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Impact of Expansion of Private Brand on Korean retail and Manufacturing

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I. Motivations

- Private Brand (PB) products are booming in Korea
 - **Categories:** Food and daily necessities → **All consumer goods**
 - **Quality:** Quality of PBs rivals that of national brands (NBs) products
 - **Popularity:** A number of **PBs ranked at top sellers** are increasing (ramen, coffee, mineral water, milk etc.)
 - Market size accounts for $\frac{1}{4}$ **of the total sales** of corporate retailers.
- However, we are just beginning to understand PBs & PB market
 - **No official statistics** on PB market are available

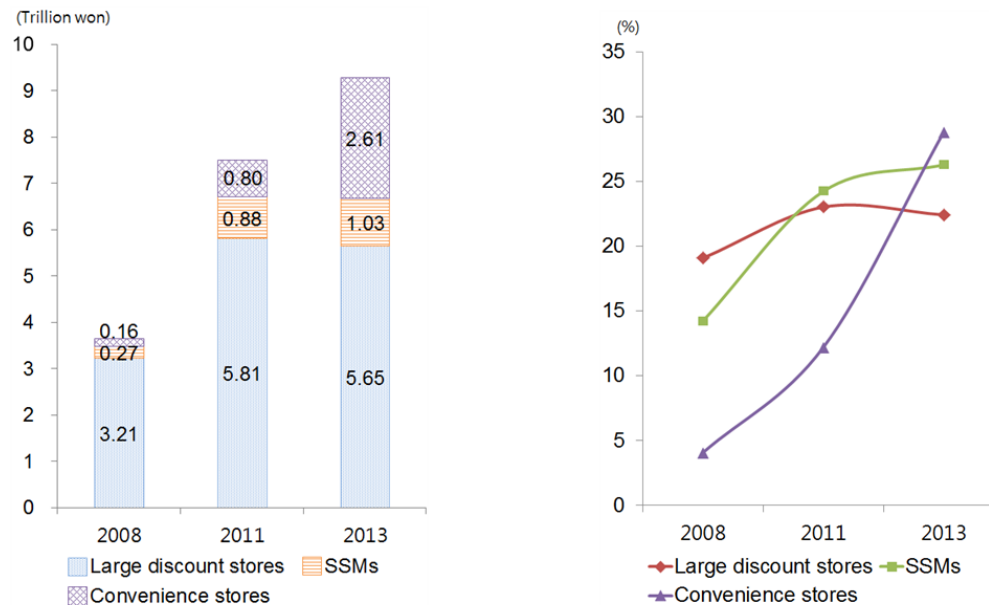
- This study closely examines the domestic PB industry as follows
 - **Industrial background** of market growth
 - **Impact on** the growth of the **retail and manufacturing industries**
 - PB development methods / **Types and frequency of unfair trade practices**
 - **Policy directions** for shared growth and fair market order.
- ✓ Use of micro-data obtained from retailers and manufacturers

II. Current Status of the Domestic PB Market

■ PB market size: **3.6 trillion won ('08)** → **9.3 trillion won ('13)**

- **Demand** ↑ : Consumer sentiment shrank, price sensitivity rose, preference for economical products became stronger
- **Supply** ↑ : PB expansion strategy at all types of retail channels

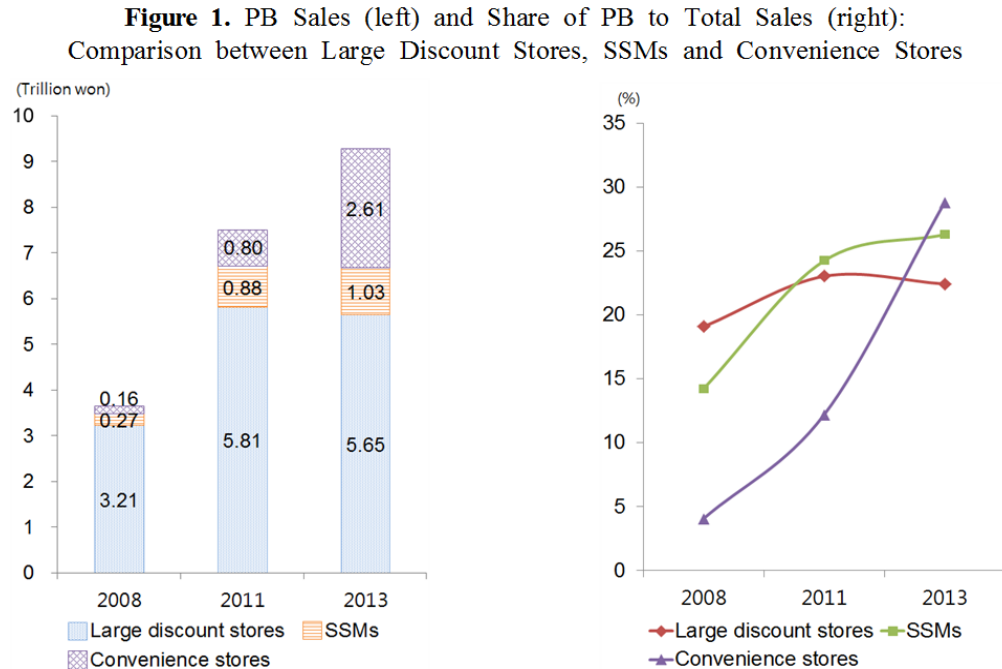
Figure 1. PB Sales (left) and Share of PB to Total Sales (right): Comparison between Large Discount Stores, SSMs and Convenience Stores



Note: Each category represents the top three chains with the highest sales volume.
 Source: Calculated using the Yearbook of Retailers (2009-15) and companies' annual reports (same period)

Recent Trends

- **Large discount stores** are still the largest sellers of PBs, however, heated competition and **market restrictions dampened their sales growth** since 2011
- Recently, **convenience stores are now spurring the growth**
 - ✓ PB sales by three largest convenience stores **increased by 16 times** from **2008 to 2013**
 - ✓ Average share of PB sales increased to **28.8% in 2013**



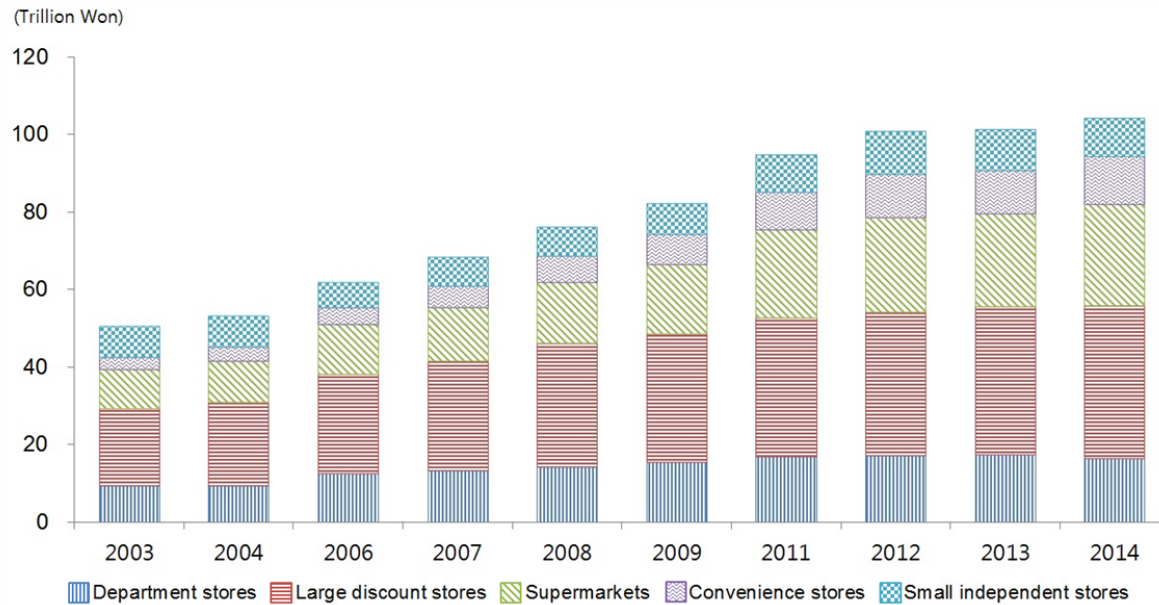
Note: Each category represents the top three chains with the highest sales volume.
Source: Calculated using the Yearbook of Retailers (2009-15) and companies' annual reports (same period)

III. Growth Background: (1) Market Concentration in General Retail

- The **growth of the general retail** business was heavily dependent on the **growth of corporate retailers**

- The market for general retail expanded by 53.7 trillion won in 2003-2014, of which 78% derived from the increased sales in corporate retailers

Figure 3. Changes in Sales by Retail Business Type



Note: Corporate retail encompasses department stores, large discount stores, SSMs within super markets and convenience stores.

Source: Based on Statistics Korea, "Wholesale and Retail Trade Survey Micro Data," 2013-14.

■ **Buyers' power has become even stronger.**

- The share of corporate retailers' sales in general retail market increased
- The stake of the corporate retail business in the distribution of manufactured goods increased

■ These changes may aggravate the **imbalance in the bargaining position** between retailers and manufacturers

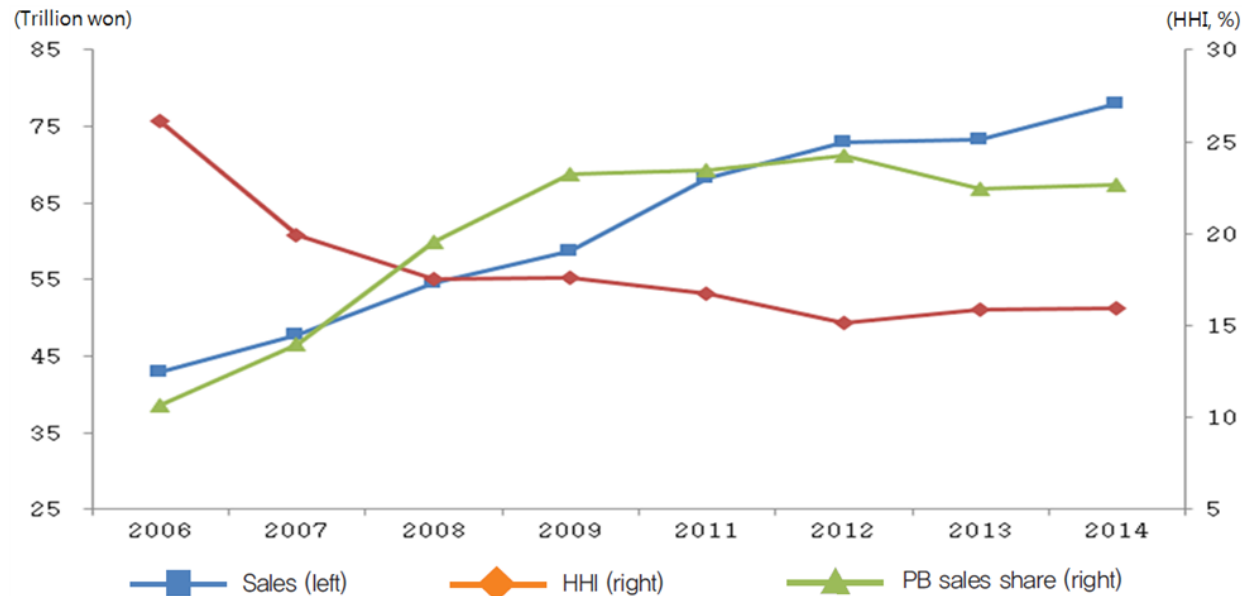
- As a seller, manufacturers have more economic incentive to supply their products to corporate retailers who dominate the retail market
- As a buyer, retailers have little difficulty in finding alternative suppliers who can offer similar or more favorable contract terms

III. Growth Background: (2) Intensifying Competition b/w Corporate Retailers

■ Competition b/w corporate retailers raises the economic incentive to release PB

- HHI of corporate retailers has been on the decline since 2006, pointing to more heated competition between rivals

Figure 4. Corporate Retail Business: HHI, Sales and PB Sales Share

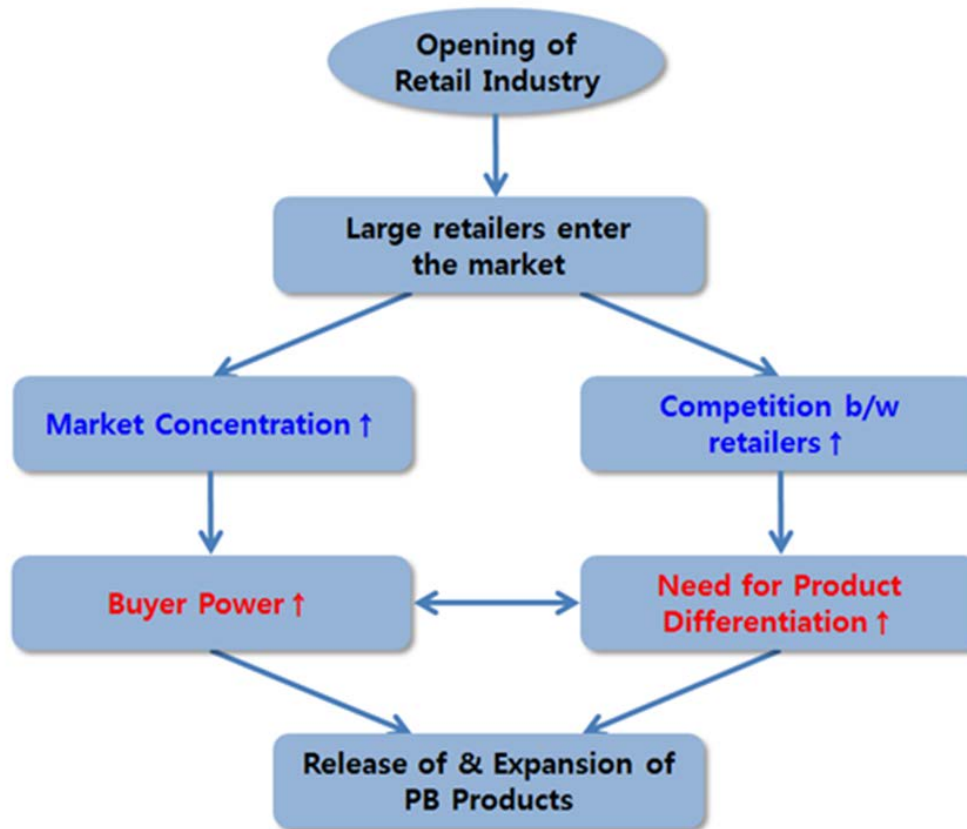


*Note: Corporate retailers include large discount stores, SSMS within super markets and convenience stores. The share of PB sales is the share of the three biggest chains of large discount stores and SSMS, respectively.
Source: Based on the Korea Chain Store Association, Yearbook of Retailers (2009-15) and companies' annual reports (2009-15)*

- In this situation, if shelves were stacked with **NB products**, corporate retailers would have no other alternative but to engage in a **discount war**
- **By making PBs**, on the contrary,
 - Corporate retailers are able to decide on the product features, and sell them exclusively at their stores → **Product Differentiation**
- Corporate retailers are free from consumers' direct comparison of price and quality, and thus can set a **stable retail margin**
 - Differentiated products → Differentiated stores → strengthening customer loyalty

- In all, PBs are a profit-maximizing solution in response to retail market concentration and increasing competition between them.

Figure 5. Structural Understanding on PB Product Expansion



Source: Created by author

IV. Impact of Increased PB Sales on the Growth of Corporate Retailers

- Data: Sales performance and characteristics (by retail store) + PB sales ratio (by year and business type)
- Empirical results
 - **PBs contributed to increasing the sales and profit of retail stores**

Table 1. Effect of a 1%p Increase in PB Sales Share on the Performance of Retail Stores

Unit: 1 million won	Model 1 (IRLS)	Model 2 (WLS_Firm)	Model 3 (WLS_Emp)
Increase in Sales	22.3	25.2	28.5
Increase in Profit	2.7	8.3	9.0

Note1: PB sales share is defined as the share of PB sales in total sales in respective retail business types.

Note2: Above estimates are all significant at the 1% level.

Source: Statistics Korea, "Wholesale and Retail Trade Survey MDIS," 2006-14; Statistics Korea, "Economic Census MDIS," 2010; Korea Chain Store Association, the Yearbook of Retailers (2009-15); companies' annual reports (2009-15)

- (In Model 1) 1%p increase in the share of PB sales causes an average increase of 22.30 million won in sales and 2.7 million won in profits

- The coefficient varies depending on the model, but all findings confirm that **PBs contributed to increasing the sales and profit of retail stores.**
- Indeed, **the strategy of expanding PBs** in response to a sluggish economy and heated competition seems to have been **successful.**

V. Impact of Increased PB Production on the Growth of Manufacturing

- List of PB manufacturers was acquired from headquarters of corporate retailers
- 1,000 manufacturing suppliers were interviewed to compile data
 - Face-to-face interviews were conducted at the firms with their CEOs as interviewees.
 - The survey was orchestrated by KDI EIEC's Public Opinion Analysis Unit from Aug. to Oct. 2016

1. Impact on the **Quantitative Growth (Sales)** of Manufacturing Firms

- All types of establishments, with the exception of micro businesses, **exhibit reduced sales** when the share of PB sales increases.

Table 2. Impact of a 1%p Increase in the PB Sales Share on the Sales of Manufacturing Firms

100 million won	Sales	NB sales share	PB sales share	establishments
Large enterprises	-10.9***	86.3	4.9	52
SMEs_top	-2.8*	76.8	7.9	228
SMEs_middle	-0.7*	69.5	8.8	305
SMEs_bottom	-0.4*	68.0	8.6	226
Micro businesses	+0.2*	60.0	15.6	115

Note 1: The share of PB sales is the share of main PB sales in the total sales of the manufacturing industry.

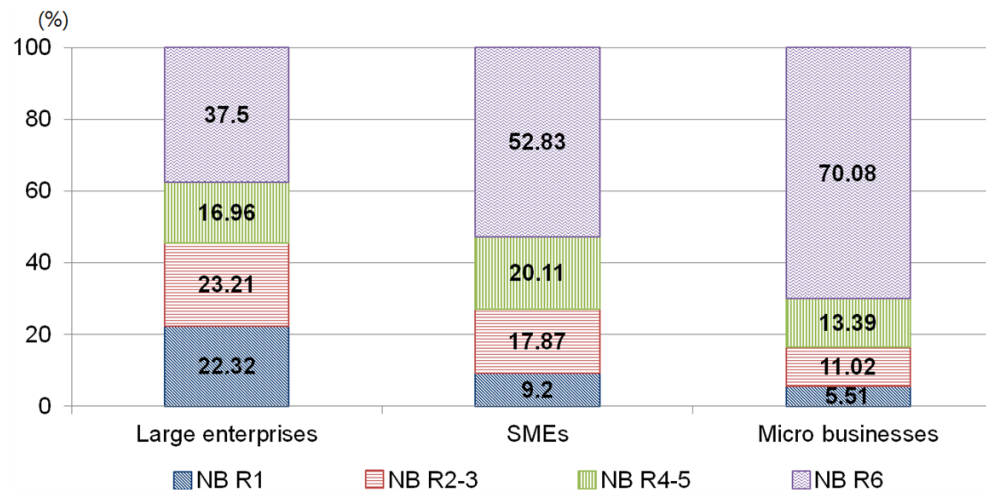
Note 2: *, **, *** denote the significance at the 10%, 5% and 1% levels, respectively.

Source: Data from the survey on manufacturing establishments (Korea Development Institute, 2016)

- **The decrement** in sales is in **proportion to the size** of the establishment
- In the case of large enterprises, a 1%p increase in the share of PB sales has a tendency to reduce total sales by 1.09 billion won.

- Such a reduction was mainly **due to the decreased sales** of manufacturers' **NBs** that are in competition with PBs.
 - The larger the firm, the more it relies on the sale of NB, and the more top-selling NBs it has in the market

Figure 6. Market Share Ranking of NB By Firm Size



Note: SMEs is the average for SME_top, SME_middle and SME_bottom

Source: Data from the survey on manufacturing establishments (Korea Development Institute, 2016)

- 1%p increase in the PB sales share generates higher sales losses (approximately 1.05 billion won) in firms that have top-selling NBs
- The cannibalization effect—PB crowding out NB—occurs more strongly in firms that have better selling NBs

- Underlying practices causing cannibalization effect
 - Producing PBs similar to best-selling NBs
 - Displaying PB and NB side-by-side
 - Replacing NB with PB

- Meanwhile, **micro businesses exhibited more gains in sales** after supplying PBs
 - NBs of micro businesses usually account for a small share of the market, and thus, the effect of cannibalization is not strong
 - Supply of PBs helped them to secure **more sales channels** and **higher capacity utilization rate**, which led to the increases in sales.

2. Impact on the **Qualitative Growth (Operating Profit)** of Manufacturing

- **Does quantitative growth lead to qualitative growth? Or, gains in operating profit?**

Table 3. Impact of Increased PB Sales on the Operating Profit of Manufacturing Firms

Billion won	Large enterprise	SME		Micro business
Total sales	⊖	⊖		⊕
Total operating profit	⊖	~		~
Operating profit from PB sales	⊕	SME_top ⊕	SME_middle · SME_bottom ~	~

Note: From a 10% level: ⊕ stands for significant increase, ⊖ for significant decrease, and ~ for no significance.

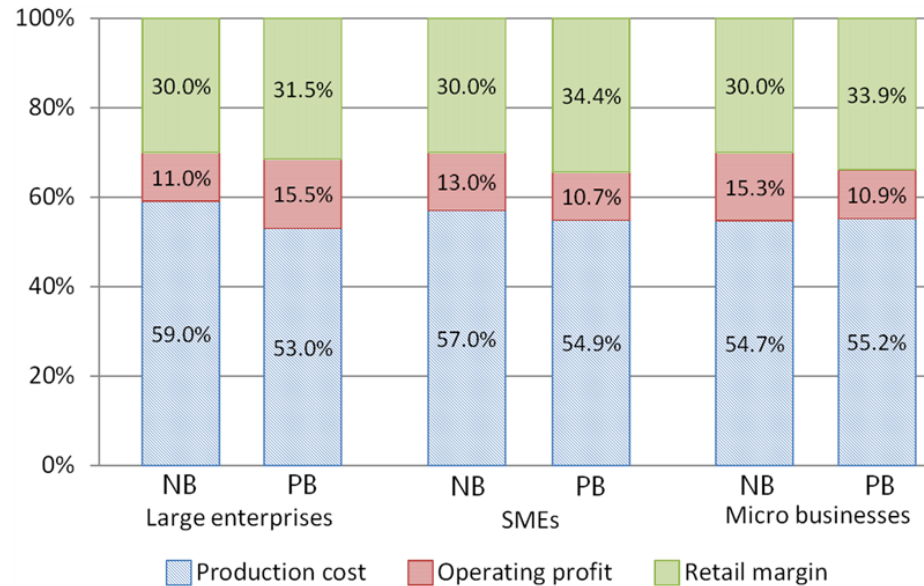
Source: Data from the survey on manufacturing establishments (Korea Development Institute, 2016)

- There were **no significant increases in the operating profit** of most SMEs and even of micro businesses
- This implies that the production increase incurred by **PB sales does not guarantee actual profit.**

■ Potential causes: **Profit sharing structure unfavorable to small firms**

- PBs cost less than NB in advertising, marketing and distribution
- This makes room for higher retail margins and operating profit

Figure 7. NB and PB: Composition of Retail Margin, Operating Profit and Production Cost



Source: Based on data on operating profit per sales, production cost, unit price for supply and list price from the survey on manufacturing establishments (Korea Development Institute, 2016)

- Meanwhile, SMEs and micro businesses exhibited decreased operating profit and increased retail margins, compared to NBs
- The increment in their retail margin appears to be higher than that in large enterprises.

- If more effort is needed in developing PBs when dealing with SMEs and micro businesses, then the increase in the retail margin can be understood as reasonable compensation.
- However, most PBs have been **slightly modified from NBs** (51.8%) or the **packaging has been merely replaced** (26.2%)
 - 88% of this occurs in SMEs and micro businesses.

Table 4. Types of PB in Comparison with NB

	Response	Percentage
Slight modification of NB	160	51.8
Package replacement of NB	81	26.2
Entirely new product	41	13.3
Others	27	8.7
Total	309	100.0

Note: Based on companies with available data on PB sales.

Source: Data from the survey on manufacturing establishments (Korea Development Institute, 2016)

- This implies that the **profit sharing structure may derive from an imbalance in their bargaining position.**

VI. Survey on the Type of PB Development and Unfair Trade Experiences

- Profit sharing structure may be closely linked to the development methods of PB products

Table 5. PB Development Methods

	Total	Large enterprise	SME	Micro businesses
Converting NB to PB at the recommendation of retailers	36 (11.7)	3 (9.4)	28 (11.2)	5 (18.5)
In-house development of PB	61 (19.7)	3 (9.4)	52 (20.8)	6 (22.2)
Development in partnership with retailers	212 (68.6)	26 (81.3)	170 (68.0)	16 (59.3)
Total	309 (100)	32 (100)	250 (100)	27 (100)

Note: Based on companies with available data on PB sales.

Source: Data from the survey on manufacturing establishments (Korea Development Institute, 2016)

- 11.7% of manufacturers converted their NBs to PBs
- 19.7% developed goods by themselves and supply them as PBs
- SMEs (32%) and micro businesses (41%) are more prone than large enterprises (19%).

■ Survey on unfair trade practices

Table 6. Experience and type of unfair trade practices (PB)

A. Experience

	Response	Percentage
Yes	30	9.7
NO	279	90.3
Total	309	100.0

B. Types and Frequencies

	Response	Percentage
Cutting delivery price	20	33.9
Passing cose of change (design/packaging)	13	22.0
Forcing PB development	8	13.6
Burdening promotion cose	7	11.9
Unreasonable return	7	11.9
Not allowing PB development with others retailers	3	5.1
Frequent changes of contracts	1	1.7
Total	309	100.0

Source: Data from the survey on manufacturing establishments (Korea Development Institute, 2016)

- 9.7% suppliers answered that they had experienced such practices.
- The most frequent unfair request was cutting the supply price (20 firms, 34%)

VII. Summary and Policy Suggestion

- The growth benefits from the expansion of the PB market has clearly reached prime retailers, however, there was little trickle down effect for subcontractors.
 - Significant cannibalization effect on NB caused by the release of similar PBs
 - Imbalance in the bargaining positions has caused operating profits to be set low while retail margins are set high

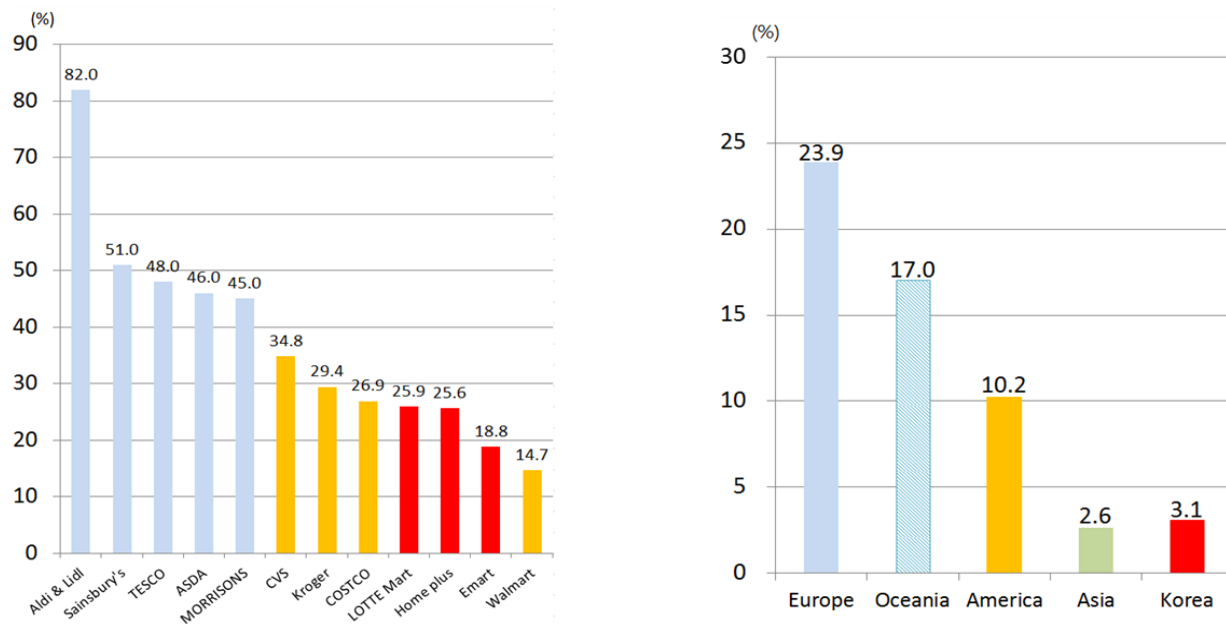
- PB business should be subject to stricter monitoring to establish fair market order
 - the Fair Trade Commission should closely examine any violations of the ban on requesting management information on PB manufacturers
 - requests for reduced supply prices, the most frequently chosen item as unfair trade practice, could originate from retailers demanding or gaining access to suppliers' information

- Stronger punishment and penalties are needed for violations against the Act on Fair Transactions in Large Franchise and Retail Business.
 - 83% of PB manufacturers who experienced unfair trade practices admitted to accepting all or a part of the requests.
 - This implies that their somewhat tepid stance is rooted in concerns over loss of profit or orders in response to any rejections of retailers' requests.

- SME manufacturers need to actively utilize government programs designed to support sales channels and to seek ways to advance into overseas markets
 - The Private Label Manufacturers Association (PLMA) holds trade shows and exhibitions every year in Amsterdam (May), Chicago (November) and Shanghai (December)
 - Retailers, buyers and PB manufacturers convene to establish new channels and share product information and ideas
 - Not many Korean manufacturers are aware and thus, there has been little participation.
 - PB manufacturers can utilize government supporting programs
 - ✓ Ministry of SMEs/Startup: Support for overseas distribution network / export marketing
 - ✓ Ministry of Trade, Industry and Energy: Consumer goods specialization / participation in overseas exhibitions
 - Government should focus on resolving difficulties these firms encounter while taking advantage of such policies and exploring trade partners.

- The share of PB sales in Korean corporate retailers is not much lower than that of their global counterparts
 - Below Aldi & Lidl, Sainsbury and Tesco / Similar to Kroger, Costco and Walmart
- Korea's PB market is still in its infancy
 - PB sales account for only 3.1% of retail trade (general + specialized retail)

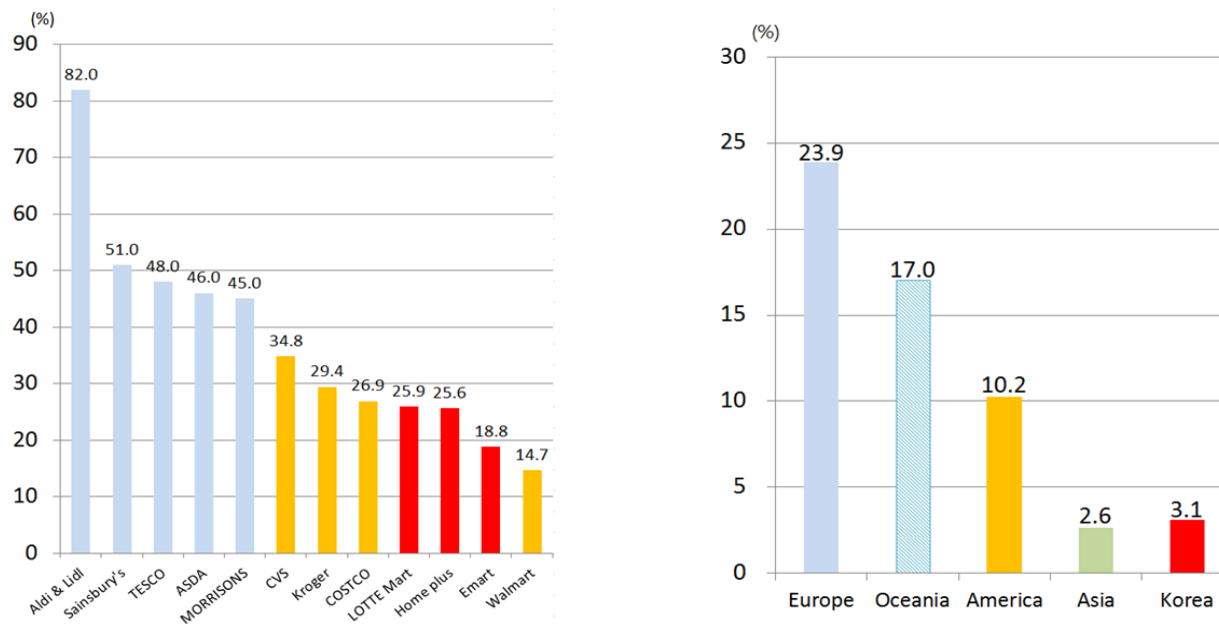
Figure 2. Share of PB Sales: By Retail Chain (left) and Continent (right)



Note 1: Share of PB sales by company (% , as of 2014) = PB sales / Company sales
 Note 2: Share of PB sales by country (% , as of 2013) = Total PB sales / Total retailer sales. The share of PB sales by continent is the mean of the share of PB sales by countries within the continent.
 Source: Calculated using PLMA (2014); Nielsen (2014); Korea Chain Store Association (2014); Statistics Korea, "Wholesale and Retail Trade Survey Micro Data," 2013.

- It has a strong potential & room for further growth
 - The market is exhibiting a similar development pattern with the oligopoly of a few companies to its counterparts in Europe.

Figure 2. Share of PB Sales: By Retail Chain (left) and Continent (right)



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