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Battling for the Household's Category Buck: Can Economy Private Labels Defend Supermarkets Against the Hard-Discounter Threat?

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Abstract

Traditional grocery retailers often use price-based strategies to defend against hard-discounters (HDs). One increasingly popular approach is the introduction of an economy private label (EPL), which provides similar or even larger price advantages over national brands than HD products. However, the jury is still out on whether these EPLs actually shield traditional supermarkets against the HD threat. To shed light on this issue, we estimate an individual-level spending model across 148 product categories, in which we assess the retailer's losses to HDs and his gains from introducing an EPL. Our results show that while EPL introductions increase category sales among the traditional chain's loyal customers, they alienate its other shoppers. On average, and in the absence of HD competitors, EPLs can enhance sales – provided they are introduced in the right (infrequently purchased and less-differentiated) categories and rolled-out sufficiently broadly. However, EPLs are not a good defense tool against the (equally cheap but often higher-quality) HDs; their impact becoming (more) negative following HD entry. The authors discuss implications for retailers in managing their EPL line.

Keywords: Economy private label; Store format competition; Hard-discounter entry; Grocery retailing

Introduction

Hard-discounters (HDs) – with Aldi and Lidl as prime exemplars – have been dramatically on the rise. With retail sales of about €60 billion each, both banners have acquired a top spot in the Western European grocery market. Market share levels have reached 35 percent in some countries, and are expected to further rise in the years to come (Cleeren et al. 2010; Gray 2014; Queck 2014; Van Rompaey 2014). In the US, Aldi is on an even more impressive course, with a projected nine percent growth rate over the next five years (compared to 3.5% in Europe). Following the takeover of former Delhaize discount stores, it may soon extend its US presence "from coast to coast" and become the second largest player in the US value channel (Chanil and Dudlicek 2014; Progressive Grocer 2013, 2015a). Likewise, Lidl – which already operates more than 10,000 stores in 26 countries – ". . .is now directing its full attention to the US" (Klaus Gehrig, CEO Schwarz Group), planning to open its first stores in this market by 2018. Business analysts anticipate that this entry will "send shockwaves through the channel" (Progressive Grocer 2015b; Queck 2014).

By streamlining their operations and economizing on assortment size and in-store service, HD chains can offer grocery merchandise at rock-bottom prices (Chanil and Dudlicek 2014; Steenkamp and Kumar 2009). Moreover, while their low price levels were initially associated with inferior product quality, the objective as well as perceived quality of their products has improved substantially over the last decade (Nauwelaers, Renders, and Vandenbroucke 2012; Van Rompaey 2014). As such, HDs have conquered the "hearts and minds" of a growing segment of consumers, who believe them to provide better value-for-money than "traditional" formats in many categories (Koll, Deleersnyder, and Sadler 2007). Even though HDs, with their limited and private-label (PL) dominated assortments, are seldom the single store-of-choice (Gijsbrechts, Campo, and Nisol 2008; Vroegrijk, Gijsbrechts, and Campo 2013), they made major inroads into the trade of traditional supermarkets – causing sales losses of up to half a trillion dollars per year (Steenkamp and Kumar 2009).

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In the face of this threat, traditional retailers were forced to develop appropriate defense strategies. One strategy that has gained common ground is to complement the standard line of private label products (SPL) with a dedicated "economy" private label tier (EPL) (Ailawadi, Pauwels, and Steenkamp 2008; Klug and Queck 2013). This EPL, also referred to as a "budget" or "value" private label, comprises basic no-frills products that (like the HDs' assortment) only come in a few varieties per product category, and receive little marketing support (Geyskens, Gielens, and Gijsbrechts 2010; Koll, Deleersnyder, and Sadler 2007; Kumar and Steenkamp 2007). EPLs tend to be sold under a different store-brand name than that of the SPL, which often emphasizes its low price and no-frills nature (e.g. Albert Heijn's "AH Basic", Walmart's "Great Value"). In this way, retailers clearly distinguish their EPL from the SPL, and position it as a cheaper, acceptable-quality alternative (Berg et al. 2012; Coriolis Research 2002; Dekimpe et al. 2011; Steenkamp and Kumar 2009).[1]

However, opinions on the effectiveness of EPLs in fending off the HD threat are diverse, and empirical evidence is scarce. Industry sources paint an ambiguous picture: while some report that budget labels prevent shoppers from defecting to HDs (Berg and Queck 2010; L.E.K. Consulting 2014), others suggest that, because of below-par quality, they have failed to do so (Brenninkmeijer 2013; De Jong 2013). Some practitioners even advise to adopt a completely opposite PL strategy in the HD battle, that is, to offer a unique assortment of premium private labels and focus on quality differentiation rather than price competition – since "price can drive a first purchase, but quality drives return purchases and loyalty" (Joppen 2014; McEwen 2014).

Previous research on EPLs focused on within-store brand competition (i.e. the impact of EPLs on other brands within the retailer's assortment; e.g. Geyskens, Gielens, and Gijsbrechts 2010), and thus provides little insight into their defensive power in the competition with other (HD) stores. Extant studies do examine the role of SPLs in building store loyalty (e.g. Ailawadi, Pauwels, and Steenkamp 2008; Koschate-Fischer, Kramer, and Hoyer 2014) and competing with "large discounters" (i.e. Walmart; see Hansen and Singh 2008), but we expect the impact of EPLs in the competition with HDs to be different, for two reasons. First, compared to SPLs, EPLs have a stronger price focus and – because of their low quality, frugal packaging and limited marketing support – probably a lower potential to differentiate a store from its competitors. Therefore, budget PLs may not foster store commitment, but rather enhance consumers' price focus (Chintagunta, Bonfrer, and Song 2002). Second, HDs constitute a different business model from large discounters. As a result of their cost-cutting assortment strategy, the HDs' appeal varies across categories, for example, because of category differences in price sensitivity, need for variety, or preference for national brands (Vroegrijk, Gijsbrechts, and Campo 2013). This makes HDs attractive as a complementary but not as a single store-of-choice, and primarily to households willing to engage in multiple-store shopping (Nielsen 2007; Vroegrijk, Gijsbrechts, and Campo 2013). Hence, the need for a defense mechanism against HDs appears more pressing for some products than others; and the defensive ability of EPLs may be category- and household-specific.

Taken together, this leads to the following research questions. Can EPLs act as a defense mechanism against HD competition? What categories should they be carried in, and how broadly should they be rolled out? And: does their impact differ among the traditional store's customer groups? To answer these questions, we estimate an individual-level model with endogeneity correction that compares consumers' category purchases at a traditional retailer (i) in the absence and presence of EPLs, and this (ii) before and after HD entry.

From an academic perspective, our study contributes to the literature on store format competition and (category-specific) store loyalty, by examining whether EPLs are an effective way to reduce losses to HDs, and how this depends on category and customer characteristics. As such, it fits into Ailawadi and Keller's (2004) call for more research on how differently positioned private labels affect retailer performance. For retailers, we highlight category and consumer differences in EPL performance, and shed light on the effectiveness of EPLs in keeping HDs at bay. Such insights are compelling given that many retailers are still rolling out (or reconsidering) their EPL programs.

The paper is organized as follows. In the next section, we characterize EPLs, and discuss why and under which conditions this tier of private labels could help to reduce HD losses. We then describe our modeling approach, followed by the empirical setting and an overview of the estimation results. The last section provides a discussion of the major conclusions, research limitations, and directions for further research.

Framework and Issues Investigated

Private label types and characteristics. PLs have become an essential part of a traditional supermarket's offer. While initially used to strengthen the retailer's bargaining power vis-à-vis manufacturers and to differentiate from other traditional retailers, changes in the competitive environment have led to a further PL expansion. In reaction to the fierce price competition from HDs, several retailers also introduced an EPL, thereby moving to a multi-tiered private label strategy (Geyskens, Gielens, and Gijsbrechts 2010).[2]

Within such a strategy, the original SPL is typically marketed as "quality similar to national brands at a lower price", geared toward competition with these national brands and other traditional supermarkets (Corstjens and Lal 2000; Kumar and

[1] While extremely low-priced, relatively sober in packaging and of lower quality than SPLs, EPLs differ from the first-generation "generic" private label products. These products had no real brand name, and a package that often contained product information only (i.e. no pictures or labels). In addition, although EPLs are generally of lower quality than SPLs, they still compare favorably to the quality of previously sold generics (Burt 2000).

[2] Many stores also introduced a premium PL in a price/quality tier above the SPL (Geyskens, Gielens, and Gijsbrechts 2010). For a recent study, see e.g., Ter Braak, Dekimpe, and Geyskens (2013) and Ter Braak and Dekimpe (2014).