



Effect of Store Brand Introduction on Channel Price Leadership: An Empirical Investigation

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Abstract

In this study, we conduct an empirical investigation of the impact of store brand introductions on the price leadership relations in a distribution channel between a retailer and national brand manufacturers. We analyze a multi-product category retail database from a major grocery chain, which captures both a period before and a period after the introduction of a store brand in each product category. By applying the time series approach to this data set, we show that store brand introductions frequently lead to price leadership changes, generally in a more favorable direction for the retailer than for the national brand manufacturer, evidenced by either the decay of the manufacturers' price leadership or the rise of the retailer's price leadership. However, such a change is not universal but tends to be concentrated among a certain quality tier of national brands, which is not always the low-tier, but sometimes the top-tier despite the low-price low-quality position of the store brand. The patterns detected in the data suggest that these changes are likely to reflect the retailer's strategic effort to reshape the price leadership environment in a product category aided by the enhanced bargaining power and managerial sophistication that accompanied the store brand introductions.

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Introduction

The proliferation of store brands (SBs) has fundamentally impacted the relationship between manufacturers and retailers. Retailers are now allocating an increasing share of their already scarce shelf space to private labels, thus making national brand (NB) manufacturers vulnerable to power of retailers to demand steep discounts (Financial Times, April 13, 2009; Karp 2012; Matlack and Tiplady 2005). For NB manufacturers, a SB means not only fiercer competition for shelf space but also the pressure to accept smaller margins, because SB products set price ceilings (Creswell 2000; Martin and Brat 2010). On the other hand, retailers typically enjoy increased margins on NBs after the introduction of SB (Narasimhan and Wilcox 1998; Sayman, Hoch, and Raju 2001). Furthermore, a retailer actively dealing with SB suppliers may gain deeper knowledge of the manufac-

turers' cost structures. All these factors point to the possibility of significant changes in the channel price leadership status between NB manufacturers and retailers after SB introductions.

During the last two decades or so, scholars have paid increasing attention to the diverse channel price leadership and their impact on channel performance. For instance, Choi (1991) theoretically analyzed three possible price leadership scenarios between a manufacturer and a retailer: the absence of a channel price leader (the "Vertical Nash" game, labeled VN hereafter), the manufacturer's price leadership over the retailer (the "Manufacturer Stackelberg" game, labeled MS hereafter), and the retailer's price leadership over the manufacturer (the "Retailer Stackelberg" game, labeled RS hereafter). He found that these channel price leadership scenarios have a significant impact on channel member prices and profits, and consequently on their optimal channel strategies. Lee and Staelin (1997) extend the study of these three channel pricing games and show that the impact of price leadership on the profitability of individual channel members is moderated by the type of vertical strategic interactions present in the channel. Trivedi (1998) examines

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the effects of the two Stackelberg leadership scenarios on channel members' performances considering competition at both manufacturer and retailer levels. Shi, Zhang, and Ru (2013) theoretically explore how the inclusion of demand uncertainty affects the relationship between the type of channel price leadership and performance of channel members. On the empirical side, Cotterill and Putsis (2001) analyze twelve retailer–manufacturer relationships in six product categories and reveal the existence of VN and MS games. In addition, Kuiper and Meulenberg's (2004) time series analysis of an agricultural product market suggests the existence of a “retailer dominance” relationship; here, the manufacturers are forced to become price takers.

Despite the significance of SB business and its potential impact on channel price leadership between manufacturers and retailers, insufficient attention has been paid to the impact of a SB introduction on channel price leadership in the literature. Many theoretical studies have examined various SB management issues by either assuming manufacturers' channel price leadership (i.e., the MS game) both before and after SB entry (e.g., Du, Lee, and Staelin 2005; Raju, Sethuraman, and Dhar 1995; Sayman, Hoch, and Raju 2001) or applying the Nash bargaining game framework (e.g., Scott Morton and Zettelmeyer 2004). Consequently, they fail to acknowledge the possibility of a SB introduction reshaping the pattern of vertical price leadership. Similarly, Ru, Shi, and Zhang (2015) analyze how the introduction of SB affects the strategic interaction between a retailer as price leader and a manufacturer as price follower (i.e., assuming the RS game), and show that the SB entry can have a positive effect on the performance of NB manufacturers under certain conditions. Choi and Fredj (2013) investigate the price competition under different price leadership scenarios in a market composed of two competing retailers selling their SB and an NB supplied by a common manufacturer. None of these previous theoretical studies addresses the potential impact of a SB introduction on channel price leadership changes.

Empirical evidence indicates that the entry of SBs indeed affects the strategic interaction in pricing between NB manufacturers and retailers, but leaves it unclear whether the impact clearly involves changes of price leadership in the channel. In particular, Chintagunta, Bonfrer, and Song (2002) show that following a SB introduction, manufacturers set their wholesale prices in a more “accommodating” fashion for retailers. Similarly, Meza and Sudhir (2010) find that retailers with SBs can benefit from lower their NB wholesale prices, which can be interpreted as the retailers' gain of bargaining power after SB introductions. Thus, these empirical studies provide evidence that SB introductions generally modify the pricing interactions in the favorable direction for retailers. Nevertheless, they fall short of explicitly linking the observed changes in channel members' pricing behavior to channel price leadership changes.

In this study, we address this gap in the literature, and present a direct empirical investigation of the impact of a SB introduction on the channel price leadership situation between a retailer and NB manufacturers. We take a purely empirical approach of time series analysis to identify the leader–follower patterns between NB manufacturers' wholesale pricing decisions and the corresponding retail pricing behavior in multiple product

categories before and after the introduction of SB in each category. In the process, we seek to contribute to the literature of store brand management and channel price leadership in several ways. First, this study is the first to investigate the impact of a SB introduction on channel price leadership explicitly. Our analysis produces empirical evidence that SB introductions frequently lead to changes in price leadership patterns between NB manufacturers and retailers. The specific changes we detect from the data are generally in the direction of either NB manufacturers' loss of price leadership or the retailer's gain of price leadership. In this way, we show that the changes in channel members' pricing behaviors after SB entries reported in previous empirical studies are partly due to switches in price leadership between NB manufacturers and retailers.

Second, our study shows that the above-mentioned general pattern is not uniformly applicable to all NBs. Instead, we find evidence that price leadership switches after SB introductions tend to take place in a targeted way, affecting certain NBs only. Prior research has suggested that the introduction of a SB improves the retailers' bargaining positions mainly against low-tier NB manufacturers (e.g., Meza and Sudhir 2010; Pauwels and Srinivasan 2004). This is not surprising given the low-quality low-price positions of many SBs. Thus, one might expect to observe price leadership changes mainly for low-tier NBs when SBs enter the category. Interestingly, our analysis shows that, even if the SB's entry is at the lowest quality and price position in the category, it may cause price leadership changes not necessarily for low-tier NBs, but, sometime for top-tier NBs.

Thus, the impact of a SB introduction on price leadership pattern for NBs is not constrained by the proximity in brand position between an NB and the SB. Instead, the retailer appears to possess some amount of power to select certain NBs strategically and change price leadership situations for them. This result has some resemblance to the previous analytical studies (Choi and Coughlan 2006; Du, Lee, and Staelin 2005; Sayman, Hoch, and Raju 2001; Scott Morton and Zettelmeyer 2004) that generally advocate positioning a SB against a target NB. Unlike their stylized models composed of only two NBs, however, we analyze data that include a larger number of NBs in each category, and, show the differential impact of a SB introduction across different quality tiers of NBs within a product category.

Third, we further look into the tier of NBs that experience price leadership changes in favor of the retailer after SB introductions, and identify their distinctive characteristics in comparison with other NBs. In particular, we find that, when the top-tier NBs have the majority market share of the category before the SB entry, a SB introduction leads to price leadership changes in favor of the retailer for the top-tier NBs but not for the low-tier NBs. Otherwise, the retailer enjoys favorable price leadership changes for low-tier NBs after SB introductions. Between these two opposing cases, we observe other interesting differences in retail margin and market shares. In general, these observations suggest that retailers may focus their efforts to change price leadership situations for the most strategically significant tier of NBs in each category.

Our study is exploratory in nature. Previous studies and existing theories offer little guidance on how a retailer selectively

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