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Aggressive or partnership strategy: Which choice is better for the national brand?

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ABSTRACT

Following the increasing popularity of private brands, national brands' manufacturers are using many strategies either to counter the threat of these brands or to collaborate with retailers. We investigate the benefit of using national brand's advertising (the aggressive strategy) that hurts the private label's demand over using national brand's revenue sharing (the partnership strategy) that fosters collaboration between the retailer and the national brand's manufacturer. We compare each strategy to the benchmark case where none of these strategies is used and where both brands (national and private brands) are offered through a unique retailer. We find that when the national brand's revenue sharing is implemented, the manufacturer and the whole chain are gaining compared to the benchmark case but the retailer is always losing. Thus, a profit sharing mechanism is needed to split the increased profit and achieve a Pareto result for all channel members. Furthermore, although the strategy of national brand's advertising is always beneficial to the manufacturer, it is not beneficial to the whole channel when the private label has low differentiation. Finally, the retailer could benefit from national brand's advertising depending on the private label's concept and other factors.

1. Introduction

According to GFK Roper study (2011), eight out of ten consumers in US say that private labels (PLs) are "as good as" , or "better" than national brands (NBs). In addition, more than 50% of consumers frequently purchase PLs. Mintel study (2011) explained that many drivers helped PLs' popularity. First, the economic recession pushed consumers to look for products similar to NBs at lower prices. Second, the consumers' positive experience with PLs resulted in greater spillover and word of mouth promotion for PLs. Third, the media publicity highlighted the PL's good quality and value for reasonable price. IDC Retail insights (2010) added many other factors to explain the success of PLs such as the size increase of many retailers, the challenge to compete on prices and margins, the balance between innovation and quality-value, the improved technology, the demand and business intelligence, and finally, the control over assortment and space management.[2]

During its evolution, PLs progressed from simple cheap generic brands (e.g., A&P Saving Plus Line from Wal-Mart) to leading NBs' copycats (e.g., ChipMates from Kroger imitating Chips Ahoy!), and finally, to premiums (e.g., President's Choice from Loblaws). Other PL's concepts were introduced but they are not the subject of our paper. The two other concepts are value innovators (e.g., IKEA products) and super-premiums (e.g., Eating Right from Safeway). Many retailers started to call their PLs "own" brands to represent their exclusive offering and distinctive level (Mullick-Kanwar, 2013).[3] Hence, it is clear that product differentiation and variety of concepts helped retailers gaining shares compared to NBs.

To combat the increasing threat of PLs, advertising is one of the key strategies used by manufacturers. According to BIA/Kelsey's study (2013), NBs' manufacturers spent $45.2 billion dollars in 2012 in local media advertising such as direct mail, television, print yellow pages, radio, out-of-home and more.[4] This amount is more than a third (exactly 33.6 percent) of all spending in local media. A Masmi research

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[2] GFK Roper study, Mintel study and IDC Retail insights are all retrieved from www.plma.com.
[3] "The evolution of private label branding" retrieved from www.brandchannel.com.
[4] "How to target a local audience" retrieved from www.radiatemedia.com.

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(2004) suggested that manufacturers should not cut their advertising for NBs even when the economy slows down.[5] In addition to innovation and product development, sustained advertising is then one of the key NB's building strategies against PLs.

Instead of using an aggressive strategy (e.g., advertising investment eroding the rival's sales), studies suggest that cooperation strategies are more successful to generate a win–win situation for both partners. For instance, Gerstner and Hess (1995) showed that price discounts can effectively improve channel coordination by increasing the whole channel profit. Desiraju and Moorthy (1997) found that channel performance could be improved by appropriate levels of price and service offered by the manufacturer to support the supplier's. Koulamas (2006) conducted a theoretical study to show that manufacturers and retailers can implement a revenue sharing policy to effectively achieve channel coordination. However, Ganesan (1993) showed that the use of negotiation strategy depends on the level of conflict (high versus low) and the importance of issues discussed (important versus unimportant). He showed also empirically that the use of aggressive strategies is moderated by the level of conflict. Hence, we are interested to investigate this specific trade-off in the context of NB and PL. Is it better for the manufacturer to be aggressive or to be a partner to the retailer and under which circumstances each strategy outweighs the other? Is it always true that cooperative strategies provide a win–win situation for both channel members?

Our paper has mainly four objectives:

- By introducing the product differentiation as a separate parameter in the context of NB and PL, we would like to assess its impact on pricing strategies and performance of both channel members (the NB's manufacturer and the retailer).
- By including NB's advertising as an aggressive tool for the manufacturer, we would like to measure its effectiveness against the PL and how it affects the performance of both channel members.
- By sharing NB's revenue with the retailer, we would like to measure its effectiveness on the performance of both channel members and reassess if it is always beneficial for both of them. If revenue sharing is beneficial to only one channel member, then, what other mechanism could be utilized to achieve full channel coordination and benefit all members?
- Comparing the NB's advertising case with the NB's revenue sharing case, we would like to uncover which strategy is better for the manufacturer, the retailer, and the whole channel?

The main findings could be summarized as follows: (1) revenue sharing is always beneficial to the whole channel and the manufacturer, but not to the retailer; and (2) advertising the NB is always beneficial to the manufacturer, but is beneficial to the whole channel and the retailer only under specific conditions.

To reach our objectives, we have organized the paper as follows. The second section reports what has been done in the literature related to NB and PL's context, advertising and revenue sharing. The third section explains the three models (a) the NB and the PL are offered in the market and the product differentiation parameter is highlighted in the model, (b) the manufacturer advertises his NB which reduces the PL's demand and (c) the manufacturer and the retailer shares the NB's revenue which enhances the collaboration between channel members. The fourth section compares the different models. The fifth section uses simulation analyses to analyze further the analytical results. Finally, the sixth section concludes and recommends managerial avenues for retailers and NBs' manufacturers.

2. Literature

Many papers studied the context of NB and PL. The literature studied the topic from different perspectives. For instance, Ailawadi and Harlam (2004) investigated how PLs could increase the bargaining power of retailers against NB's manufacturers. Morton and Zettelmeyer (2004) explained that PLs give retailers more control over brands' assortment and positioning on the shelves. Amrouche and Zaccour (2007) elucidated the importance of PLs' quality to hold a better positioning on the shelves. Ailawadi et al. (2008) proved empirically that PLs increase store traffic and loyalty. Dhar and Hoch (1997) uncovered the determinants of PLs' success. Erdem et al. (2004) studied the consumers' purchase behavior for NBs versus PLs. Sethuraman et al. (1999) focused on the price competition between PLs and NBs. Putsis and Dhar (2001) examined the effectiveness of promotion on category expansion versus brand switching. Finally, the impact of PLs' introduction on pricing and performance of channel members was the interest of many papers (e.g., Mills, 1995–1999; Narasimhan and Wilcox, 1998; Raju et al., 1995; Chintagunta et al., 2002; Ailawadi and Keller, 2004). Few papers analyzed theoretically the variety of PL's concepts. Amrouche and Zaccour (2009) introduced an analysis of a shelf-space dependent incentive based on different types of PLs. Amrouche and Yan (2012) examined also the impact of PLs' concepts in introducing an online store for NBs either to counter PLs or to expand the market. Both papers defined the PL's differentiation based on quality differential and cross-price effect.

Few studies focused on advertising the NB. Connor and Peterson (1992) and Abe (1995) showed that advertising the NB allows national manufacturers to ask for higher prices, which boosts the price differential with the PL. Kim and Parker (1999) and Soberman and Parker (2004) showed that advertising the NB increases both retail prices and allows for better price positioning to differentiate between both brands. Our paper would like to assess the benefits and pitfalls of using national brand's advertising when a product differentiation parameter is taken into account. In our paper, the product differentiation parameter captures the overall positioning of the PL compared to the NB in the mind of consumers (either close or distinct positioning). Our paper studies also the pricing strategies in the NB–PL context jointly with the effect of NB's advertising used as an aggressive strategy against the PL.

The channel coordination through revenue sharing between the manufacturer and the retailer has been intensively studied by theorists. For example, Koulamas (2006) studied the value of revenue sharing policy in a single manufacturer–retailer channel and showed that both (the manufacturer and the retailer) may benefit from revenue sharing. Linh and Hong (2009) studied the channel coordination through revenue sharing contract between a single retailer and a single wholesaler in a two-period newsboy problem. Their results showed that the optimal revenue sharing ratio is linearly increasing in the wholesale price. Cai (2010) utilized a game-theoretic model to show that revenue sharing contract could be beneficial for both channel members when the supplier opens an online channel. Cai et al. (2012) showed that suppliers and retailers could form exclusive deals only with revenue sharing. Kunter (2012) showed that channel

[5] "National brands and private labels: Fierce rivals, uncomfortable bed fellows, or enlightened partners?" retrieved from www.masmi.com.