

The first glance at the growing impact of private labels on the upstream local food suppliers in Finland

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Introduction

The last twenty years has witnessed substantial changes in retailing across most European countries. Particularly, the increased prevalence of category management, the significant investment in new technology and improved logistics have enabled the supermarkets in the European countries acquired an increasing share of grocery markets. As a strategic tool, private labels (PL) has become increasingly important for European retailers to gain market share, loyalty of customers and reinforce the bargaining power toward suppliers and countervailing power against manufacturing brands. (Bonfrer and Chintagunta, 2004; Hansen et al., 2006; Groznik et. al. 2010 EU commission, 2011). The combination of recession and a retail food price spike during the last 5 years provides even more opportunity for PL growth as increasingly price-sensitive customers shift to PL alternatives.¹(Volpe, 2011) According to statistics from Private Label Manufacturer Association (PLMA), the market share of PLs accounts for 17 to 48% of the groceries market in the EU in 2012. Many consumers see private label not only a trade-down but more often as another branded options. (Nielsen, 2010)²

In Finland, the sales of private labels have been growing significantly during the last five years. However, the total share of the sales is still lower than in the EU countries on average. PL share is commonly positively correlated to concentration levels in food retail. (Lincoln and Thomason, 2009). Table 1 presents the concentration of national grocery markets in a number of EU countries versus the market shares of PLs based on the volumes obtained from PLMA. Figure 1 displays the total market share of PLs including food and non-food in Finland calculated in value. Clearly, Finnish grocery trade is the most concentrated amongst EU members of states. Even though the market share of PLs in Finland has not reached as high level as the other European countries such as Germany and UK, the market share of PLs in food sector based on sales value, has been steadily grown from 7.6% in 2003 to 12% in 2012³(See Figure 1). Given the close link between concentration levels and PL share, the expectation that PL market share in Finland is projected to increase by between 3- 5% points yearly in the coming five years. Compared to the current level of 12 percent, this entails that PL market share is set to over 20% in value in the coming 5 years.

The growing importance of PLs has spawned an academic literature empirically investigating the factors that facilitates its success (Cotterill et al, 2000; Chintagunta et al, 2002; Richards et. al., 2007; USDA, 2011) different countries (Cordeiro, 2007; Kilic and Hakan, 2009). One of common consequences of high concentration and growing PLs sales is a growing imbalance of bargaining power within food supply chains, i.e. the power of supermarkets over their suppliers. In Finland, the economic and social effects of such imbalanced bargaining power on producers and processors are increasingly recognized (FCA, 2012)⁴, however, the empirical research related to PLs has been very limited (Delvecchio, 2001). Amongst the limited publication related PLs, many concentrated on retailers and consumer' welfare being (Gabrielsen and Sorgard, 2007; Perrin 2006; Uusitalo and Rökman 2004; The Economist Intelligence Unit: Industry report, 2010). However, very limited research (Suvanto et.al, 2006), stood into suppliers' shoes.

¹ http://www.gov.mb.ca/agriculture/statistics/food/global_private_label_trends_en.pdf

² Source: The Nielsen Company, Global Online Survey, Q3, 2010

³ Source: Finnish Grocery Trade Association and AC Nielsen

⁴ Finnish competition Authority (2012). Study on Trade in Groceries. FCA reports 1/2012.

Table 1. Selected national food market concentration ratios in the recent years.

Country	Year	Percentage of national food market in recent years ¹⁾	Concentration ratio ²⁾	Market share of PL based on volumes ³⁾
USA	2006	35 (2006)	CR ₄	23
UK	2011	76 (2011)	CR ₄	45
Germany	2011	85 (2011)	CR ₄	42
Switzerland	2011	81 (2011)	CR ₃	53
Norway	2011	81 (2011)	CR ₃	27
Finland	2011	88 (2011)	CR ₃	29

¹⁾Source: International Consumers, and own calculation ²⁾Concentration ratios are defined as the combined sales of the largest x companies divided by total industry sales. ³⁾Source: PLMA 2013 yearbook: The data varies from difference sources. The figures of PLMA are provided by ACNielsen according to the volumes.

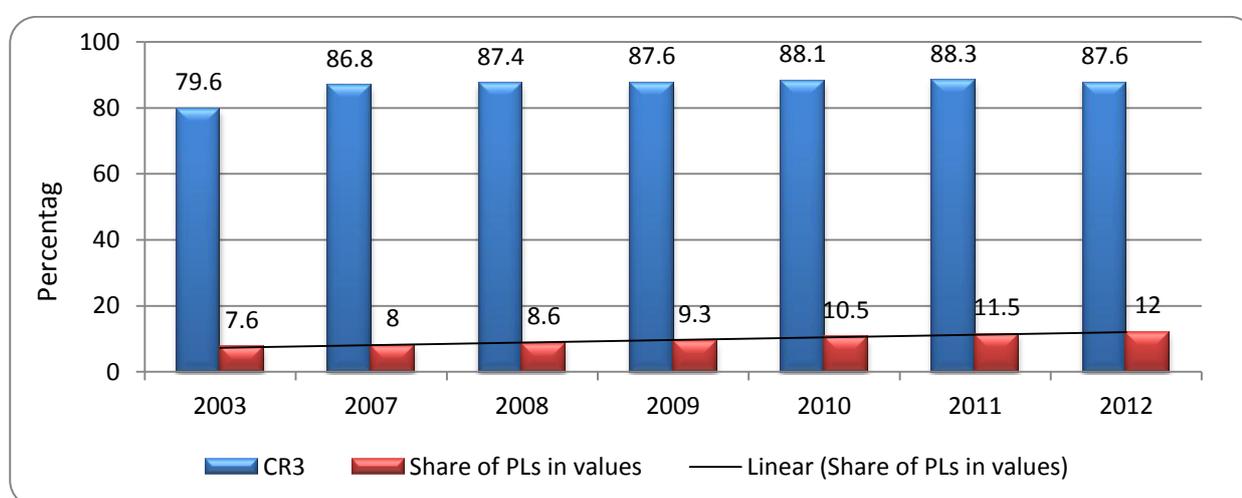


Figure 1. Concentration rate vs. share of PLs in values in Finland between 2007 and 2012

Thus, the aim of this study is to investigate the motivation of local B-brand producers/processors to produce the PLs. Moreover, we overlook the impact of growing PLs sales on the business relationship between such suppliers and the retailers from local suppliers' perspectives. We select the following food sectors in this study: meat sector, mills, eggs and fluid milk sectors. Furthermore, we overview how the enhancing bargaining power of retailers due to PLs affects typical Finnish local food suppliers' business practice. The rest of paper is constructed as follows: in the following section, we briefly introduce the situation of Finnish food industry and the development of PLs. In the 3rd section, the method and process of the research are introduced. We present and analyze the insights of results with a discussion of our results.

Finnish food Industry and Private Label

The food industry is the fourth largest industry in Finland, after metal and engineering, forest, and chemical industries. Gross value of production 11.3 billion Euro in 2011. 12% labour of Finland work for food industry. Finnish food industry has been characterized as highly localized industry. For example, in 2012, domestic sale of food accounted for over 79% and food content made in Finland accounted for 82%. Nevertheless, these figures were shrunk by 10% and 7% respectively in comparison to the ones in 2004. Meanwhile, the shares of importing foodstuff have been increasing ever since 2004. In comparison to highly concentrated supermarket, most of Finnish local food producers/processors are medium and small sized business, many

of which are run by families. Up to 2012, there are 1869 firms in food industry in Finland running, and 65% of these firms have had workers less than 5. Only 2% of the firms employed more than 200 people. Nevertheless, there are few local food processing industries that have high concentrated level in Finland: For example, 70-80% of processing meat market is shared by the top two suppliers; 50% of liquid milk market is dominated by one supplier; half of eggs packaging is provided by one supplier, etc.

While PLs production and sales in Finland has about 20 years of history, the market share of PLs had stayed fairly stable before 2005. One of reason was that Finland is a small consumer’s good market that has not attracted too much attention to international retailing group and multinational food industry. Finnish retailers traditionally have concentrated mostly local branded products and PLs had not become very popular until hard discounter shop Lidl entered Finnish grocery business in 2003 when the Private Label business model concept was first introduced to the consumers. Figure 2 shows the development of market share of Finnish retail chain between 2001 and 2012. Seen from the figure, two leading retailers in Finland have been always S-Group and K-Group. Their combined market share has grown from 67% in 2001 to 80% in 2012, 13% in 11 years. Lidl’s market share has been increasing significantly from less than 2% in 2003 to 6.5% in 2012.

Table 2 presents the major PLs and their changes in the last 7 years. Clearly, S-Group put more effort into the developing new items of their PLs in last decades, in both categories of premium private labels marked as Rainbow and low-priced private labels such as X-tra. In comparison, K-Group as well as other retailers fell behind the racing. Even though the Pirkka, which is premium PLs for K group owns still the most items in the shops in 2012, but the growing speed has been much slower than the similar one – Rainbow.

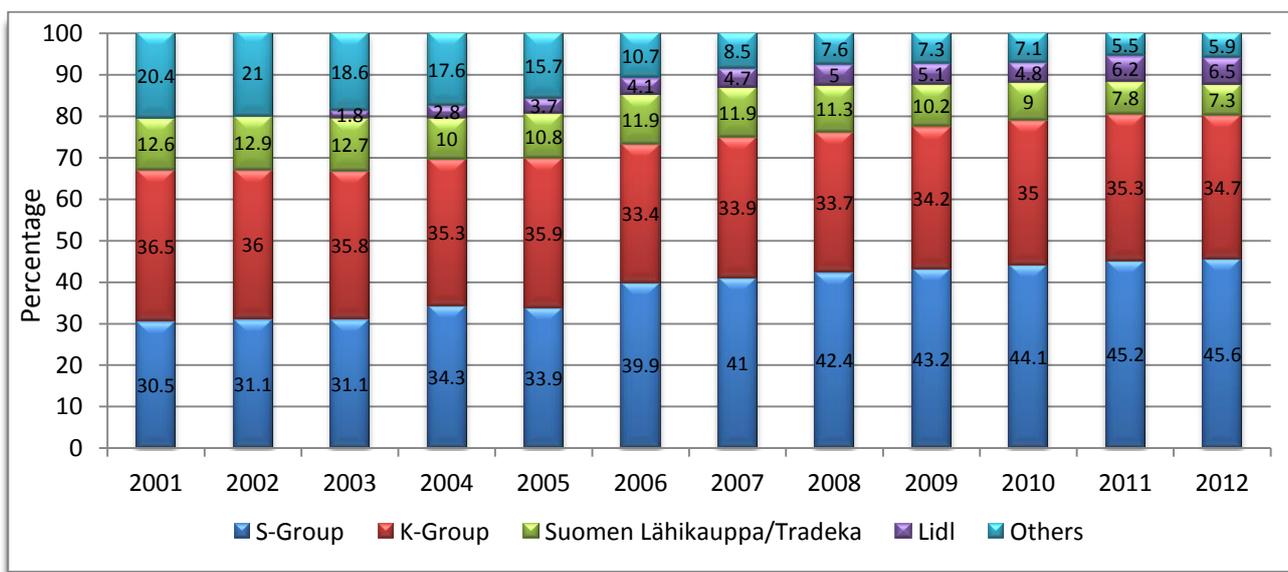


Figure 2. The development of market shares of Finnish retail chains in 2001-2012

Table 2. Major Private Labels, their owners and their development within the last 7 years

		2005	2012	Owner of the brands
S- Group	Rainbow	1046	1900	S-Group
	X-tra	62	350	Coop Trading
K-Group	Pirkka	1715	2200	K-Group
	Euroshopper	338	260	AMS-Group
Suomen Lähikauppa, Stockmann and Tarmo	Eldorado	396	440	Tuko Logistics
	First Price	65	30	Tuko Logistics

Compared to other sector of grocery trade, food sector in retailing has maintain relatively low share, which was less than 21% in volume

Research Methods

As there has been little know and limited research has been done in Finland, we conducted mainly qualitative method our research. Qualitative research may reveal processes going beyond surface appearances (Holloway & Wheeler, 2000). The interviews were conducted semi-structured.

We obtained a list of interviewees through a visit to stores and obtained the input of the Finnish Grocery Trade Association, Finnish Meat Association, Finnish Organic Food Association, Finnish Egg association, Finnish Farmer, the Central Union of Agricultural Producers and Forest Owners as well as suggestions from a few experts. 13 interviews were eventually carried out. In order to gain a full understanding of impact of PL development on the Finnish local suppliers and the factors related to manufacturing PLs for retailers. We focus on typical “B-brand” suppliers in our sample. B-brand suppliers are referred to the local suppliers, that normally well-known only by Finnish customers. They produce both own national brands and PLs. We also designed questions for the suppliers which produce organic food. In addition, three experts in the grocery trading business were also interviewed. The average time for each interview was 1 hour. Table 1 shows a summary of interview data

Table 1. summary of interview data

Types of Interviewees	Numbers of Interviewees	Firms’s products
B-brand suppliers	10	Milk, meat, mills, eggs
Organic food suppliers	3 (also B-brand suppliers)	milk, meat, mills and eggs
Experts	3	meat, organic food

We design our questionnaire questions into three parts. In Parts 1, we overviewed the background and business practices related to PLs production with each interviewee. In Part 2, opinions concerning changing negotiation power between the suppliers and retailers due to growing PLs sales were asked. Especially, we focus on two major questions:

- What is the motivation of suppliers produce PLs?
- Whether the relationship between the suppliers and retailers has changed when the sales of PLs increases and how?

The questions in Part 3 were designed for organic food suppliers. Food manufacturers view organic food as niche and high margin products and the demand for organic products in Finland continues to increase. Most of the organic products (84%) are sold in mainstream retailing channels (Pro Luomu, 2013). Meanwhile, the sales of organic product by PLs grew also dramatically. The powerful position of food retailers can be a reason impeding the successful listing of organic products. Therefore, we attempt to detect the positive and negative impact of PLs on organic food manufacturing from suppliers perspectives.

The individual answers to the questionnaire are kept confidentially. Therefore, the names of the brands and manufacturers are not publishable. These interviewees from manufactory are either the owners of the companies or the CEO of the firms. All of the interviewees have long-time been in the business with a great deal of knowledge about PL products via their own experience dealing with retailers. All the interviews were conducted face-to-face with tape recording. Summarized data are grouped and further compared with similar research done by European commission (EU commission, 2011). The similarity and differences are identified and reported in the result section.

Findings and Discussion

- Keep friendship with suppliers are the No.1 motivation for suppliers to produce PLs.

There are mainly three major factors that motivate manufactures to support PLs: improved profitability for the firm (Burt and Johansson, 2004); gaining a new direction for the manufactures (Timmor, 2007) and enhancing relationships with retailers (Davies and Brito, 2004; Bontemps, *et. al*, 2008). Figure 3 shows that 11 out of 13 our interviewees scored the importance of keeping relationship with retailers are the number one motivation. It indicates that the most important motivations for food manufacturers in Finland to produce PLs is to keep and enhance relationship with retailers. For all of B-brand producers answered universally that they have to produce the PL products in order to make the retailers “happy”, thus maintain the orders of their own brands products in addition to PL products from the retailers. And only one interviewee feels that the increasing profitability is the most important reason for them to produce PL. Nevertheless, the domestic sales in his firm account for smaller share than export, thus producing PLs can help his firm to reach economic scale and increase the firm’s profitability. All the interviewees including firm’s CEO and experts in the fields expressed the “no other option” feeling toward bargaining power of domestic retailing chain. Especially, the retailers had absolute power in pricing negotiations and suppliers had no room to negotiate.

- The relationship between the suppliers and retailers has become volatile as the demand from retailers to the PLs increases.

Even though all the interviewees admitted that they have and are willing to keep the partnership and collaborative relationship with retailers, all of them deeply concern the upcoming of increasingly common lower-price-only of procurement strategies from retailers which might lead to a fragile partnership between the suppliers and retailers. Often, suppliers consider many asked PLs products are direct competing with their NBs products, thus reluctant to produce them continuously. As a consequence, the harmony between the suppliers and retailers would be hampered if the suppliers refused to supply PLs products. This result explained partly the reason why the suppliers play PLs as a strategic tool to keep retailers happy rather than an economic role to reach their profit maximum. Interestingly, suppliers expressed their positive experience with the PLs strategies of Lidl’s. Especially, “different” from other retailers, often Lidl’s management teams are more willing to encourage and assist suppliers by launching campaign of new series of PLs products, covering the costs of marketing new products, showing interest in discussing and exchanging ideas with suppliers. “We felt more equal and interactive with Lidl’s than with other retailers”.

- Impact of PLs on organic food manufacturing from suppliers has been mostly positive. Organic food suppliers in Finland had had very hard time to keep the sales figures up till recent two years. K-group of “Pirkka” has been very helpful in creating a platform for marketing the organic food associated with the idea of local food.

Figure 4 compares the firm’s sales proportion of PLs in the current year in comparison to the estimated future target in the next 5 years. All the B-brand organic producers (B-bran-O-C and B-brand-O-M and B-brand-O-Ba) showed less interest in producing PLs in the future due to slim margin and fierce of “bad influence” to their own brands. However, all of interviews involving in organic food industry agreed that the domestic sales of organic food industry rely on PLs in great deal. However, as organic food is a niche product and its features of both scarce resource and increasing demand should yield high-margin profit. Obviously, the PLs do not meet the objective. On the other hand, when the food is commodity like rest of goods, the future target of sales in PLs is expected at least the same level to double sales in the next five years. The results are well in line with Dobson and Waterson (2000). Furthermore, when a B-brand supplier’s idle capacity is larger and the change in perceived quality is lower, it is relatively more convenient for it to produce PLs. Thus, by producing a private label of better quality, a may avoid the threat posed by PLs produced by other manufacturers and by other B-brand competitors. This conclusion is more important as the retailer’s shelf space becomes scarcer.

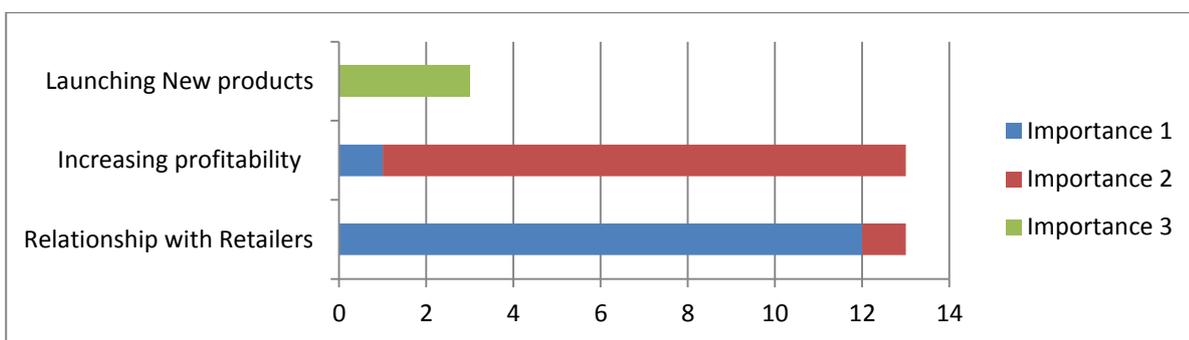


Figure 3. Motivation of producing PLs

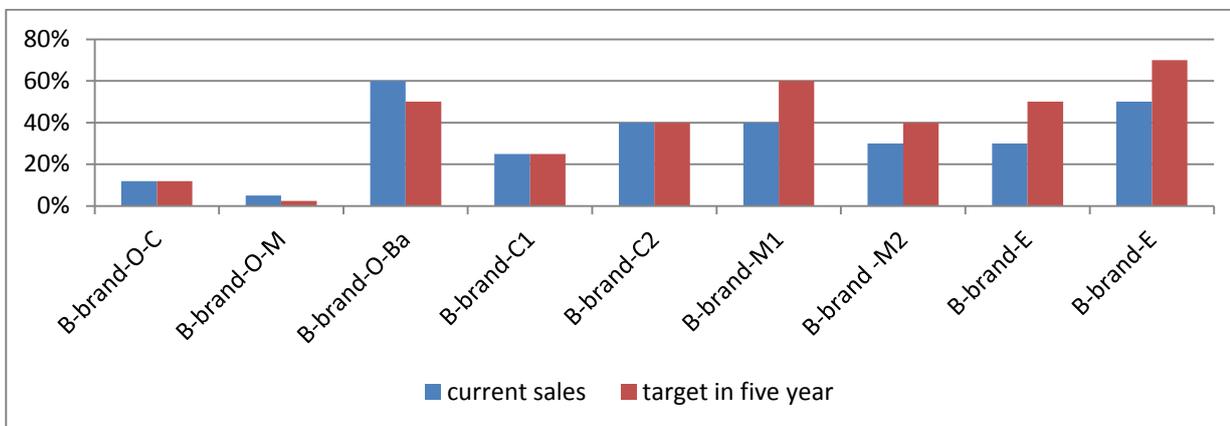


Figure 4. Sales proportion of PLs in the current year vs. target in the next 5 years

The lines between brands and retailer private labels are becoming increasingly blurred in the global organic food industry. Private labels are leveraging organic values and winning consumers by marketing products at competitive prices. Organic brands are having to re-invent themselves, with many focusing on new values to broaden consumer demand. With increasing commoditisation of organic products, there is growing pressure for leading brands to differentiate themselves. Those that do not maybe confined to specialist retailers, the same channel which they have worked hard to expand from. However, while suppliers’ may reach the scales of economics by producing PLs and thus maintain their profitability, they may lead to foreclosure effects as PL products become a direct competitor to supplier’s own brands thus squeeze the

profitability of NBs. Similarly, although they provide opportunities for their producers to have access to a large customer base, they may also reinforce their dependency on a particular retailer.

This is particularly true for some SMEs producers. The potential negative impact of PLs on the suppliers' NB production make suppliers hesitate and eventually reluctant to increase the production of PL products. Consequently, the relationship between manufacturers and retailers become rocky and non-collaborative, which leads to lose-lose situation for both. Therefore, while PLs has grown in strength and prestige, retailers must be wary that it is possible to take PLs too far.

Several ways for Finnish local suppliers coped with PL. development:

- Increasing international trade, by doing so, manufacture decreases the dependencies of local retailers.
- Setting up enough price differential between the own brand and PLs. so that the perceived quality difference can be reflected and the price of national brands at the discount store needs to be lower than at mainstream retailers.
- Further differentiating their products of NBs from the PLs by improving packaging, improving quality and changing recipes more frequently.

PL is not going to increase from industry perspective. If retailers want to continue to increase PLs share, they have to either increase the purchase price or diversify their purchasing channel, i.e., increasing imports when the domestic sources are limited. If PL is not going to increase, a Finnish company should increase their selling channels, i.e. not only depends on S-group or K-group, which indicates that increasing the sales of international market is the only choice.

In order to cushion the negative impact on operating profitability, the pressurized B-brand suppliers basically has two options left: either want to move "up" to a higher price level or move "right" towards lower costs. Trying to do both at the same time would be counterproductive in each direction.

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