Working Paper

Private Labels, Brands and Competition Law Enforcement

Ariel Ezrachi[*] *and Ketan Ahuja*[**]

Introduction

Private labels have become a common phenomenon in retail outlets. These labels, procured and sold by the retailers, increasingly dominate shelf space and benefit from brand power in their own right. In the majority of outlets, private labels compete alongside traditional brands to satisfy consumers' need for economy or premium products.

This paper explores the nature of competition between private labels and brands. Commentators generally see the proliferation of private labels as contributing to a more competitive environment, to the benefit of consumers. However, at times, private labels may lead to mixed effects and could reduce consumer welfare in the long run. This paper considers the unique characteristics of label/brand competition, which combine horizontal, vertical and market power elements. These mixed characteristics pose a challenge to traditional competition analysis. An interesting question subsequently emerges - can traditional competition analysis capture the complex competitive landscape and accurately weigh the short and long term effects of private labels on competition?

Part I of the paper describes the proliferation of private labels and the central role played by supermarkets and other retailers in brand competition. Part II explores the unique characteristics and the possible welfare effects of label/brand competition. Part III explains the limitations of traditional competition analysis and reflects on possible enforcement options.

I. The Proliferation of Private Labels

A private label is a brand which a retailer owns, and which upstream manufacturers produce according to the retailer's specifications. Private labels are brands in their own right, and often have significant consumer following and associations. This paper shall therefore refer to private labels as 'private brands' to distinguish them from 'traditional brands'.

Over the past five decades, retailers have steadily grown in size, from local, specialised shops, to large supermarkets. The largest supermarket chains now achieve similar or greater sales to the largest manufacturers of consumer goods. For example, in 2005, the French retailer Carrefour achieved sales of $94 billion, while the largest manufacturer of consumer goods (Nestlé), achieved sales of $75 billion.[1] CocaCola, the eighth largest manufacturer of consumer goods only achieved sales of $23 billion.[2]

Retailers have made use of this market power: they have significantly developed their private

[*] Slaughter and May Professor of Competition Law, The University of Oxford. Director, Oxford University Centre for Competition Law and Policy.

[**] Oxford University Centre for Competition Law and Policy and Latham & Watkins LLP.

[1] N Kumar and J Steenkamp, *Private Label Strategy: how to meet the Store Brand challenge* (Harvard Business Review Press, 2007) 3.

[2] Ibid.

brand offerings.[3] According to a recent survey, across Europe, private brands have a market share of 36.7 per cent of sales by value, and 47.1 per cent of sales by volume, and a number of retailers almost exclusively sell private brands, including Marks & Spencer's and Aldi.[4] This represents significant growth since 2008, when private brands commanded roughly 23 per cent market share.[5] Private brands command a higher market share in the UK than in any other European country, with 51.1 per cent of sales by value, and 57.6 per cent of sales by volume.[6] Nonetheless, private brands markets are not equivalently mature in all EU member states: for example, in Greece private brands only accounted for 14.6 per cent of sales by value.[7]

This trend is global, with private brands' market share growing significantly in all regions worldwide.[8] Private brands will continue to gain market power for the foreseeable future: they are growing at a faster rate than traditional brands in almost all western economies, except for the US and France.[9]

Previous orthodox wisdom suggested that private brands are a recessionary phenomenon: they do well when the economy is weak, but lose any gains when the economy strengthens.[10] Private brands do perform well in weaker economies:[11] for example, Spain had the highest rate of private growth in Europe in 2013, buoyed by its struggling economy.[12] However, many consumers never return to traditional brands when the economy strengthens: a portion of private brand growth in recessions is permanent.[13]

Importantly, retailers have the financial and logistical capabilities to offer an ever-expanding range of private brands, which can cater to all levels of price, quality and sophistication. Decades ago, private brands were viewed as 'a cheap and nasty substitute for the real thing',[14] but they have expanded beyond that role, and now compete aggressively against traditional brands on quality and other non-price parameters.[15] Indeed, in mature private label markets, private brands offer more than the 'economy' alternative and cater for a range of qualities using different branding to signal the difference in cost and quality.[16] For example, in 2005, Tesco Premier Cru was named the best non-vintage champagne in the UK, and it beat

[3] R Herbert, 'Private labels – what drives them forward' in A Ezrachi and U Bernitz (eds), *Private Labels, Brands and Competition Policy, the Changing Landscape of Retail Competition* (OUP, 2009).
[4] IRi Special Report, 'Private Label: Balancing Quality and Value' (November 2013) 3 http://www.iriworldwide.eu/Portals/0/articlepdfs/PrivateLabel_2013_ExecutiveSummary.pdf#zoom=75 accessed 1 June 2014.
[5] European Commission, 'The Impact of Private Labels on the Competitiveness of the European Food Supply Chain' (January 2011) 11 http://ec.europa.eu/enterprise/sectors/food/files/study_privlab04042011_en.pdf accessed 1 June 2014.
[6] Ibid at 4.
[7] IRi Special Report (n 4).
[8] N Kumar and J Steenkamp (n 1) 6.
[9] IRi Special Report (n 4) 10.
[10] J Quelch and D Harding, 'Brands versus Private Labels: Fighting to Win' (1996) 1 Harvard Business Review 99-109.
[11] L Lamey, B Deleersnyder, M Dekimpe and J Steenkamp, 'How Business Cycles contribute to Private Label Success: Evidence from the US and Europe' (2007) 71 Journal of Marketing 1.
[12] IRi Special Report (n 4) 3.
[13] L Lamey, B Deleersnyder, M Dekimpe and J Steenkamp (n 11).
[14] 'Make it your own' 4 March 1995 The Economist 8.
[15] N Kumar and J Steenkamp (n 1) 8.
[16] For example, Sainsbury's has a high-value private brand (Taste the Difference), a mid-value brand (By Sainsbury's), and a low-value private brand (Basics), as well as a number of other specialist brands (including SO Organic, and Be Good to Yourself).

traditional brands Tattinger and Lanson in blind taste tests.[17] What is more, a product's complexity is no longer a bar to retailers who wish to develop a private brand for that product: Aldi even offers its own brand of PCs (Medion).

This increase in quality is driving growing consumer acceptance of private brands. 54 per cent of US consumers say they intend to buy more private brands in the future.[18] Similarly, only 29 per cent of US consumers believe that traditional brands are worth the price premium, and only 16 per cent believe that private brands are generally of lower quality than traditional brands.[19] Private brands carry no social stigma, with only 6 per cent of consumers reporting that they would feel uncomfortable serving private brands in their home.[20]

Management literature accounts for this proliferation of private brands by dividing them into four sub-categories.[21] While the reality on the outlet floor may be more complex, this division helps appreciate the breadth and sophistication of retailers' private brand offerings. The first category includes 'generic' brands of poor quality, which are generally the cheapest products on offer. The second category includes 'copycat' brands which attempt to imitate brand leaders' packaging and quality as closely as possible, but sell for a lower price. A third category includes 'premium' brands which offer high quality products, and differentiate themselves from traditional brands. Retailers use them to engender store loyalty, and price them comparably with brand leaders. The last category includes 'value innovators'. These products offer high quality without frills and with significant price-saving innovation.

II. The Characteristics of 'Private' and 'Brand' Competition

The growing market share of private brands has transformed the landscape of retail competition in developed countries. Major retailers are no longer confined to their traditional roles of purchasers and distributors of branded goods. By selling their own label products within their outlet they compete with their upstream brand suppliers on sales and shelf space.[22]

This unique vertical/horizontal relationship is key to understanding private and traditional brand competition. While private and traditional brands compete against each other, the retailer which owns the private brand also controls the arena in which they compete (the outlet). As illustrated below, the retailer can therefore determine pricing, shelving, promotion and access.[23]

Gatekeeper

Traditional brand manufacturers depend on retailers, which control their access to customers. At times, the retailer may derive unfair advantages and high levels of market power from its 'gatekeeper' position. For the traditional brand producer, switching between

[17] N Kumar and J Steenkamp (n 1) 8.
[18] Ibid 11.
[19] Ibid 15.
[20] Ibid.
[21] Ibid 28.
[22] A Ezrachi 'Unchallenged Market Power? The Tale of Supermarkets, Private labels and Competition Law' (2010) 33(2) World Competition 257.
[23] For a review of these points, see: A Ezrachi 'Unchallenged Market Power? The Tale of Supermarkets, Private labels and Competition Law' (2010) 33(2) World Competition 257.

distribution channels is difficult, costly and generally impossible in the short term.[24] As a result, it can only replace main distributors 'at the cost of very heavy financial losses, if at all,'[25] and may suffer detrimental outcomes even if a small distribution channel is eliminated.[26]

This dependency is amplified where customers' loyalty to the retailer overrides their brand loyalty. As private brands gain prominence, customers exhibit greater loyalty to particular retailers at the expense of loyalty towards traditional brands. Between 1975 and 2000, the percentage of Americans between 60 and 69 who said they stuck to well-known brands declined from 86 per cent to 59 per cent.[27] Another US study found that between 1992 and 2007, brand loyalty declined in ten of fifteen product categories.[28] Indeed, consumers are increasingly loyal to specific retailers.[29] As customers trade brand loyalty for store loyalty, brands become even more dependent on retailers to distribute their products.

Importantly, a retailer's gatekeeper role gives it a very high degree of market power, which its market share may not reflect. A small number of retailers have enormous bargaining power over suppliers, and can deny market access to new or existing products.[30] This power of retailers to foreclose the market particularly threatens secondary brands, which consumers do not view as 'must have' products.

Just as significantly, retailers can also use their buyer power to combat competition from other retailers, and foreclose the retail market for consumers. Illustrative are comments made by a Vice President of Procurement of a large European retailer who stated that if a traditional brand manufacturer would supply the hard discounter, the retailer would substantially reduce the shelf space allocated to the brand in question.[31]

Switching Costs

Outlets face low switching costs when procuring supplies for private brands: they can source from more than one supplier, and face minimal consumer backlash as consumers are rarely aware of the ultimate manufacturer's identity.[32] Private brand manufacturers are substitutable, and have virtually no product differentiation, because they build products to retailers' specifications. They also generally have low individual market shares, and retailers are well informed about product quality and cost.[33] The European Commission noted in *Rewe/Meinl* that low switching costs give retailers a high degree of market power when negotiating with

[24] H Laaksonen and J Reynolds, 'Own Brands in Food Retailing Across Europe' [1994] 2 Journal of Brand Management 37, [97], [102].
[25] Ibid [101].
[26] WS Grimes, 'Buyer Power and Retail Gatekeeper Power: Protecting Competition and the Atomistic Seller' [2004-2005] 72 Antitrust Law Journal 563.
[27] N Kumar and J Steenkamp (n 1) 14.
[28] Ibid.
[29] Ibid.
[30] J Berasategi, 'Supermarket power: Serving Consumers or Harming Competition' (February 2014) 10 http://www.supermarketpower.eu/documents/38179/39950/Supermarket+Power.pdf/9c0ed73f-37db-4d23-bd2d-1f583bf501e9 accessed 10 June 2014.
[31] Ibid 19.
[32] H Smith and J Thanassoulis, 'Bargaining Between Retailers and their Suppliers' 47, in A Ezrachi and U Bernitz (eds), *Private Labels, Brands and Competition Policy, the Changing Landscape of Retail Competition* (OUP 2009).
[33] N Kumar and J Steenkamp (n 1) 111.

private label manufacturers.[34] It is worth noting that markets for private label production are highly competitive, and manufacturers often have difficulty sustaining their prices significantly above marginal cost.[35] Instruments such as real-time-online-biding enable the retailer to increase pressure on producers, driving their price down, to the benefit of consumers. Note, however, that the improvement in range and quality of private brands may limit the number of producers capable of delivering the product specifications. In these cases, retailers develop close relationships with particular private label manufacturers, and switching costs may increase as producers are less easily substitutable.[36]

Quality Erosion

The intensive competition among private label manufacturers forces them to accept intensive downward pressure on prices. This produces welfare benefits for consumers, but it may also erode quality in a way which hurts consumer welfare. Aggressive downward pressure on prices may force manufacturers to bid for contracts at a loss, forcing them to reduce quality to regain profitability. They may also pre-emptively erode quality to sustain profit margins. Significantly, manufacturers' ability to erode quality is often limited and depends on the nature of the product, the retailer's quality control mechanism and the customer's ability to detect a reduction in product quality. Quality erosion can cancel out welfare gains which result from lower prices: 'although the customer pays less, it receives less than it bargained for.'[37] As private brands manufacturers do not own the brands which adorn their products, they externalise part of the risk associated with quality degradation. It is the retailer which owns the brand that may suffer the consequences of quality erosion on its brand loyalty.[38] It is important to note that quality degradation is not a leading strategy for a private brand manufacturer. It may however become a necessary strategy if it forms the only means to stay active on the market. In such a case, the benefit from quality erosion outweighs the risk of detection.

By contrast to private brands manufacturers, traditional brand manufacturers are less likely to engage in quality erosion. Product quality is often an essential feature of traditional brands' reputations, so brands will suffer if customers detect a reduction in product quality.

Buyer Power and Competing Brands

Private brands increase a retailer's buyer power when negotiating the purchase of traditional brands. A retailer's buyer power depends not only on its size and economies of scale, but also on whether the manufacturer can confidently expect the retailer to purchase the product. Absent private brands, a supplier which produces a 'must stock' brand can expect to conclude deals with all major retailers. It therefore knows roughly what its final output will be, and will be unwilling to sell to a large retailer at below a profitable price.[39]

However, private brands may provide retailers with good alternatives to leading traditional

[34] *Rewe/Meinl* (Case IV/M.1221) Commission Decision 1999/674/EC [1999] OJ L274/1 at [76].

[35] N Kumar and J Steenkamp (n 1) 111.

[36] A Braak, M Dekimpe, and I Geyskens, 'Retailer Private-Label Margins: The Role of Supplier and Quality-Tier Differentiation' (2013) 77(4) Journal of Marketing 86-103.

[37] A Ezrachi and K De Jong, 'Buyer power, private labels and the welfare consequences of quality erosion' [2012] ECLR 257, 258-260.

[38] Ibid 259.

[39] H Smith and J Thanassoulis (n 32) 49-50.

brands. Leading brand manufacturers are therefore not certain that large retailers will purchase their products. As a result, manufacturers see large retailers as incremental business. Large retailers can therefore negotiate better deals because manufacturers will not rely on them to bear as large a share of the manufacturer's fixed costs. Note that as a result, prices for small retailers may increase. The UK Competition Commission's empirical evidence supports this analysis.[40]

At times, a retailer may benefit more from the buyer power it gains from a private brand than from selling the private brand itself. A retailer's threat not to purchase a leading traditional brand is more credible if it already carries an alternative private brand, than if it threatens to procure an alternative private brand, because creating a private brand involves significant up-front costs.[41] This explains why supermarkets maintain unsuccessful private brands. For example, two Unilever brands dominate the Dutch market for cooking margarine. Leading supermarket chains Albert Heijn and C1000 introduced unsuccessful private brands which command very low market shares. What is more, inventory costs for margarine are very high, because it has to be chilled. Nonetheless, they continue allocating expensive chiller space to their unsuccessful private brands to give them negotiating power against Unilever.[42]

Store and Brand Loyalty

A supermarket's private label offering is unique to that chain, and is therefore one of the main variables in a customer's choice of outlet. In contrast, traditional brands are available at every major retailer, and so do not provide customers with a reason to choose one retailer above another. Retailers therefore develop private label offerings which engender store loyalty, often at the expense of secondary and slower-selling traditional brands. Market research demonstrates their success. Studies of American and French consumers show a strong correlation between their store loyalty, and the number of privately branded goods they purchase.[43] This increase in store loyalty comes at the expense of loyalty to traditional brands.

In this context, it is noteworthy that the cost of switching outlet often is higher than the cost of switching product. In other words – once a consumer is accustomed to a certain retailer – it will not easily switch to another just because a certain traditional brand is not on offer. Unless it is a 'must stock' brand, the customer is likely to accept a private brand substitute.

Pricing Private and Traditional Brands

The offering of private brands increases competitive pressure and often results in lower prices of all brands, to the benefit of consumers. As for the relative pricing of private and traditional brands, it is interesting to note that the retailer controls the price difference between its private brand and the traditional competitor. It can therefore manipulate the perceived value of goods, to benefit its private brand. For example, the leading Parisian supermarket Casino overprices traditional brands compared to other retailers, but prices its private brands competitively. 'The French Competition Authority has concluded that this practice restricts consumers' freedom of choice and competition.'[44]

[40] Ibid 47-48.

[41] N Kumar and J Steenkamp (n 1) 116.

[42] Ibid 117.

[43] Ibid 119.

[44] J Berasategi (n 30) 203.

Retailers can also manipulate the price difference between private and traditional brands to improve their margins, or foreclose traditional brands from retail markets. Often, retailers earn higher margins on private brands than traditional brands. However, note the reported practice of Spanish supermarkets which overprice traditional brands to extract maximum value from brand-loyal customers, while rendering traditional brands uncompetitive for other customers. If they matched traditional brand margins with private brand margins, the average price of traditional brands would fall by 20 per cent.[45] Nonetheless, retailers' control over pricing of leading brands is not unlimited. Market forces, including competition between retailers and traditional brands' advertising, determine leading traditional brands' pricing to a large extent.

By contrast, retailers have greater control over pricing of private brands. Private brands differ in size, nature and quality between supermarket chains which makes it difficult for consumers to engage in price comparison. This reduced transparency tends to soften price competition between the private brands of different retail chains.[46] However, prominent private brands are likely to be priced competitively and form a visible part of retail competition,[47] as are private brands which retailers use to engage in price competition against other retailers.

Finally, retailers can create pricing structures which encourage customers to buy higher-margin products. Generic brands attempt to offer consumers very cheap options, and often are not profitable enough to justify their shelf space. Retailers often use them to attract customers, in the hope that customers ultimately purchase both generic brands, and other higher-margin products.[48]

Shelf space

Retailers are able to arrange their shelves in a way that promotes their private brands. They can, for example, place products at eye-level to draw customers' attention. More significantly, they can arrange products in ways that allow consumers to make certain comparisons. This is particularly relevant for copycat brands, which retailers generally place next to the leading brand to allow consumers to make favourable price and quality comparisons with the copycat brand. Retailers can also arrange shelving to prevent their low-margin generic brands from competing with higher-margin premium or traditional brands. Target positions its premium private brands next to other premium products, while its generic private brands sit next to lower-priced products, to prevent the consumer from directly comparing its two private brands.[49] What is more, retailers can use shelf arrangements to put pressure on traditional brands, and thereby increase their bargaining power.[50]

Marketing

---

[45] The Brattle Group 'Competitive Assessment of the Spanish Food Supply Chain' (6 April 2012) http://brattle.com/system/publications/pdfs/000/004/816/original/Competitive_Assessment_of_the_Spanish_Food_Supply_Chain_Garcia_Delgado_Apr_6_2012.pdf?1378772132 accessed 10 June 2014; also see J Berasategi (n 30) 11.

[46] UK Competition Commission Grocery Market Inquiry 'The supply of groceries in the UK market investigation' Final Report (2008) Appendix 9.10, [20].

[47] Ibid [25].

[48] N Kumar and J Steenkamp (n 1) 33.

[49] N Kumar and J Steenkamp (n 1) 87.

[50] Ibid 19.

Retailers control product displays and in-store marketing. As consumers make many decisions in-store, particularly for low involvement goods, this control gives the retailer a decisive advantage over brand suppliers.[51] As a result, traditional brands must engage in extensive out-of-store marketing to ensure consumers notice their products, whereas this is not necessary for retailers who wish to draw consumers' attention to private brands. Also, retailers can afford to adopt general 'umbrella' private brand lines which cover a wide range of products: they do not need to invest in highly focussed brands or expensive marketing strategies for each product category.[52]

Retailers also have significantly lower marketing costs when introducing new private brands. A retailer can ensure that its new private brand reach consumers, while a manufacturer must put significant effort into marketing its products to ensure retailers distribute them.[53] In addition, new products will benefit from the retailer's 'umbrella' range, making specific advertising unnecessary.

Copycat brands, and to a lesser extent value innovators, are also designed to free-ride off traditional manufacturers' promotional activities, further reducing marketing costs for the private brand. Private brands which copy a leading brand's packaging may increase their market share by up to 55 per cent above a private brand which uses dissimilar packaging to a leading rival's product.[54] Copycat packaging may lead consumers to believe that the product is produced by the traditional brand manufacturer, is of a similar quality, shares the same characteristics, or is in fact the traditional brand itself.

Nonetheless, intellectual property law limits a retailer's ability to copy another brand's packaging. However, the threshold for intervention under intellectual property law does not eliminate weaker forms of copying, which may still influence consumers. Also, a traditional brand may not wish to damage its relationships with its major distributors by rigorously enforcing its copyrights. Moreover, not all private brands attempt to free-ride off traditional brands' reputations. Some retailers develop highly distinctive premium private brands to compete on quality with leading brands, and engender customer loyalty to the retailer.[55]

Finally, the existence and market power of private brands means that traditional brands must invest more heavily in marketing to protect themselves.[56] This further strengthens the inbuilt cost advantage that private brands have over traditional brands.

Access to Information and Innovation

As the distributor, the retailer has access to confidential information from the suppliers ahead of new product launches. This may enable the retailer to produce private brands which incorporate innovations faster than traditional manufacturers. This can weaken

---

[51] A Ezrachi and J Reynolds, 'Advertising, Promotional Campaigns, and Private Labels' in A Ezrachi and U Bernitz (eds), *Private Labels, Brands and Competition Policy, the Changing Landscape of Retail Competition* (OUP, 2009) 259.

[52] Ibid.

[53] Ibid.

[54] UK Competition Commission Grocery Market Inquiry 'Working paper on the competitive effects of own label goods' (Final Report published 30.04.08) [31]-[36].

[55] N Kumar and J Steenkamp (n 1) 41.

[56] N Kumar and J Steenkamp (n 1) 92-101.

manufacturers' incentive to invest in innovation, for it undermines the innovator's profitability. [57] The European Commission noted in its *Kesko/Tuko* decision that retailers' access to confidential product and strategic information gives them considerable leverage over traditional brand producers.[58] Yet, arguably, retailers will *self-police* the extent to which they follow-up innovation, since, in the long term, their profitability will benefit from the presence of the leading brand.

However, conversely, traditional brand manufacturers' incentive to innovate may increase as they lose market share to private brands, because innovation offers them a chance to restore high levels of profitability. Studies conclude that new products released by traditional brands will boost the brand's market share. However, innovation is more likely to hurt secondary traditional brands than private brands, and only the leading traditional brand's innovation will steal significant market share from all tiers of privately branded products. Generally, innovations with new intrinsic benefits, which maintain a large price gap, are more likely to affect premium private brands, while innovations with a lower price gap and fewer intrinsic benefits are more likely to affect generic private brands.[59] Nonetheless, innovation does significantly help traditional brands maintain market power: private brands have on average 56 per cent higher market share in product categories with low innovation than in product categories with high innovation.[60]

A retailer also has access to detailed market information, which is not available to traditional manufacturers. This may enable retailers to identify gaps in the market more readily than branded manufacturers. This has been the case in the UK in the chilled food, fresh pasta and ethnic food categories. In those instances, retailers identified a gap in the market, which they filled with new product categories.

Risk Management

When engaging in follow on innovation, retailers generally face lower risks of failure when introducing their new product as they control marketing and shelf space. This gives retailers an in-built cost advantage.[61] By contrast, when retailers develop more complicated premium brands and value innovators, they take on failure risks which are similar to those manufacturers face when introducing new products. For example, 'Saks Fifth Avenue launched three new private label brands in 2004, but none did as well as expected, [which] forced higher markdowns and lower margins.'[62] To ensure premium brands are successful, retailers must invest in significant market research, and must engage expensive marketing to create brand imagery. They have a more limited ability to recoup these costs than traditional brands because the private brand will only sell at that retailer's stores.[63] Failure can have serious consequences for a retailer as private brands are often closely associated with the

---

[57] As reported by the Competition Commission, some suppliers have reacted to this risk by delaying the release of sensitive information to retailers and limiting its scope. See UK Competition Commission Grocery Market Inquiry 'The supply of groceries in the UK market investigation' (n 47) **[**40].

[58] *Kesko/Tuko* (Case IV/M 784) Commission Decision 97/409/EC [1997] OJ L 174 02/07/1997 P. 0047 - 0050 [152].

[59] Katrijn Gielens, 'New Products: The Antidote to Private Label Growth?' (2012) 49(3) Journal of Marketing Research 408-423.

[60] N Kumar and J Steenkamp (n 1) 168.

[61] N Kumar and J Steenkamp (n 1) 98.

[62] Ibid 56.

[63] Ibid

retailer's image, or umbrella range.[64]

Retailers also use their buyer power to transfer trading risks to suppliers of traditional brands. Common practices include negotiating for guaranteed margins, agreeing that the retailer can return unsold items to the manufacturer, and trading on credit from manufacturers.[65] As a result, retailers can be seen more like providers of distribution services rather than customers which purchase the manufacturers' products outright.

III. Assessment of Private Brands under Traditional Competition Analysis

Private brands produce significant verifiable short and mid-term welfare benefits. On the other hand, their long term exclusionary effects are more speculative and harder to quantify. In what follows we consider the possible pro- and anti- competitive effects of private brands and the way traditional competition law assesses these effects.

Verifiable Positive Effects

Private brands usually offer consumers a range of products at *lower prices* than those of competing brands. Evidence from studies in the US and France indicates that traditional brands generally sell for 37 per cent more than private brands of equivalent quality.[66] According to the UK Competition Commission, 40 per cent of consumers who purchase private brands do so due to their lower prices. Moreover, 30 per cent of consumers believe private brands are better value than the branded equivalent.[67] This increases the competitive pressure on brand leaders and generally reduces the price of branded goods across the board.

Retailers can achieve these cost-savings on private brands because they have significant in-built marketing advantages, which generally make expensive advertising unnecessary.[68] Copycat brands in particular are able to free-ride on traditional brands' marketing investments. Also, private brands generally undertake lower risks of failure than traditional brands, so they can adopt generally lower prices as they do not have to compensate the brand-holder for the costs of previous failures. Retailers have significant bargaining power as a result of their 'gatekeeper' role, low switching costs, and private brand offerings, which allows them to negotiate better prices with manufacturers, which they will then pass on to consumers as long as retail markets remain competitive. Finally, as retailers grow, they benefit from significant economies of scale which allow them to source goods at lower prices, and reduce processing costs.[69]

Private brands may also *stimulate innovation* from traditional brand manufacturers, as innovation offers a traditional brand manufacturer a chance to regain lost market share, higher margins, and ultimately profitability. Nonetheless, private brands do not universally increase traditional brands' incentive to innovate. Traditional brands are more likely to harm rival traditional brands with innovations than private brands, and only the leading brand in any given product category is able to significantly harm private brands with new innovations.

[64] Ibid 87.

[65] J Berasategi (n 30) 42-43.

[66] Ibid 98.

[67] UK Competition Commission Grocery Market Inquiry 'Working paper on the competitive effects of own label goods' (n 55) [8].

[68] A Ezrachi and J Reynolds (n 52).

[69] N Kumar and J Steenkamp (n 1) 70.

While innovations are successful against premium private brands, they offer fewer benefits against generic private brands.[70]

What is more, private brands can stimulate innovation by retailers. Retailers have extensive market information unavailable to traditional manufacturers, which allows them to more easily identify demand patterns and gaps in the market, which private brands may satisfy. This has been the case, for example, in the UK for chilled food, fresh pasta, and ethnic food. In addition, recall that manufacturers of private brands operate in an extremely competitive market, and must therefore focus on efficiency, flexibility, and innovation in manufacturing to remain profitable.[71]

A private brand can also help *counterbalance the leading brand's market power*, in product categories which are dominated by a traditional brand. Other traditional brands might find it impossible, too expensive, or too risky to enter a product category dominated by a leading brand. The retailer may be in a better position to take on the dominant brand because of its in-store marketing advantage, price advantages, control over shelving, and label reputation. In this respect, private brands may provide more viable competition for the leading brands than secondary and tertiary brands.[72]

Potential Negative Effects

Conversely, private brands produce a number of possible adverse effects which competition analysis may take into account. As indicated above, these are longer term effects and as such are less certain. They stem predominantly from the unique competition landscape discussed in Part II above.

Possible adverse effects include the *risk of foreclosure*. Retailers' gatekeeper role, low switching costs, and private brands give them significant buyer power, which they can use to foreclose the market to traditional brands. What is more, stores have the incentive to foreclose the market to secondary traditional brands, and replace them with private brands. A retailer's private brands help it engender loyalty among customers, and can produce higher profit margins than traditional brands. Accordingly, the retailer may have the incentive to push out branded goods as long as this does not undermine the volume of sales in the outlet.

Retailers can also foreclose traditional brands by offering them less favourable price and non-price trading conditions than they offer to their own private brands. Retailers can price their private brands in ways that are less advantageous to traditional brands. By manipulating the quality, quantity, and positioning of shelf space that a retailer gives to a traditional brand, it can ensure the traditional brand does not sell as well as its private brand.

In exchange for lower competition among traditional brands, some secondary brand producers may shift from traditional brand to private brand production, thereby increasing competition among private label suppliers. Secondary brands may therefore regain market

[70] Katrijn Gielens (n 60).

[71] N Kumar and J Steenkamp (n 1) 154.

[72] See the submission by Morrisons describing Morrisons' advantages over secondary and tertiary brands when facing the leading brand. 'Secondary brands tend not to have the marketing support of the brand leaders and find it difficult to compete against own-label products. Own-label products acquire the well-known reputation of the retailer, which promotes sales over less well-known secondary and tertiary brand reputations'. UK Competition Commission Grocery Market Inquiry 'The supply of groceries in the UK market investigation' (n 47) [23].

access on a large scale, and with lower risks, which may yield efficiencies. However, markets for private brand suppliers are already highly competitive, and it is unclear that additional competition upstream yields welfare benefits. What is more, added pressure in private brands supply markets may force suppliers to consolidate or result in quality degradation. Other secondary brands which are foreclosed from large supermarkets may access retailers through alternative, smaller, distribution channels or may simply exit the market. Significantly, loss of a major retail channel can devastate a traditional brand: a loss of 22 per cent of turnover involves a serious risk of bankruptcy for the brand producer.[73] Overall, in the long term, private brands could lead to high levels of concentration to the detriment of consumers.

Private brands may also *chill innovation*. Private brands which act as innovation-followers may weaken traditional brands' incentive to innovate. Retailers have access to confidential product information before new product launches, and can therefore produce copycat private brands faster than traditional brands can incorporate innovations.[74] Copycat brands which quickly incorporate innovations undermine the innovator's profitability and incentive to innovate. Yet, arguably, retailers will self-police the extent to which they follow-up innovation, since, in the long term, the leading brand's presence will boost their profitability.

Moreover, private brands may suffer from *quality erosion*, as a result of the retailer's high market power when negotiating with private label manufacturers. This may occur when downward pressure on price forces the manufacturer to accept negligible profits, or even losses, and customers have difficulty detecting changes in product quality. Quality erosion directly harms the final consumer, and may cancel out benefits of lower prices.[75]

Competition Law Analysis

Traditional competition law analysis does not easily take account of the nature of competition between private and traditional brands, described above. As this article focusses on retailers' unilateral conduct, this section will assess the ability of current competition law rules on unilateral conduct to regulate competition between private and traditional brands. Nonetheless, we note that the nature of private label and brand competition may also have implications for competition law rules on anticompetitive agreements and mergers.

Article 102 TFEU controls *dominance and the abuse of dominance*. Dominance is defined as an undertaking's position of economic strength, which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave, to an appreciable extent, independently of its competitors, customers and its consumers.[76] Findings of dominance require high market shares: the European Commission considers undertakings will generally not be dominant if they have market shares of below 40 per cent.[77] In the context of this paper it is important to note that in most jurisdictions, a single retailer is unlikely to meet this threshold, because it is likely to operate in generally competitive markets, with a number of strong market players, none of which are

[73] Ibid [101]; WS Grimes, 'Buyer Power and Retail Gatekeeper Power: Protecting Competition and the Atomistic Seller' [2004-2005] 72 Antitrust Law Journal 563.
[74] See *Kesko/Tuko* (Case IV/M 784) Commission Decision 97/409/EC [1997] OJ L 174 02/07/1997 P. 0047 - 0050 [152].
[75] A Ezrachi and K De Jong (n 37) 262.
[76] Case 27/76 *United Brands v Commission* [1978] ECR 207, [1978] 1 CMLR 429.
[77] Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings [2009] OJ C 45/7 [14].

overwhelming. Accordingly, under traditional analysis, retailers' conduct will rarely trigger Article 102 TFEU.

However, one may argue that conventional economic benchmarks should be adjusted when applied to large retailers, because of their gatekeeper role, low switching costs, and private brand offerings. These features give retailers a greater degree of market power on upstream markets than companies with equivalent market shares would have in different industries. In other words, market shares and market concentration do not provide a good proxy for market power. A retailer may have a relatively low market share, and face strong competitors on downstream markets, and yet it may still have the power to foreclose upstream producers from reaching consumers. The retailer may therefore be able to behave independently of upstream traditional brand manufacturers which compete with its private brands, even if it cannot behave independently of competitors on downstream retail markets. Note, on this point, that a retailer's market share on upstream procurement markets may be more relevant to assessing its dominance than its share of downstream retail markets, as the European Commission recognised in *Rewe/Meinl*.[78]

To address these concerns, one may argue in favour of lowering the threshold of dominance. For example, Finland now deems that any grocery retailer with a market share of more than 30 per cent is dominant.[79] Such approach, however, provides a sub-optimal solution. It is under-inclusive, for it does not address non-grocery retailers, or retailers with less than 30 per cent market share, which may still be able to foreclose competition. It's ultimate failing, however, is that it attempts to use rigid market share thresholds to establish dominance in an industry where an undertaking's market power comes from its gatekeeper role and strong bargaining position, which are only loosely related to its market share.

Even if a retailer has a position of dominance, one needs to consider whether it has *abused* that position. Here one may find it difficult to balance between verifiable short term benefits and speculative long term effects. This would make it difficult to establish that retailers abused their dominance. The Commission's Guidance on Article 102 TFEU indicates that the Commission will intervene to prevent foreclosure on intermediate or final-consumer markets.[80] When establishing foreclosure, the Commission states that it will take into account general market evidence (such as the dominant undertaking's position in the market), as well as evidence on specific types of exclusionary practices (for example, loyalty-inducing rebates).[81] Although general market evidence may point to foreclosure, it is unlikely that any existing exclusionary practices will support arguments that retailers foreclosed traditional brands. Retailers may foreclose products by refusing to buy them on fair terms, or manipulating shelving, in store marketing, or pricing. It is not clear that existing exclusionary practices cover these types of conduct, and one may find it hard to establish consumer harm when such practice result in the offering of cheaper alternatives. The long term effects may be too speculative to be taken into account in the analysis of abuse.

Buyer Power

---

[78] *Rewe/Meinl* (Case IV/M.1221) Commission Decision 1999/674/EC [1999] OJ L274/1 [76].

[79] M Oinonen, 'The new 30 per cent rule: a viable solution to detrimental buyer power in the Finnish grocery retail sector?' (2014) 10(1) Euro CJ 97, 98.

[80] European Commission Guidance (n 78) [19].

[81] Ibid [21].

Part of the reason competition law underestimates retailers' market power is that it generally assumes *buyer power* benefits consumer welfare. In the context of Article 102 TFEU the European Commission recognises that counterveiling buyer power can constrain undertakings that might otherwise be dominant. In its Guidance on Article 102, the Commission notes that 'Even an undertaking with a high market share may not be able to act to an appreciable extent independently of customers with sufficient bargaining strength… [who] may deter or defeat an attempt by the undertaking to profitably increase prices.'[82] The Commission is also evidently aware of counterveiling buyer power arguments in merger cases: it found the *Friesland Coberco/Nutricia* merger would not significantly impede effective competition in part because retailers had significant counterveiling buyer power as a result of their large market shares, and private label ranges.[83] Overall, European competition law has developed a clear approach to assess counterveiling buyer power arguments, which takes into account market share, ability and incentive to switch suppliers, and the likelihood that savings would reach most consumers.

In contrast, competition law does not have as clear of an approach to assessing arguments that buyer power harms competition. The Commission's Article 102 Guidelines do not specifically address the anticompetitive effects of buyer power, and only a few of its merger cases discuss the negative effects of buyer power in detail.[84] Most notably, in *Kesko/Tuko*, the Commission blocked Kesko's proposed acquisition of Tuko, in part because the merged entity would have significant buyer power as a result of its large market share, customer loyalty schemes, and private label ranges.[85] The Commission's primary concern was that the merged entity could use its buyer power to disrupt retail competition, rather than to foreclose competition at the supplier level.[86] Notably, the merged entity would have been dominant even under a traditional analysis (with a 55 per cent share of the Finnish grocery market).[87]

In practice, however, buyer power will rarely constitute grounds for blocking a transaction, but will more likely force merging parties to offer commitments.[88] Applying similar reasoning, under the Commission's current approach, misuse of buyer power is unlikely to constitute a standalone abuse under Article 102 TFEU, and the Commission may be more inclined to address buyer power arguments with behavioural remedies.

Theories of harm regarding the negative welfare effects of buyer power currently provide imperfect analytical tools for competition enforcement agencies.[89] This may explain the European Commission's reluctance to seriously address arguments that buyer power harms competition.[90] In any case, competition law fails to take sufficient account of the potential for buyer power to foreclose competition.

Concluding Remarks – Enforcement Choices

[82] Ibid [18].

[83] *Friesland Coberco/Nutricia* (Case COMP/M.2399) [2002] OJ C18/14.

[84] A Ezrachi and M Ioannidou 'Buyer Power in European Union Merger Control' (2014) 10(1) Euro C J 69, 75.

[85] *Kesko/Tuko* (Case IV/M.784) Commission Decision 97/277/EC [1997] OJ L110/53 [133].

[86] Ibid [150].

[87] Ibid [106].

[88] A Ezrachi and M Ioannidou (n 85) 83.

[89] Ibid 70-74.

[90] Ibid 83.

It is important to note that our analysis does not argue in favour of intervention. We illustrate the range of effects which private brand competition generates and the limited capacity of traditional competition analysis to take them fully into account.

We note the mismatch between the unique characteristics of the vertical competition between private and traditional brands and the benchmarks for intervention as outlined in Article 102 TFEU. Indeed, the relationship between private and traditional brands produces a unique set of competitive conditions, which result from the retailer's position as a horizontal competitor to and vertical distributor of traditional brands. This position allows the retailer to control competition between products, and gives the retailer a higher degree of market power than its market share would reflect in another industry. Traditional competition law is ill designed to deal with this sort of vertical competition, and as a result will rarely trigger intervention.

The challenges described above, and the limitations of traditional competition analysis, lead to a number of key enforcement choices;

One option is to focus on the short term benefits and conclude that the use of private brands by retailers does not give rise to a competition problem. On the contrary, private brands vigorously compete with traditional brands, producing significant short term benefits in the form of lower price, wider choice and better quality. Accordingly, as long as traditional competition law benchmarks are not satisfied – intervention is not required as there is no competition problem.

Another approach is to accept that competition law may need to evolve to capture vertical competition. It should find market power with limited market shares, and intervene despite private brands' short term benefits. Competition law errs by treating distribution channels as analytically neutral, and should recognise that firms compete when they can 'take sales, margins and market shares from each other.'[91] Intensive vertical competition may harm welfare without any significant changes in retail market structure. As retailers unilaterally introduce and strengthen their private brands, they generate a cumulative effect upstream, which may have detrimental results in the long term on consumer welfare. Such approach calls for a change in our analytical benchmarks and theories of harms. It may lead to novel approach to dominance, abuse and remedies.

An alternative approach may reject the call to widen the competition law toolbox and change its analytical benchmarks. Such changes risk creating legal and business uncertainly and would be based on controversial theories of harm. Accordingly, while it is accepted that some anticompetitive effects may exists, the prism of competition law cannot easily process the complexity of vertical brand competition and should therefore not play a leading role on this matter. The solution is to be found outside the competition law landscape, in the form of soft or binding tools or sector regulation. These tools would more adequately deal with the risk of foreclosure and long term up-stream and mid-stream effects while taking into account social, economic and industrial considerations.

[91] R Steiner, 'Market power in consumer goods industries' in A Ezrachi and U Bernitz (eds), *Private Labels, Brands and Competition Policy, the Changing Landscape of Retail Competition* (OUP 2009).