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Manufacturer's retailer dependence: A private branding perspective

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ABSTRACT

With the recent increase in the power of major retailers through consolidations, the world of brands has divided in two categories: national brands belonging to manufacturers and private brands belonging to retailers. While national brands are well studied in the literature, there is a dearth of studies on private brand phenomenon particularly from a manufacturer's point of view as opposed to that of retailers and consumers. To address this gap, we explore the antecedents and consequences of a manufacturer's private brand retailer dependence with a focus on the manufacturer's relationship with retailers. Drawing on the Resource Dependence Theory and Transaction Cost Economics, we examine various products and market characteristics as potential antecedents of a manufacturer's private brand retailer dependence while adopting private brand sales growth and returns from private brand production as outcomes using a sample of 153 South Korean manufacturers currently involved in private brand production. The results show that the private brand retailer dependence of a manufacturer leads to private brand sales growth directly and returns from private brand production indirectly through private brand sales growth, and has a negative effect on return from private brand production directly. Furthermore, product characteristics, such as product innovativeness through collaboration with retailers and search goods, and market characteristics, such as high retailer power and knowledge specificity of a retailer, increase a manufacturer's private brand retailer dependence and, therefore, private brand sales growth. The theoretical and managerial implications of the findings are discussed at the end.

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1. Introduction

While major retailers are gaining more power through consolidations and by collecting information about and understanding the consumers in the market, the world of brands has divided in two categories: national brands owned by manufacturers and private brands often owned by major retailers. While national brands are well studied in the literature, we have a limited understanding on private brands particularly from a manufacturer's point of view as opposed to that of retailers and consumers. Given the rapid growth of its market share in recent years (González-Benito & Martos-Partal, 2012), private brands are becoming increasingly important even for the manufacturers regardless of their own brand portfolio in the context of B2B marketing. In the U.S. for instance, private brands accounted for 15.6% of total dollar share in 2007. Since then, their share increased 16.6% in 2008, 17.0% in 2009, and 17.4% in 2010 (Nielsen, 2011). Moreover, product categories of private brands are spreading from grocery items to household goods, clothing and electronics (Groznik & Heese, 2010).

As Ezrachi and Bernitz (2009) and Philipsen and Kolind (2012) describe in their exploratory, yet informative studies, private brands are often referred to as store brands, private labels, distributor brands, and retailer brands. Private brands are typically owned by large individual distribution channel members – usually retailers – who buy these products in bulk from manufacturers with the retailer's name imprinted on them (Kumar & Steenkamp, 2007). On the other hand, national brands are those developed and owned by manufacturers (Keller, 2008).

Several differences exist between private brands and national brands (Kumar & Steenkamp, 2007). First, private brand products are not advertised and there is no entrance cost for them (Chaniotakis, Lymperopoulos, & Soureli, 2009). Second, the retailers take full responsibility for promoting the private brands (Kumar & Steenkamp, 2007). Third, the price of private brands is generally lower than that of national brands (Keller, 2008). Finally, while private brands are often distributed by the respective distributors/retailers who are the sole owners of the brand, national brands usually are carried by most major retailers (Hoch, 1996).

It should be noted that generics or generic private labels are not always considered a private brand (Kumar & Steenkamp, 2007). Generics are usually manufactured with the product characteristics often following those of a leading brand in the market but they may be packaged with or without a brand including a retailer brand (Keller, 2008).

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Private brands provide retailers increased channel powers in their relationships with manufacturers (Corstjens & Lal, 2000) and offer more marginal contributions, improved sales, market share and profitability (Oubiña, Rubio, & Yagüe, 2006). For example, Wal-Mart's private brand generates more revenue than that of Nestle, the world's largest fast-moving consumer goods manufacturer, illustrating the current role and size of private brands in the market (Kumar & Steenkamp, 2007). Specifically, Wal-Mart's private brands generated $126 billion in sales in 2005 (Lincoln & Thomassen, 2009). Reflecting the trend, retailers are increasingly developing and building private brands (Groznik & Heese, 2010).

Despite the increasingly important role of private brands in the market, studies focused on the manufacturer–retailer perspective of the private brand phenomenon are scant (Dunne & Naradimhan, 1999). Extant studies on private brands can be classified into three categories according to their focus on each of three stakeholders: consumers, retailers, and manufacturers (Hoch, 1996; Kumar & Steenkamp, 2007). Although researchers have explored how retailers and consumers respond to and take advantage of private brands (Ailawadi & Harlam, 2004; Palmeira & Thomas, 2011; Sprott & Shimp, 2004), the manufacturer–retailer side has remained intact. The strategic implications of manufacturers' production and supplying of private brand products, therefore, are largely unknown (Gómez & Benito, 2008; Oubiña et al., 2006).

Furthermore, manufacturers often consider private branded products critical for maintaining long-term relationships with retailers (Philipsen & Kolind, 2012), but often must compete against these same retailers in the market (Gómez & Rubio, 2008). When private brands were first introduced, manufacturers did not view them as a threat to their own national brands because many consumers were skeptical of the quality of private branded products given their lower cost. Manufacturers did not view private branded products as an attractive alternative to national brands because their production often created negative effects on the value perception of their own national brands and profitability (Timmor, 2007).

Consequently, manufacturers focused on differentiating their own national brand products by improving the quality of their product while coping with price competition against private branded products (Bontemps, Orozco, & Réquillart, 2008; Wedel & Zhang, 2004). The literature even suggests that manufacturers refrain from producing private branded goods, maintain the equity of their core national brands and introduce their own low-priced competing brands against private brands to secure channel power over retailers (Gómez & Okazaki, 2009).

Numerous manufacturers, however, continue to produce private-branded goods as well as their own national-branded goods because they view private brands as strategic alternatives in building long-term relationships with retailers (Kumar & Steenkamp, 2007; Philipsen & Kolind, 2012). Some manufacturers actually take a proactive approach to private brand goods, supplying them to retailers in addition to their national brand product and expanding their distribution channel with little investment. Other manufacturers recognize this approach as an opportunity to create strategic partnerships with retailers and take a stable market position by producing private brand goods ahead of competitors. More private brand suppliers recognize relational benefits, such as goodwill and product innovations, through collaboration with retailers (Braak, Deleersnyder, Geyskens, & Dekimpe, 2013; European Commission, 2013; Philipsen & Kolind, 2012). Dedicated private brand product manufacturers who make only private brand products routinely obtain consumer insights and ideas for product innovation through their collaboration with retailers (Braak, 2011; Philipsen & Kolind, 2012).

Despite the recent private brand trend and phenomena in the retailing industry, little is known about how producing private brand goods and national brand goods simultaneously affect manufacturer performance. Although numerous manufacturers are involved in producing private brand goods, literature is unclear on whether such involvement will eventually benefit their overall performance. To fill this literature gap, we explore the antecedents and outcomes of manufacturers' private brand retailer dependence with the following contributions. First, we identify factors that influence private brand retailer dependence through an exploratory study. With the emergent theme in product and market factors, this study conceptualizes its research framework to explain manufacturers' involvement in producing private brand goods. Through the empirical study, this research contributes to the literature by identifying product and market level antecedents of private brand retailer dependence (Verhoef, Nijssen, & Sloot, 2002). Second, this study investigates the nature of a manufacturer's private brand retailer dependence on its performance. Quelch and Harding (1996) argue that the production of private brand products is advantageous to short-term retailer relationships, but harmful to long-term performance because it increases manufacturer dependence on retailers. To clarify the nature of private brand effects, we examine how manufacturer involvement in the production of private brand goods leads to enhanced market performance, including sales growth and profitability.

2. Theoretical background, conceptual framework and hypothesis development

This study draws on the Resource Dependence Theory (RDT) and Transaction Cost Economics (TCE) in exploring why private brand manufacturers are prone to dependence on retailers. With the power in the distribution channel shifting more toward retailers (Dawar & Stornelli, 2013) and the concentration ratio of big retailers increasing (Chen, 2009), big retailers are focusing on their private brands and destocking weak national brands (Neff, J, 2009). As a result, retailers have more resources and power. Manufacturers without leading national brands, on the other hand, need to build and nurture their relationship with powerful retailers (Philipsen & Kolind, 2012).

While how retailers' resources lead to manufacturers' dependence on these retailers remains unclear, RDT argues that the success of the manufacturer is determined not only by environmental factors but also by the critical resources they possess, and that it is impossible for a firm to own all the resources needed within the organization (Pfeffer & Salancik, 1978). In other words, manufacturers engaged in private brand products have an advantage over retailers in the production of goods, but not in the collection of information about consumer insights, new product ideas, assortment planning, and promotions (Scaff, Dickman, Berkey, & Baran, 2011). According to RDT, these activities are important resources for retailers, and manufacturers depend on these retailers for such information (Philipsen & Kolind, 2012; Rubio & Yagüe, 2008).

In a similar vein, TCE maintains that market uncertainty, asset specificity and frequency are critical dimensions of inter-firm transactions (Williamson, 1991). While TCE views brand name as a means to enhance asset specificity, Chen (2009) argues that private brand can be a special case of asset specificity. That is, the increased power of retailers has prompted them to take over branding functions previously performed by manufacturers by focusing on private brand products, thus maintaining their power within the channel.

During the exploratory part of the study, we interviewed several manufacturers who currently supply private brand products to the most recognized retailers in South Korea. This exploratory part was crucial in gaining insights on the factors of a manufacturer's private brand participation as the private brand phenomenon is still emerging in the literature.

Responses were classified into several categories, including certain ex-ante internal variables of the manufacturing firm mainly related to the product, such as whether or not there is potential to enhance product innovation through collaboration with retailers and whether the product type warrants private brand success. According to the respondents, search goods, as opposed to experiential goods, and those product categories already dominated by private brands, are more likely to be successful. Search goods were mentioned often by the respondents