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PRIVATE LABEL AND MANUFACTURING STRATEGIES: A CASE STUDY OF BRAZILIAN SUPPLIERS FROM THE FOOD INDUSTRY

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Abstract

The private label strategy has been adopted by retailers who seek a competitive advantage through the commercialization of products sold under their brand names. This strategy has created a new demand for suppliers, who need to reevaluate their manufacturing structures in order to decide whether or not they should produce such goods. Aiming to analyze the manufacturing strategy adopted by suppliers of private labels, we conducted a qualitative research based on six case studies with private label manufacturers and classified them according to their reported competitive priorities. All the companies considered quality as their top priority, but diverged between flexibility, cost and service as their secondary and third priorities. We highlight the fact that private label strategies do not determine, but rather influence decisions on manufacturing strategy.

***Key-words*:** private label, manufacturing strategy, competitive priorities.

1. INTRODUCTION

A private label is a brand that is owned or controlled through contract rights by a retailer or buyer organization and that is solely sold at their own establishments. Private labels were first adopted in the 70's in Europe and in the United States, following the consolidation of the retail industry. At that time, retailers started expanding internationally and changed from mom-and-pop stores to global players (COUGHLAN et al., 2002; KUMAR, STEENKAMP, 2008).

In Brazil, in the 70’s, the private label initiatives comprised generic and low quality products (commodities “with no brand names”, sold in plain packages). They only began to be treated as a strategy in the 90’s, after the opening of the economy and the stabilization of the local currency (LEPSCH et al., 2005; OLIVEIRA, 2005). During this period, the opening to the global market resulted in the need to adopt strategies of differentiation in order to achieve a better competitive position (BORGES, CUNHA, 2004; BURT, 2000; SHOCKER, et al., 1994). We can notice an evolution on the concept of private labels, whereby retailers worked to eliminate the image of cheap products by placing an emphasis on quality products and standardized packaging (AAKER, 1998; PEETERS et al., 2006; STEINER, 2004).

As pointed out in the 17th ACNielsen Private Label Study, a growing trend of this market can be noticed in Brazil. It grew by 18% in number of available products over a period of two years, reaching 56500 goods in 2011. This market achieved a participation of 4.9% in terms of sales and 6.5% in terms of volume in 2011. However, private labels in Brazil are still far from achieving the same level of integration when compared to countries like Switzerland, the United Kingdom and Spain, which have a market share of 48%, 42% and 38%, respectively (ACNIELSEN, 2011). In this sense, Diallo (2012) analyzed how Brazilian retailers may increase consumer purchase intention regarding private labels, through efforts focused on store image, price-image and perceived risk. In addition, Herstein and Jaffe (2007) argue that retailers worldwide are adopting marketing efforts to ensure that private labels are no longer exclusive to developed countries.

In the private label strategy, product property and right of use are transferred to retailers, but the manufacturer is still responsible for producing such goods (BATRA, SINHA, 2000; BOWERSOX, COOPER, 1992; PARENTE, 2000). Thus, manufacturers must assess their strategy to decide whether or not they should manufacture private label products. Specifically to the manufacturing strategy, companies must reassess their competitive priorities, establishing guidelines to conduct their long-term activities.

According to Herstein and Jaffe (2007), the supply of private label products in developed countries is provided by leading companies or enterprises specialized in this market. Conversely, in less developed countries 75% to 80% of the products are supplied by local manufacturers who do not possess strong or recognizable brands. From this perspective, private labels are important for the competitive survival of middle-sized and small manufacturing companies, as they provide an opportunity for such companies to thrive in markets in which theywere not active(LEPSCH et al., 2005; SPINELLI, GIRALDI, 2004).

Having set the context, the overarching purpose of this research is to classify the Brazilian suppliers of private labels according to their manufacturing strategy. To meet such objective, we conducted a qualitative research based on six case studies of companies from the food industry. The section that follows presents the theoretical background of both the manufacturing and the private label strategies. Then, we present the research methodology and the results. The discussion section presents our findings and encompasses managerial implications. In the final considerations, we discuss the limitations of this research and give suggestions for future studies.

2. THEORETICAL BACKGROUND

2.1 MANUFACTURING STRATEGIES

Manufacturing strategies aim to ensure the alignment between manufacturing processes and the company's strategic intent. They involve decisions and actions that establish the manufacturing role, objectives and activities, defining how to create a competitive advantage (CORRÊA, CORRÊA, 2005; LEONG et al., 1990). The performance of competitive priorities determines how the manufacturing strategy contributes to the achievement of the firm's objectives (LEONG et al., 1990; RYTTER et al., 2007; SLACK et al., 2002). The most commonly accepted competitive priorities are: cost, quality, flexibility, delivery and service (GARVIN, 1993; JABBOUR, 2009; WARD, DURAY, 2000)

Low costs are important to increase corporate profits and allow a reduction of selling prices to consumers. In general, low costs can be obtained through the management of expenditures with employees, facilities, technology, equipment and materials. Companies need to focus on three classic concepts of manufacture in order to reach excellence in cost: economy of scale, learning curve, and productivity (PIRES, 1995; SLACK, 2002; SLACK, LEWIS, 2001).

The concept of quality evolved over the years and changed from the stage of offering durable products to the point of offering products with low defect rate and in accordance with established standards. More recently, reference models have been used to guarantee process standardization, product safety and traceability. As an example, the set of ISO 9000 regulations is recognized worldwide as a standard for quality management system. ISO 22000 was developed for the food industry and aims to combine the key elements of food safety along the agribusiness chain (MARTINS, 2007; TOLEDO, 2001).

Flexibility is the ability to change the product and the production time, i.e. the ability to develop new and differentiated products and respond to peaks and troughs in demands (CHASE et al., 2006). Product development is a procedure whereby a company develops the specifications and production process according to customers' needs (ROZENFELD et al., 2006).

Delivery is the time that customers must wait to receive their products or services and represents the commitment of providing goods or services in accordance with the pledged amount and time (LEONG et al., 1990; SLACK et al., 2002).

Service is mainly related to customer support and sales support. Customer support is the ability to serve clients by rapidly replacing defective parts or replenishing stock. Sales support is the ability to increase sales through real-time demonstrations of technology, equipment or production systems (GARVIN, 1993).

Although all competitive priorities are important, it is essential that organizations select an order of importance, so that they can structure the company's strategic decisions (HILL, 1994). The competitive effectiveness depends on the degree of consistency between the elected priorities and the corresponding actions implemented in structure and infrastructure, such as technology, capacity, organization, human resources, quality and production control (HAYES, et al., 2008; LEONG, et al., 1990).

2.2 MANUFACTURERS AND PRIVATE LABEL STRATEGIES

While private labels are brands owned by retailers which are only on sale at their establishments, manufacturer brands are possessions of the manufacturers and may be sold by different customers (COUGHLAN et al, 2002; KUMAR, STEENKAMP, 2008; PARENTE, 2000).

According to Oubiña et al., (2006), manufacturers started supplying private labels due to the growing power of retailers as well as the lower costs of offering products with the retailers' brands. As a result,manufacturers can pursue two options: (1) focus exclusively on producing private labels; or (2) produce both the manufacturer's brand and the private label (BAILY et al., 2000; KUMAR, STEENKAMP, 2008).

As stated by Oubiña et al. (2006), non-leader manufacturers are producing private label products as a matter of survival, that is, to remain in the distribution channel and try to increase their market share. This makes them strongly dependent on major retailers (McGOLDRICK, 2005). Because of such dependence, we suppose that manufacturers are being pressed to satisfy their customers' requirements. In this sense, retailers have been investing in elaborated products that are superior to market-leading brands. The development of premium brands aims to provide unique and superior quality products, enabling the differentiation of retailers by encouraging consumer loyalty (AAKER, 1998; CONN, 2005; HUANG, HUDDLESTON, 2009; LEPSCH et al., 2005). Thus, we propose that manufacturers who focus exclusively on private labels must develop flexibility skills in order to be able to offer superior products to retailers, as stated in our first proposition:

Proposition 1: manufacturers with exclusive dedication to the private label market will consider as competitive priorities, in order of importance: quality, flexibility and cost.

As a second group of manufacturers, we have companies that produce both private labels and manufacturer's brands. Hoch (1996) states that manufacturers should face this situation with more attention, as retailers are both competitors and customers. Manufacturers who partially specialize in private label markets usually supply to groups where consumers look for medium-quality products, yet at lower prices (LAAKSONEN, 1994). Despite this fact, as this group of manufacturers also has their own brands, we assume that their level of dependence to retailers is lower than that of the first group. They are more concerned with developing their own manufacturer's brand so that the option of flexibility will only be offered in special cases. Based on this, our second proposition states that:

Proposition 2: manufacturers with simultaneous production of private labels and manufacturer's brands will consider as competitive priorities, in order of importance: quality, cost and flexibility.

Manufacturers with powerful brands may refuse to supply private label products to maintain the strength of their brands and in order not to produce any product that might dilute their brand image and jeopardize their market positions. Some of them are taking commercial and marketing actions in order to avoid losses in market share (TOILLIER, 2003; SPINELLI, GIRALDI, 2004). Olson (2012) states that manufacturers need to be in a constant search for innovation to ensure a supply of products with superior taste, durability, convenience and variety.

Thus, manufacturers need to maintain an advantage in terms of value, quality, and performance, so that customers can easily experience the difference from private label products.

Some leading companies decide to supply to the private label market in an attempt to improve their bargaining position and limit the growth of private labels. According to Oubiña et al. (2006), these companies manufacture private label products for strategic reasons. Thus, we assume that leading companies will prefer to secure the strength of their brands and only offer flexibility in special cases (SPINELLI, GIRALDI, 2004). Apart from that, we propose that leading companies will offer the service structure that is available to manufacturer's brands as a differential from the smaller competitors, as stated next:

Proposition 3: companies with representative manufacturer's brands will consider as competitive priorities, in order of importance: quality, service and flexibility.

3. RESEARCH METHODOLOGY

Manufacturing management is an applied discipline that requires the direct observation of the studied phenomenon in order to fully capture its complexity (BEACH et al., 2001; CRAIGHEAD, MEREDITH, 2008). In this paper, due to the lack of previous research considering the manufacturer's side in the private label market, we performed a case study, which is considered to be an appropriate methodology for studying emergent practices, factors or situations (MEREDITH, 1998).

In order to define the research target, we considered the results from the 14th Annual Private Label Study (ACNIELSEN, 2008). According to this study, the 10 private label product categories with the highest revenues in Brazil comprise 30% of the total amount of sales. Out of these ten categories, nine are made up of food products, which attest the importance of this category to the study of private labels.

As explained throughout the development of the propositions, the case studies were selected as shown in figure 1: suppliers with exclusive dedication to private labels; suppliers with simultaneous production of private labels and manufacturer's brands; and suppliers of private labels with a representative manufacturer brand. To define the representativeness of manufacturer's brands, we considered the size of the market share to be the best criteria. In total, we contacted thirteen food companies by email and telephone and six of them agreed to participate in this research. As requested by the interviewees, the names of the companies were kept anonymous and will not be disclosed.

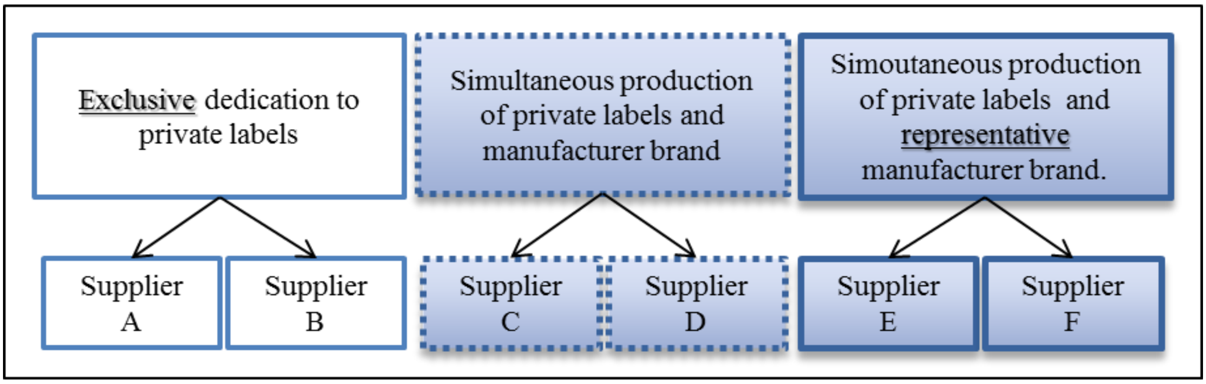

Figure 1.Case selection.

From the study and understanding of the main issues involved in this research, we developed a semi-structured questionnaire, which was then used as the main source of primary data collection. The interviews, conducted in Portuguese between 2009 and 2010, were digitally recorded and transcribed. The duration of the interviews ranged from 1.5 to 2.5 hours.

Data analysis was performed qualitatively using the theoretical propositions strategy, in which procedures adopted by the companies were compared with the literature. Yin (2005) states that the construction of an explanation should be the result of an iterative process, in which the interpretation of previous theories may be reviewed.

Lewis and Ritchie (2003) state that reliability in qualitative studies may be achieved by internal checks on the quality of the data and interpretations. Thus, whenever possible, we interviewed more than one person from the same organization. We also used multiple sources of evidence, which include in-depth interviews, site visits and materials provided by the firms. The objective was to explore different views and representations of the subject in order to identify perspectives that revealed the dynamics of the problem under consideration (BAUER, GASKELL, 2002). This triangulation method is a means of testing out arguments from different angles. Being open to different ways of seeing, constructing meanings and acknowledging divergence, enables researchers to pursue interpretations further and deepen their understanding in order to portray a valid picture (SIMONS, 2009).

3.1 RESEARCH CONTEXT

The case studies were performed in six companies from the food industry which produce potato chips, homemade-like pasta, yogurt, frozen food, panettone (a sweet bread loaf enjoyed for Christmas), chocolate Easter eggs and açaí berry in the bowl (a typical Brazilian dish made of mashed frozen açaí berries from the Amazonian region). Chart 1 presents the main characteristics of the studied companies.

	A	B	C	D	E	F
Product	potato chips	homemade-like pasta	yogurt	frozen food	panettone& Easter eggs	açaí berries in the bowl
Interview with	Owner & Production manager	Commercial manager & Quality manager	Owner	Private label manager	Commercial manager	Commercial manager & Operations manager
Number of employees	100	80	50	200	200	180
Year of foundation	1978	1985	1984	1991	1983	1994
First supply of PL	2000	1990	2000	2000	1990	1999
% of PL	98%	90%	60%	60%	less than 50%	3%

Chart 1.Suppliers presentation

The interview at company A was conducted with the owner and the production manager, both of whom allowed us to visit the manufacturing facilities. Company B was represented by the sales manager and the quality manager, who also showed us the production line. The owner of company C showed us the new installations of the company and the packaging process. Company D was the only company to have a specific manager for private label products, whereas company E was represented by the commercial manager. In company F, we succeeded to interview the commercial manager and the operations manager.

The volume of private label products commercialized by suppliers A and B, correspond to 98% and 90% of their total production volume, respectively. This accounts for their classification as companies that are exclusively dedicated to the private label market. Suppliers C and D commercialize 60% of their production to private label market, which led us to consider them as manufacturers with simultaneous production of private label and manufacturer's brand. Suppliers E and F commercialize, respectively, less than 50% and 3% of their production volume in the private label market. Supplier E's manufacturer's brand is the second bestseller in the domestic market of panettone and fifth in the market of Easter eggs. Supplier E is considered the leading provider of private label products in these segments. SupplierFproducesaçaí berries for the private label market and its manufacturer's brand is the leader in sales in theBrazilian market. These characteristics classified them as companies that present simultaneous production of private labels and representative manufacturer's brands.

4. RESULTS

Based on the research propositions, we are going to discuss the order of importance of the manufacturing competitive priorities reported by each supplier. We will also present quotes extracted from the interviews in an attempt to increase the explanatory power of our results (PRATT, 2009).

As predicted, all suppliers considered quality as their top manufacturing priority. Regarding food safety, every supplier from our case study adopts the Good Manufacturing Practices (GMP) and Hazard Analysis and Critical Control Points (HACCP). Supplier E is one step ahead with initiatives to implement the ISO 22000 certification. This feature corroborates the statement of Aaker (1998) and Lepsch et al., (2005) that the Brazilian private label market has invested in elaborated products, emphasized on quality and closed the gap with market leaders. As stated by Supplier B's commercial manager:

> *"Nowadays, private label production is thoroughly monitored, to the point where it is safer to consume private labels than manufacturer's brands. Manufacturers are constantly audited by retailers and that's why we need to be continuously evolving to meet their full demands."*

According to *proposition 1*, there was an expectation that companies from the first group would rank their competitive priorities in the following order: quality, flexibility and cost. Flexibility would be offered in order to meet the retailers' requirements. In this sense, the commercial manager from supplier B believes that offering an innovative product is a good way to increase the range of products that will be commercialized with retailers. This may happen because the production of homemade-like pasta restricts the use of equipment and is labor-intensive. Thus, adjustments in the manufacturing process and, therefore, development of new products can be made with ease. According to our expectations, supplier B ranked its competitive priorities in the following order: quality, flexibility and cost. The excerpt below expresses the manager's point of view:

> *"To conquer the private label market, you have to offer a product with added value, with new parameters. If you produce pasta that does not exist in the market, the customer will mandatorily have to buy it from you"*

In contrast, supplier A presents the option of just changing the aroma of the product with no possibility of modifying the remaining manufacturing process. They are concerned with maintaining the manufacturing stability to achieve large-scale production, with better utilization of production batches – one of the concepts stated by Pires (1995). Supplier A focuses on cost reduction and has plans to acquire new equipment to reduce losses, increase productivity and better use the production capacity. This focus can be noticed in the production manager's words below. Concerning its competitive priorities, the owner ranked quality, cost and flexibility in this order of importance.

> *"We have 18 different aromas and we try to commercialize the same options with as many customers as possible to decrease the number of machine setups. Apart from the 18 aromas, we also offer 4 different potato cuts, and a diversity of packaging sizes, brands and clients, which total about 150 SKU's."*

According to *proposition 2*, companies with simultaneous production of private labels and manufacturer's brands would be more concerned with cost in an attempt to differentiate their manufacturer's brand. In this sense, supplier C offers exactly the same product for its manufacturer's brand and private label. Since the manufacturer's brand also targets low-cost segments, decisions on the manufacturing process highlight cost reduction. Bearing this in mind, supplier C has recently acquired new fermentation tanks that allow the composition of manufacturing batches and the better utilization of the installed capacity. This strategy is used to achieve the lower prices required by private label markets, as shown in the excerpt below. As expected, the owner of supplier C considered quality, cost and flexibility in this order of importance.

> *"I usually manufacture private labels only after receiving an order from the customer. If I get an order of 6000 liters for private labels, I can use the remaining capacity to produce my manufacturer's brand, since I offer exactly the same product for both markets"; "the cost with labor, energy for heating and stirring the tank and cleaning materials are the same regardless of capacity utilization".*

Supplier D, on the other hand, offers a greater degree of flexibility by offering exclusive recipes for each client through product customization. We could observe that the existence of a large variety of products require a greater amount of work by the production and planning control because they operate on a make-to-stock system for private label products. Thus, to improve efficiency in its production process, supplier D works with well-defined parameters to determine the minimum quantities of raw materials and packaging and also the days of inventory for finished products. This company ranked, in order of importance: quality, flexibility and cost. The extract below is from the private label manager.

> *"Each company has an exclusive recipe, I do not offer the same product for different clients"; "As we work with a minimum stock for each product, we have a cold storage chamber with capacity to store 450 tons of frozen food."*

In *proposition 3*, we assumed that companies with representative brands would offer the service structure that is available to manufacturer brand, besides flexibility in special cases. Both suppliers pointed out quality and service as main competitive priorities. As predicted, supplier E considered flexibility as the third manufacturing objective, while supplier F considered delivery.Supplier E performs adjustments in the product specification or the full development of new products, taking into account the economic and industrial viability. The products created for private label market are protected by contract exclusivity, due to which the new product cannot be traded with any other company. In the words of the commercial manager:

> *"We use contracts of exclusivity for a certain period in which we cannot sell the product to other customers or as a manufacturer brand. This helps the creation of retailer's identity and a sense of loyalty with consumers, who may associate that particular brand with the retailer image."*

Supplier F, on the other hand, expressed concerns against the private labels growth and does not offer any kind of product development for this market. According to the respondent, product launch should be made first for the manufacturer brand, so that exclusivity is linked to his brand from the beginning,as can be seen in this quote:

> *"The innovations should be launched first for manufacturer brand and then for private labels. I don't want consumers to think that I am copying from the private labels. If I proceed this way, I will give all the advantages for the private label market."*

5. DISCUSSION

Taking into consideration the previous statements about the order of importance of competitive priorities, we propose a classification to discuss how the private label strategy can influence the achievement of manufacturing strategy objectives. In figure 2, we can visualize how the companies were classified.

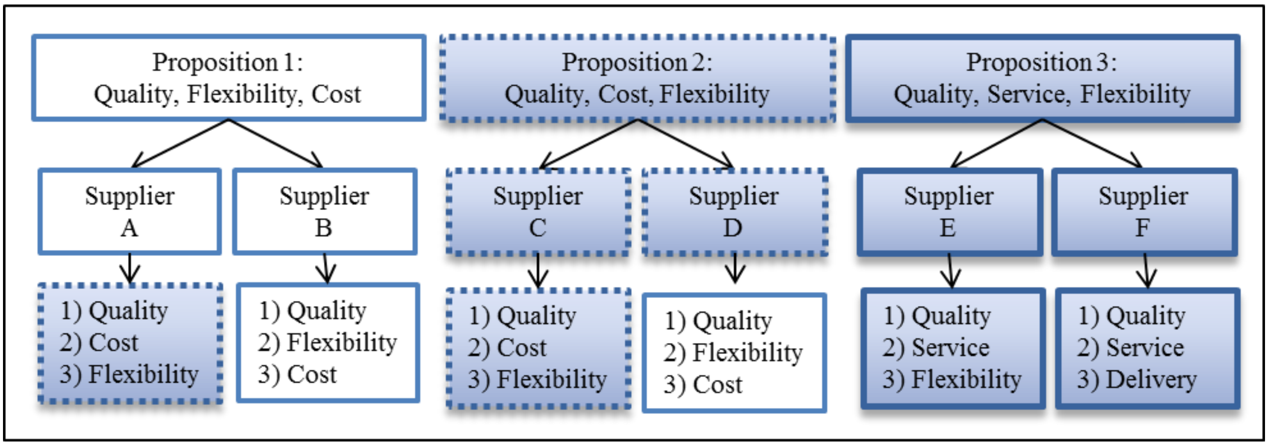

Figure 2.Manufacturing strategy classification

According to Miller and Roth (1994), the determination of taxonomic groups has a significant value for the study, research and discussion of manufacturing strategies. Cagliano et al., (2005) conducted a literature review identifying the main authors who proposed taxonomies and found that the classifications based on competitive priorities, tasks and missions converge on four types of strategies: market, product, capability and price.

According to the classification proposed by Cagliano et al., (2005), suppliers A and C are following the price-based strategy in which manufacturers operate in markets with products in maturity stage; emphasize the price-quality relation; and are able to adapt to some client requirements. As described previously, both suppliers seek cost reduction through large-scale production and through the better utilization of production batches. Besides that, they offer flexibility through small adjustments in flavor and aroma. In this sense, supplier C has an advantage when compared to supplier A, as it may recover its investments on innovation more quickly. This happens because supplier C can immediately commercialize the jointly developed product as a manufacturer brand item, while supplier A would have to make a commercial effort to convince other customers to add the new product to their portfolio. The inclusion of a new product can take months, as all the proper tests need to be carried out by the retailer's staff.

Suppliers B and D follow the product-based strategy whereby companies seek to compete through innovation and new product development (CAGLIANO et al., 2005). Supplier B offers the possibility to develop new lines of pasta through its labor-intensive process, while supplier D customizes the products according to customer needs. Similar to supplier A, supplier B has to make commercial efforts to convince new customers to add the developed product to their mix.

However, if they succeed in getting new clients, they can have scale gains and dilution of fixed costs. Supplier D, on the other hand, presents difficulties to achieve economy of scale, since it works with exclusive recipes and cannot commercialize the new product with other customers, even as manufacturer brand products.

Despite the divergence reported in the third competitive priority, suppliers E and F follow the market-based strategy, which is followed by companies that offer high quality products, superior customer service and product variety (CAGLIANO et al., 2005). Companies E and F have a service structure that is available to manufacturer's brands and is also offered to the private label market. This structure includes customer support, sales support, promoters and stockists. Supplier E reported that, although there is no agreementon contractual terms, all the structure of promoters and sales support (order entry, billing, and product exchange) can be used for private label negotiation. Supplier F, on the other hand, offers sales support and customer support to the private label market but does not offer the structure with promoters and showrooms. They reported that these services would increase product costs and thus have to be made by retailers.

Both companies offer private label products for strategic reasons, as stated by Oubiña et al. (2006). While supplier E is more flexible on trading conditions, supplier F protects the manufacturer's brand and seeks to control the growth of private labels, as Spinelli and Giraldi (2004) pointed out.

5.1 MANAGERIAL IMPLICATIONS

Even though we had predicted that suppliers from our proposed groups would present the same manufacturing strategy, the collected data did not support this assumption. We could observe that the private label strategy does not determine, but influences the decisions on manufacturing strategy. Therefore, the simultaneous production of private label and manufacturer's brand, as well as the representativeness of the manufacturer's brand may interfere in manufacturing results such as economy of scale, dilution of fixed costs and return on innovation investments.

In general, we found that companies with representative brands had advantages in early negotiations, as they may offer the structure of manufacturer's brands (quality, service, flexibility) to the private label market. Manufacturers with less known brands or with exclusive dedication to private labels reported the need of improvements (especially in quality) before entering the private label market.

Since small manufacturers are constantly audited by retailers, they must conform to demands to be certified as private label suppliers. At the end of this qualification process, they are able to offer products with better quality, by improving their management techniques, as well as their manufacturing processes. In summary, the competitive priority of quality guarantees food safety, work safety and social and environmental responsibility.

Accordingly, the supply of private labels in Brazil can be seen as a possibility for small businesses to get qualified and start trading with major retail chains (LEPSCH et al., 2005; SPINELLI, GIRALDI, 2004). This is consistent with Amoako-Gyampah and Acquaah (2008), who concluded that firms in developing economies have greater benefits from an emphasis on the quality strategy. Thus, we believe that small companies should seize the opportunity for growth and get better qualified to meet retailers' changing demands, such as flexibility and service.

6. FINAL CONSIDERATIONS

During this research, some difficulties were encountered, resulting in limitations that should be considered. The utilization of personal interviews as an information source has the bias of the interviewee and the researcher. This bias involves the fact that managers may not want to disclose some information in order not to compromise the company's interest and/or the investigator may not understand the answers well, both of which situations can cause distortions in the analysis. To counterbalance this limitation, we performed interviews with different employees and visited the manufacturing facilities whenever possible. The use of different sources of information may help to improve the clarity and precision of a research finding (LEWIS and RITCHIE, 2003).

Besides that, the analysis of manufacturing strategies was based on the managers' report on the order of importance of competitive priorities. This limitation was reported by Pires (1994) and Silva and Santos (2005), who showed that responses tend to reflect the position of managers and may not necessarily belong to the content of a formally established strategy.

According to Donmoyer (1990), case study research may be used to expand and enrich the repertoire of constructions available to practitioners and others. Thus, the results presented in this study may be used as hypotheses to be tested in further studies (SCAPENS, 1990). We also recommend that research is carried out with firms from different industries, besides comparative studies with suppliers from other countries. Such study may lead to a better understanding of manufacturing strategies and provide recommendations that will lead to the better practices adopted overseas.

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