national brands are believed to be more successful in doing so (Bronnenberg and Mahajan, 2001; Pauwels, 2007); witness the loss-leaders in key retail categories. Likewise, Kumar and Steenkamp (2007) note that the velocity (or shelf-space turnover) of national brands is typically 10 percent higher than that for store brands. As a result of the above factors, recent papers argue that store brands are not as profitable as national brands (Corstjens and Corstjens, 1995). A private Price Waterhouse study commissioned by Pepsi in Canada showed that the national brand is typically more profitable than store brands once all factors, including deal allowances, warehousing, transportation and in-store labor were accounted for (Corstjens and Lal, 2000).

However, store brands clearly have the potential to increase category demand and store traffic. As to the former, low-end store brands make the category affordable to budget-restrained shoppers, while premium store brands may attract shoppers who value their quality and/or unique features (e.g. Tesco's Finest). As to the latter, Corstjens and Lal (2000) argue that retailers can attract shoppers with quality store brands, and they report that store brand penetration is positively related to store loyalty and customer share of wallet at the chain. Moreover, Sudhir and Talukdar (2004) find that a household buying store brands in more categories spends more at the store. In contrast, Uncles and Ellis (1989) question the role of store brands in store loyalty, and Richardson (1997) finds no evidence of store brand differentiation in five product categories. A recent study accounts for reciprocity and nonlinearities in the relationship between store brand buying and store loyalty for all categories of a leading supermarket chain (Ailawadi et al., 2008). Their analysis finds that the relationship is inverted U-shaped, with the highest benefits to store loyalty at around 40 percent of store brand share. Stores with lower store brand shares may thus increase store loyalty by pushing their own brands, but only up to a point. Anecdotal evidence suggests that pushing store brands (especially in terms of shelf space) at the expense of national brands may generate a backlash from consumers who value

freedom of choice (*ibid.*). In sum, the ability of either national brand or store brand to bring in truly new purchases depends not just on their individual consumer appeal but also on the current ratio of consumer purchases and shelf space devoted to store brands.

**DRIVER 5: STORE IMAGE** At the category level, US consumers still believe that manufacturer brands are better than store brands in 89 percent of categories (Aimark, 2006). In general, the introduction of store brands with high objective quality may be beneficial to the retailer even if there is no margin advantage for the store brand because quality store brands increase store differentiation (Corstjens and Lal, 2000). Just like manufacturers, some retailers spot a 'hole in the market' for a product with a unique feature currently not offered by competitors. For instance, Tesco is able to offer freshly squeezed orange juice in its stores, which is not logistically feasible for the likes of Tropicana and Minute Maid (Kumar and Steenkamp, 2007). Retailers do not compromise on quality of store brands because they cannot really afford to put their store name or their own brand name on a product that is inferior (Fitzell, 1998). For example, if Dominick's were to use its name on a product that is inferior, there would likely be a negative spillover effect on all products and stores carrying that label.

### 3.4 *Pricing implications*

**3.4.1 *What is the preferred price gap for the manufacturer?*** It differs for premium versus second-tier brands, which face different own and cross-price elasticities with the store brand. This is graphically illustrated by Kumar and Steenkamp (2007, p. 202) and empirically demonstrated in Pauwels and Srinivasan (2004). First, premium brands get a substantially smaller sales increase from a price drop because their customers are more niche and less price-sensitive. At the same time, a price cut from the store brand won't affect them much, either. The recommendation is to keep prices high while justifying the price premium by continuous improvement in the identified drivers of market power (quality, imagery, innovation, association with specific usage occasions, category and store traffic drawing power). Moreover, the manufacturer can add a low-end brand to fight the store brand (e.g. P&G added Mister Clean detergent to its leading Ariel brand in Germany). Second-tier brands face a tough dilemma: they typically cannot win a price war with the store brand, so such brands need to choose between upgrading the brand (a large and uncertain investment) versus head-on value competition with the store brand. The latter strategy is impeded by the absence of the true leverage that national brand manufacturers possess to determine the price gap with store brands: while they can set recommended prices and send consumer coupons, the retailer decides on promotional pass-through and may engage in 'price shielding' by promoting the store brand at the same time (Hoch and Lodish, 2001). In some cases, the manufacturer may be better off divesting in such second-tier brands to focus its resources on a portfolio of leading brands. Unilever, for instance, decided to cut 75 percent of its brands because it had insufficient brand power, defined as the potential to be number one or two in its market and to be a must-carry brand to drive retailer's store traffic (Kumar, 2004).

**3.4.2 *What is the preferred price gap for the retailer?*** Answering this question requires knowledge of the performance criterion for the retailer. If only store brand volume is of

interest, larger price gaps may yield more immediate success even though smaller price gaps, accompanied by the necessary investments in store brand quality and the communication thereof, should yield higher sales in the long run (Dhar and Hoch, 1997). Moreover, as argued earlier, store brand volume is only part of the retailer profitability equation. Therefore retailers need to consider the effect of the price gap on category revenues and gross margin. If the price gap is too big, the retailer may lose both manufacturer brand revenue and store brand revenue! In a rigorous field experiment, Hoch and Lodish (2001) found that increasing the price gap from 33 percent to 50 percent for analgesics increases category sales units but reduces revenue as the price elasticity for store brand is low:  $-0.56$ . In summary, we obtain consistent advice for retailers aiming to increase (long-run) store brand sales and category performance: strive for smaller price gaps. To this end, the above-identified drivers suggest that retailers should strive to reduce the gap in (perceived) quality, innovation and imagery; increase the store brand's availability and associated usage occasions; and position store brands to expand the category, improve store image, and thus, traffic and basket size in the chain (van Heerde et al., 2008).

In principle, the retailer can manipulate the price gap by changing the retail price of either the store brand or the manufacturer brands. However, the latter is often not a realistic option: increasing national brand prices may induce shoppers to buy them at other retailers, and reducing national brand prices eats away the retailer's margin on them unless the retailer can negotiate for lower wholesale prices. If store brand purchases are being driven by the price component only to a small degree, then the retailer can lower the price gap between the store and national brand and improve profitability (Hoch and Lodish, 2001). In order to do so, the retailer would have to know the answer to the question of which store brand purchases are being driven by brand preferences versus price considerations (Hansen et al., 2006).

#### **4. Future research directions**

Our review has emphasized the role of price premium, volume premium and margin premium in national brands versus private label brands. As Table 12.4 indicates, empirical work in this area has been expanding rapidly. These previous studies have dealt primarily with understanding the drivers of price premium or volume premium for national brands versus store brands. Recently, however, we have witnessed research in this area addressing a new set of strategic questions on national brands versus store brands, five of which we briefly examine below:

##### *4.1 What are the most important drivers of the premiums?*

While several of the above-mentioned drivers have been well documented in isolation (or within a small subset of candidate drivers), we know little about the relative importance of the major classes of drivers. Are the premiums mostly driven by national brand characteristics and actions, and thus largely under the control of national brand manufacturers? Or do retailer characteristics and actions yield most influence on the price, volume and margin premium of national brands over store brands? Alternatively, do (external changes to) consumer characteristics determine the fate of national and store brands in a category? Answering these questions requires a comprehensive study, including the following variables:

- (a) Brand manufacturers: prices, quality, innovation, imagery, distribution, promotions, packaging, marketing communication spending, volume versus margin goals.
- (b) Category characteristics: category concentration, size, growth, etc.
- (c) Retailer characteristics: size, marketing spending, quality and price image, EDLP versus Hi-Lo, country and format type (e.g. grocery store, drug store versus mass merchandisers), store brand portfolio, store brand experience, etc.
- (d) Consumer characteristics: quality and price sensitivity, brand loyalty, innovation proneness, product usage occasions and their importance for consumers' self-image (Assael, 1998), hedonic value (Holbrook and Hirschman, 1982), and social expressive or sign value (McCracken, 1986), etc.

#### *4.2 To what extent do store brand investments benefit the investing retailer?*

While many retailers appear to believe they reap the full benefits of investments in store brands, recent research has called this into question. First, it appears that most store brand shoppers are 'loyal' to store brands in general, not to the store brands of any specific retailers (Ailawadi et al., 2008). Because store-brand-prone shoppers may not be most profitable for a retailer (Ailawadi and Harlam, 2004), pushing the store brand at the expense of national brands may not be best strategy to increase retailer profitability. Moreover, Szymanowski and Gijsbrechts (2007) find that investments in store brand quality and reputation by one retailer appear to benefit other retailers. Reputation spillovers constitute a pitfall, as they limit the potential of store brands to differentiate retailers. As such, retailers wishing to use store brands as a differentiating strategy need to pursue a quality leadership strategy with their store brands. Such an approach diminishes subsidizing of rival brands or suffering from negative quality perception spillovers from these brands.

#### *4.3 Can manufacturers manage premiums with product line extensions and contractions?*

With the growth of their store brand programs, retailers are willing to carry those manufacturer brand assortments that result from successful product innovation and are able to command price and volume premiums. In this context, it has been increasingly important for manufacturers to add SKUs that enhance brand equity while at the same time deleting SKUs that do not enhance brand equity. A recent paper by Pauwels et al. (2007) examines the impact on brand price premium and volume premiums with a focus on manufacturer product assortment decisions. Specifically, they analyze the weekly short-term and long-term effects of SKU additions and deletions on the components of brand equity – brand price premium and brand sales volume premium – over the store brand. From a manufacturer perspective, SKU additions with similar attribute levels as the store brand are found to lower market-based brand equity while SKU additions are especially beneficial in categories with a high store brand share.

#### *4.4 Do store brands provide a reference price for how much a basic product should cost?*

The store brand's price could be an important external reference price against which the national brand price is evaluated (Deleersnyder et al., 2007). Many researchers (Ailawadi et al., 2003) have suggested the use of store brands as the comparison brands for national brands. This is important for novices and could shape their price image of the retailer. Despite its managerial relevance, store price image research in the marketing literature

has remained quite scarce, and research is needed to generate guidelines for retailers on how to manage store price image (Lourenço et al., 2007).

#### 4.5 Are multi-tier store brands the holy grail for retailers?

Consultants and retailers alike believe that adding premium store brands is the number one growth priority, but preliminary evidence suggests complex and surprising substitution patterns in the presence of such store brands (Geyskens et al., 2007). Given the growth of multi-tier store brand portfolio strategies, it is increasingly important for retailers to understand whether a three-tier store brand strategy enhances their store brands to make them stronger competitors to manufacturer brands. Will the introduction of a premium store brand versus an economy store brand reinforce the standard store brand's position in the eyes of the consumer, or will it cannibalize the retailer's existing store brand offering? Or will the economy store brand simply steal share from the incumbent standard store brand and possibly even backlash on the image of the retailer's standard store brand line (Kumar and Steenkamp, 2007)? Addressing these questions, Geyskens et al. (2007) show that whereas incumbent store brands have borne the brunt of the negative impact in terms of consumer preferences, the introduction of economy and premium store brands may actually be beneficial for premium and secondary national brands.

Overall, store brands affect the pricing of national brands in complex ways. In this new environment, where retailers have succeeded in building up trusted store brands, manufacturers and retailers need to find 'win-win' situations in order to be successful in the market. In order to make further inroads, retailers will, for example, increasingly need to adopt a portfolio approach to managing their product lines. Manufacturers will be able to recapture their significance to consumers by continuing to innovate and use SKU assortment strategies that enhance brand equity. The findings in this chapter are important because they show the empirical realization of mutual benefits and because they identify marketing strategies that lead to such win-win situations. Ultimately, the nature of the competitive/cooperative interactions between manufacturers and retailers helps determine success versus failure in tomorrow's marketplace.

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