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The Impact of Private Label Brands of Milk on Competition in Fluid Milk Markets

Robert L. Beck and Ronald G. Alvis*

Introduction

Branding, as a means of product differentiation, is a practice of long standing in the food industry. Historically, food manufacturers have used brands as a means of gaining a larger share of the market while avoiding the consequences of direct price competition. Merchandising food, and particularly dairy products, under private label brands,[1] however, is a practice of more recent origin.

The introduction of private label brands of dairy products can be traced to the period of the 1920's when private label brands of evaporated milk first appeared in some markets. This was followed by private label brands of butter in the 1930's and fluid milk and ice cream during the 1950's [3, p. 44].

Today, private label brands account for a significant portion of the dairy products moving through the market system. For example, a recent study involving major food chains operating in Kentucky and the North Central region showed that two-thirds (65 percent) of the chains interviewed had some type of central milk buying program. Seventy percent of the food chains

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with central milk programs (excluding chains which owned and operated their own milk processing facilities) carried their own private label brand of milk which accounted for 56 percent of their fluid milk sales [2, p.iv].

The increased use of private label brands of fluid milk during the past two decades has no doubt influenced the structure of fluid milk markets. Since market conduct is generally considered to be a function of market structure, some have expressed concern as to the effect of private labeling on buyer-seller relationships existing between retail food chains and milk processors.

Studies in recent years have tended to focus primarily on the extent and growth of private labeling in the dairy industry as associated with changes in market structure. Little research effort, however, has been devoted to studying the implication for, or the impact on, market conduct. This study was an attempt to determine the effects of private label brands of milk on fluid milk processors (the seller).[2] More specifically, the overall objective of the study was to determine the impact of private label brands of milk on the competitive behavior (market conduct) of fluid milk processors. This involved an analysis of the effects on pricing policies, product policies and policies regarding competitive practices used in the marketplace.

Through personal interviews with plant managers, data were collected from 31 of the 35 fluid milk processors in Kentucky. In addition to general information about individual plant operations, data were obtained relative to (1) a history of involvement in packaging private label brands, (2) reasons for packaging, or not packaging, private label brands of milk and (3) management's reactions about the effect of private labeling on competition and firm behavior. Additional information from secondary sources was also used. The primary focus of this paper is the analysis of data for (2) and (3).

Results and Discussion

Factors Influencing the Decision to Package or Not to Package Private Label Brands

What factors influence a manager in a decision to package private label brands of milk? Or why do some firms avoid the practice? To get an idea of the effect of certain factors on these decisions, managers were asked to indicate the importance of each of a set of factors in reaching the decision. A scale of 1 (no importance) to 99 (very important) was used. An analysis of managers' responses are shown in Table 1 (reasons for packaging private label brands) and Table 2 (reasons for not packaging private label brands).

Reasons for packaging private label brands.-- Managers of fluid milk plants currently packaging private label brands were presented a set of fourteen reasons why a firm might seek out private label accounts. Each responded to these on the basis of their importance in reaching that decision. Their responses, in descending order of importance, are found in Table 1.

Arbitrarily selecting factors with a mean score in the top two-thirds, some patterns tend to appear. An important reason for packaging private label brands centered around reduction of costs - either directly or through increased volume of operation. Being able to compete price-wise in the market was also an important consideration. A third reason of somewhat less concern, but still important, was to hold accounts and to retain display space for the

Table 1--Managers' Responses to Reasons for Packaging Private Label Brands of Milk, Fluid Milk Processors, Kentucky, 1972

Reason	Mean Score	Relative frequency of scores (1-39)	(40-69)	(70-99)
1. Increase volume of business	84	1	1	14
2. Compete price-wise in the market	61	5	1	10
3. Meet the needs of a particular retail customer	54	6	2	8
4. Reduce any desire by retailers to change processors	52	6	2	8
5. Keep space for processor brand display	43	8	3	5
6. Reduce plant operation costs	40	8	3	5
7. Obtain savings in distribution costs	40	8	3	5
8. Prevent retailers from processing and packaging their own private label brands	31	11	1	4
9. Obtain space for processor brand display	30	10	3	3
10. Cut costs by decreasing services offered with private label brands	27	11	3	2
11. Avoid some risk and uncertainty of day-to-day fluctuations in sales	24	12	2	2
12. Expand distribution area	21	13	1	2
13. Eliminate or reduce advertising and promotion costs	18	14	1	1
14. Reduce problems with trade practice regulations	12	15	0	1

Table 2--Managers' Responses to Reasons for Not Packaging Private Label Brands of Milk, Fluid Milk Processors, Kentucky, 1972

Reason	Mean Score	Relative frequency of scores (1-39)	(40-69)	(70-99)
1. Have built up strong consumer loyalty to processor brand and want to retain that loyalty	51	7	0	8
2. Volume of operation too small to adequately handle contracts in market	37	9	2	4
3. High risk of building volume on private label contracts	31	10	2	3
4. Reduced services on private label brands do not affect lower wholesale prices	31	9	1	5
5. Have not been approached by retailers wanting private label brands	30	11	0	4
6. No cost savings in processing and distributing private label brands	30	10	0	5
7. Unable to compete price-wise with competitors for contracts	28	11	0	4
8. Cannot sell private label brand cheaper than processor brand for equal volumes and types of service	25	11	0	4
9. Processor has little or no control over price (retail)	23	12	0	3
10. Processor has little or no control over display, advertising, and promotion	21	11	2	2
11. Retailers are too demanding on contract terms	21	11	2	2
12. No desire to increase volume of business	21	12	0	3
13. Retailer's sale volume in market too small to justify pursuing private label contracts	17	12	1	2
14. Private label contracts would lead to larger distribution areas and not equipped for such	15	13	0	2
15. Want to avoid contracts	12	13	1	1

processor's own brand in the retail outlets. It should be pointed out that in some cases, the processor was only responding to a special need of an individual retailer and was not making any concerted effort to expand private label accounts.

Reasons for not packaging private label brands.--Likewise, managers of milk plants without private label brands were asked to evaluate the influence of selected factors on their decision to package only their own brand. Their responses, again in descending order of importance, are presented in Table 2. In this particular group, no real important factor or pattern emerged. Perhaps this could be expected since the norm over the years has been to package one's own brand while private labeling requires a definite management decision. Retaining consumer loyalty to one's own processor brand and inadequate capacity for handling private label accounts tended to weigh heavily in their decisions. While other factors were important to individual firms, many of these were closely associated with size of operation.

In summary, processors were packaging private label brands of fluid milk to remain competitive in the market, reduce costs, retain accounts, and hold display space in retail outlets. Firms not packaging private label brands were doing so because of inadequate capacity and the desire to build consumer loyalty to their own brands.

Effects of Private Label Brands on Price and Product Policies

While most fluid milk markets may be characterized as oligopolistic in structure and even though firm behavior with respect to many aspects of marketing fluid milk is either regulated or administered, processors still exercise some degree of control over price and product. An analysis of firm policies with respect to these for both private label brands and processor brands is as follows:

Pricing policies.--Two aspects of pricing policies regarding private labels are worthy of notice. First, a majority of the firms that packaged private label brands indicated that the wholesale price of the private label was less than that charged on their own processor brand. It is possible that part of this price differential may be accounted for in the type of services provided on private label brands. While most processors indicated that reduced services was a factor in the lower price, it was apparent that in many cases the cost savings were far less than the price differential. Even when identical services were provided, the price of the private label was still less than that of the processor brand.

A second aspect of pricing private label brands involves behavior patterns in seeking out private label accounts and in negotiating price. Some evidence suggested that the nature and size of the accounts as well as the leverage held by food chains through the threat of either operating their own processing facilities or changing processors influenced the competitive behavior of the processor in negotiating a price.

Product policies.--The pricing policies for private label brands take on new emphasis when considered along with product specifications. While most retailers did require certain product specifications, processors indicated that these were basically the same as the minimums required for their own processor brands. Thus, while the private label brand was essentially the same quality product as the processor brand, in most instances the wholesale price was lower.

Effect of Private Label Brands on Market Conduct

To further assess the influence of private label brands of milk on market conduct, managers were asked to react to several statements regarding the effect of private labels on the competitive climate in markets in which they were currently operating. They were asked to indicate agreement or disagreement with each statement by numerical scores ranging from -99 (strongly disagree) to +99 (strongly agree), with a zero score indicating no opinion.

For convenience in analysis, the statements have been placed in three categories: (1) general impressions with implications for the processor's own behavior, (2) behavior of retailers, and (3) behavior of competitors. An analysis of the responses of the two groups (i.e. processors with and those without private label brands) is shown in Table 3.

General impressions.--Apparently, managers viewed and evaluated these statements in terms of their implication or influence on their own firm's behavior. As might be expected, responses varied between the two groups. While both groups agreed that private label brands have increased competition and that some processors benefited from the practice, there was a difference in the extent to which the two groups viewed the benefits.

Responses to statements 3 and 4 tend to indicate that the private label is used as a price competitive device. In addition to the impact on price, private labels become important in retaining display space for the processor's own brand.

Behavior of retailers.--Managers tended to agree that while the private label brands and/or the threat of such gives the retailer a competitive edge in bargaining power, private labels can also provide one way

Table 3--Managers' Reactions about the Effect of Private Label Brands of Fluid Milk on Competition and Firm Behavior, Fluid Milk Processors, Kentucky, 1972

Statement	Mean Score		F value
	With private label	Without private label	
General Impressions			
1. Private label brands have increased competition	46	39	.13
2. Private label brands have been beneficial to some processors	72	11	6.30**
3. The price differentials between private label and processor brands represent a savings to the processor in services provided	-16	-35	.73
4. The price differentials between private label and processor brands represent decreased costs of operating at higher capacity	10	-4	.34
5. Providing private label brands for some retailers is often necessary to retain display space for the processor's own brand	58	39	3.91
6. The availability of private label brands removes the need or desire for retailers to integrate into processing	17	-13	1.57
Behavior of Retailers			
7. Private labels leave the processor in a poor bargaining position	43	50	.11
8. The threat of private label brands by retailers has been used effectively in bargaining for lower prices on dealer brands	50	61	1.08
9. Private label brands provide one way for processors to meet competition of the large supermarket chains	49	44	.07
10. Retailers too often use private label brands of fluid milk as price leaders	75	71	.16

Table 3--Continued

Statement	Mean Score		F value
	With private label	Without private label	
11. Retailers are often unreasonable in bargaining private label brand contracts	40	40	.06
12. Supermarket chains pressure milk processors into providing private label brands of milk	61	45	.66
13. Supermarket chains demand excessive discounts on private label milk	39	48	.18
Behavior of Competitors			
14. Most processors are quite anxious to negotiate private label contracts	11	40	1.47
15. Private label contracting has led to unfair practices by some competitors	48	58	.21
16. Competitors often compensate for lower wholesale prices of private label brands by sacrificing quality	-17	0	.34
17. Some processors who do not package private labels have lowered the price of their own processor brand to meet the competition of private label brands	37	55	1.25

** Significant difference at the 5 percent level.

for the processor to meet competition from food chains which have integrated into processing and packaging their own private labels.

Behavior of competitors.--While managers may be somewhat reluctant to divulge their own competitive practices, they normally aren't too hesitant in discussing the practices of their competitors. Both groups agreed that private labeling has led to unfair practices by some competitors.

Responses varied with respect to the extent to which these private label accounts are sought, but the analysis showed that most processors are anxious to negotiate such.

While there was no strong feeling that competitors offset the lower wholesale prices of private labels by sacrificing quality, there was the indication that private label brands have influenced the pricing policies of those processors who package only their own brands.

Some Observations

In summary, there is evidence to suggest that private label brands of fluid milk have substantially affected the market conduct of fluid milk processors. Perhaps the most noticeable impact has been on pricing policies for both private label and processor brands, primarily through a shift in the location of bargaining power within the system.

While not fully developed in this paper, the idea has been suggested elsewhere that through private labeling, a changed role of brands *per se* has occurred [1]. Historically, branding has been used as a means of product differentiation and as such, a means for engaging in nonprice competition. Instead of this traditional role, private label brands are being increasingly used for engaging in direct price competition. The analysis of the reasons for packaging private label brands, along with the analysis of managers' responses to the effect of private labels on competition and firm behavior, has tended to reinforce that belief.

As a result, the introduction of a private label brand of milk into any given market tends to set off a different chain of reaction (market conduct) among processors in that market than with the introduction of an additional processor brand. Thus, what appears at first glance to be a similar situation (i.e. the entry of another brand into the market) may evoke an entirely different reaction depending upon whether that brand is a private label or processor brand.

Footnotes

[1]Private label refers to merchandise packaged mainly to a distributor's specifications by either a distributor or a manufacturer, for resale only by a distributor, under a brand name owned by a distributor. Processor brand refers to a manufacturer's or producer's brand of merchandise having wide distribution, usually heavily advertised regionally or nationally with advertising paid for by the manufacturer.

[2]For some indication of the effect of private label brands on this buyer-seller relationship from the buyer's side, see Fallert's study of central milk programs in Midwestern food chains [2, pp. 14-21].

References

[1] Beck, Robert L., "Private Labeling: Nonprice Competition in Reverse," Journal of Farm Economics, 49: 1401-05, Dec. 1967.

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