PROGRESS REPORT 237

The Effects of Private Label Brands of Milk on the Fluid Milk Industry

UNIVERSITY OF KENTUCKY · AGRICULTURAL EXPERIMENT STATION
DEPARTMENT OF AGRICULTURAL ECONOMICS · LEXINGTON

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CONTENTS

SUMMARY

Private label brands are an increasingly important part of fluid milk marketing, causing many changes in the market system. This growth in the use of private label brands has been at the expense of the established processor brands. Retailers saw in private label brands an opportunity to decrease the difficulty of introducing new brands to consumers. Increased profit margins made private label brands even more attractive. As a result, private label brands took on a somewhat different role than that normally assumed for the processor brand. Emphasis has changed from a nonprice to direct price competitive role.

By the early 1950's, retailers of milk were in a position to bargain for private label brands packaged to their specifications. Handlers became aware that private labels were becoming a competitive force in the market. Some processors decided to meet retailers' requests for private labels, while others refused to package private labels that might be in competition with their own processor brand.

The bulk of the private labels processed was concentrated in the larger plants. Location, size of operation, and economies of scale seemed to be an influencing factor.

Private label brands have affected the structure of Kentucky's fluid milk markets. The number of firms selling milk within some market areas decreased following the introduction of private label brands. Private label brands also brought about a shift in market shares. Losses of market shares by some processors were attributed to the introduction of private label into markets already supplied by processor brands, retailers entering into the processing business, termination of private label contracts, and decreased display space for merchandising processor brands. Gains in market shares resulted from either packaging the private label brand or an increase in the shelf space allotted to their processor brands.

Handlers felt that larger plants were in a better position to handle private label contracts than the smaller plants. Managers agreed that retailers have used private labels to gain market power, and while there is some risk associated with private label accounts, they have added a degree of stability to the market.

There is evidence that some shift in market power from processors to retailers has affected individual firm conduct. This shift is exemplified by food chains' threat to vertically integrate into processing, retailer control of shelf space, influence on consumers and the importance of supermarket accounts.

The majority of processors felt that retailers are often unreasonable when negotiating a price for private label brands. In addition, there was the feeling that private labels are used too frequently as loss leaders and that some firms have lowered processor brand prices to compete with the private labels. Processors also indicated that retailers often expect excessive discounts on private label brands.

Some reasons given for packaging private label brands were: increasing volume of business, allowing processors to compete price-wise in the market, meeting the needs of certain retail customers, retaining retail accounts, and keeping shelf space. Some handlers do not package private label brands because they fear a loss of consumer loyalty to the processor brand and the volume of their operations is too small to handle contracts in the market.

Private label brands have also affected the daily operations of processing plants. Their influence was seen most often by changes in the type of delivery and in the cost of producing each unit of product. Modifications were evident in other areas including routes, size and type of delivery vehicles, compensation of salesmen, labor requirements, and selling techniques or salesman's time allocations.

Processors noted some disadvantages and advantages associated with the packaging of private label brands. Some of the disadvantages mentioned included business in large lumps, low profit margins, loss of identity, and having to sell at, or near, cost. Some advantages included increased volume, keeping retail space for processor brands, and a reduction in the cost of distribution.

THE EFFECTS OF PRIVATE LABEL BRANDS OF MILK ON THE FLUID MILK INDUSTRY

*Robert L. Beck and Ronald G. Alvis**

INTRODUCTION

Branding, as a means of product differentiation, is a practice of long standing in the food industry. Historically, food manufacturers have used brands as a means of gaining a larger share of the market while avoiding the consequences of direct price competition. Merchandising food, particularly dairy products, under private label brands,[1] however, is a practice of more recent origin.

The introduction of private label brands of dairy products can be traced to the 1920's, when private label brands of evaporated milk first appeared. This was followed by private label brands of butter in the 1930's and fluid milk and ice cream during the 1950's [4, p. 44].

Local independent processors were the first to supply private label brands. Later, national dairy companies became involved. Often, these firms were packaging private label brands that were in competition with their own processor brand. Despite competition with their own brands, processors continued to package private label brands primarily to: (1) gain new business and increase volume, (2) discourage retailers from processing their own private labels, and (3) obtain or retain shelf space for their own brands.

*Associate Professor and former Graduate Research Assistant, Department of Agricultural Economics, University of Kentucky. This report is based on, Ronald G. Alvis, "The Impact of Private Label Brands of Fluid Milk on Competition in the Dairy Industry in Kentucky," unpublished M.S. Thesis, University of Kentucky. The research was a contribution to Regional Project SM-40: Market Organization, Power and Policies and Programs in the Dairy Industry (Kentucky Project 88).

[1]Private label refers to merchandise packaged mainly to a distributor's specification by either a distributor or a manufacturer, for resale only by a distributor, under a brand name owned by a distributor. Processor brand refers to a manufacturer's or producer's brand of merchandise having wide distribution, usually heavily advertised regionally or nationally with advertising paid for by the manufacturer.

With the growth of the supermarket and the increased mobility of consumers came increased use of the private label brand in merchandising milk. The shift from home delivery to retail distribution accelerated the practice.

Today, private label brands account for a significant portion of dairy products moving through the market system. A study of major food chains in Kentucky and the North Central Region showed that two-thirds (65 percent) of the chains interviewed had some type of central milk buying program. Seventy percent of the food chains with central milk programs (excluding chains which owned and operated their own milk processing facilities) carried their own private label brand of milk which accounted for 56 percent of their fluid milk sales [2, p. iv].

A more recent study of central milk programs of food chains and private labeling in the South showed that 60 percent of the chains responding merchandised some milk under their own private label. Twenty-two percent reported carrying only a private label brand of milk. Food chains in the survey with central milk programs operated or had associated with them approximately 20 thousand retail stores of which about 31 percent were supermarkets. Milk was supplied on a centralized basis to 77 percent of these stores, while the remaining 23 percent arranged for their own needs [3, p. 8].

The use of central milk programs has accelerated in recent years. Only 4 percent of the programs in the Southern Region were started prior to 1950, with 32 percent initiated between 1971 and 1975 [3, p. 11].

OBJECTIVES

The increased use of private label brands of fluid milk has affected all segments of the marketing process. Some have indicated that much of the existing competitive behavior among processors in recent years can be linked to the increased use of private label brands [1]. Recent studies have focused primarily on the extent and growth of private labeling in the dairy industry as associated with changes in market structure. Only limited research, however, has been devoted to studying the implication for, or the impact on, market conduct. Thus, this study was initiated with its primary focus on changes in market structure and competitive relationships associated with private labeling of milk and their effect on fluid milk processors.

The primary objective of the study was to determine the effects of private label brands of milk on the structure of Kentucky's fluid milk industry, competitive behavior and the operation of individual plants. Specifically, this involved (1) evaluating the impact on the structure of Kentucky's fluid milk industry with emphasis on market shares, (2) examining buyer-seller relationships between retailers and milk processors, (3) examining price and product policies of fluid milk processors and (4) looking at private labeling as it affected the day-to-day operations of individual processing firms.

PROCEDURE

At the time of the study, there were 35 fluid milk processors in Kentucky. Through personal interviews with either the production, sales or general manager of each plant, 31 usable questionnaires were obtained.

While some data were obtained relative to procurement, pricing and distribution of milk, the main emphasis was on private labels and their effect on market structure and competitive behavior. Secondary data and case studies were also utilized.

EXTENT OF PRIVATE LABELING

Most of the private labels were being packaged by the larger firms, with the smaller plants taking care of the local outlets of large chains and perhaps a few independent retailers who wanted a private label brand packaged. Table 1 shows the number of private label brands being packaged by plant size and indicates that the number of private labels per plant was in direct proportion to plant size.

Table 1.—Number of Fluid Milk Processors with Private Labels, Kentucky, by Size, 1972.

Size (000,000 lb)	Number of Plants	Number of Private Labels
Under 2.5	7	0
2.5 to 4.99	1	1
5.0 to 9.99	0	0
10.0 to 17.99	6	2
18.0 to 35.99	12	11
36.0 +	5	18

The high number of private labels coming from the larger plants could be associated with either their capacity to handle the volume necessary for chain store accounts, or their location near population centers where labor and many retail stores were available. Another cause could be their desire to achieve economies of scale.

EFFECTS OF PRIVATE LABELS ON MARKET STRUCTURE

An important part of the study centered on determining the effects of private label brands on the structure, or organization, of fluid milk markets. Since market structure influences competitive behavior, any change in structure brought about by private label brands would affect market conduct as well. Although market structure is more inclusive than either the number of firms operating in a market or the shares of the market controlled by each, they are frequently used as measures of structural changes in a particular market and were so used in this study.

Number of Competitors

Changes in market structure were identified by asking handlers to indicate instances in which competitors left a market following the introduction of a private label brand. Managers identified a total of 21 firms that had left 7 major market areas because of competition from private label brands. The number of competitors leaving these markets ranged from one to as high as 7 per market (Table 2).

Table 2.—Number of Fluid Milk Processors Leaving Seven Major Markets Following the Introduction of a Private Label Brand, Prior to Mid-1972.

Market	Number of Plants
Maysville	3
Newport	7
Lexington	1
Louisville	5
Paducah	1
Ashland	3
Madisonville	1
Total	21

Market Shares

To evaluate the effect of private label brands on market shares, managers were asked to estimate their own share of the market one year prior to and one year following the introduction of private labels into various markets. These estimates, plus data from other sources, provided the basis for a detailed examination of three selected markets (Lexington, Paducah, and Bowling Green). The results are summarized in Table 3.

The reason cited most often for changes in firms' market shares in a particular market was usually associated, directly or indirectly, with priate labeling. Market shares decreased in some cases because private labels had come into a market area and had been successful in obtaining some of the wholesale business.

Some processors lost outlets because retailers started packaging their own brand. This particular situation involved a food chain that integrated into milk processing and was supplying its own retail stores. Processors who had been packaging private labels for retailers lost these accounts, while others lost shelf space in the stores. The loss of shelf space is not uncommon since the retailer controls the amount of space allotted to each brand. Some handlers refused to process private brands and, as a result, lost a share of the market.

Overall Effect of Private Labeling

To further isolate the effect of private label brands on market structure, managers were asked to express an opinion about various statements concerning market structure. They were asked to assign numerical values to these statements ranging from -99 (strongly disagree) to +99 (strongly agree). All managers were asked to respond regardless of whether private label brands were packaged by their firm. Thus, the analysis could be divided into two parts, i.e., responses of (1) those who packaged private label brands and (2) those who did not. The individual statements, means, and F values are shown in Table 4. The responses can generally be summarized as follows:

1) All respondents agreed that private label accounts are particularly suited to large-scale processors. It is possible that some firms might not be able to handle certain private label accounts because of the size of their operations, since many private label accounts are with food chains and the volume required could be large.

2) Managers of both groups agreed that small processors had been unable to compete in some markets and in certain cases discontinued operations because of private label brands.

3) There has been concern over the possibility that retailers have gained market power through private label brands. There is competition for private label accounts and this type of competition usually leads to lower prices, better service or both. These lower prices are sometimes extended to the processor's own brand as well. Individual handlers were in agreement that some bargaining power had shifted to the retailer.

4) If processors have a large portion of their business concentrated in private label accounts, there is the possibility these accounts might be terminated suddenly. A significantly greater number of processors packaging private labels were aware of the increased risk associated with private label contracts. Perhaps some processors had actually experienced the sudden loss of an important account, whereas those managers not packaging private label brands could only speculate about such a possibility.

5) Managers were asked if they thought that a more stable market situation could be brought about through contractual agreements between processors and retailers. While processors generally agreed that variations in price and volume could be decreased, the number agreeing differed in the two

private label brands [1]. Recent studies have focused primarily on the extent and growth of private labeling in the dairy industry as associated with changes in market structure. Only limited research, however, has been devoted to studying the implication for, or the impact on, market conduct. Thus, this study was initiated with its primary focus on changes in market structure and competitive relationships associated with private labeling of milk and their effect on fluid milk processors.

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2) Managers of both groups agreed that small processors had been unable to compete in some markets and in certain cases discontinued operations because of private label brands.

3) There has been concern over the possibility that retailers have gained market power through private label brands. There is competition for private label accounts and this type of competition usually leads to lower prices, better service or both. These lower prices are sometimes extended to the processor's own brand as well. Individual handlers were in agreement that some bargaining power had shifted to the retailer.

4) If processors have a large portion of their business concentrated in private label accounts, there is the possibility these accounts might be terminated suddenly. A significantly greater number of processors packaging private labels were aware of the increased risk associated with private label contracts. Perhaps some processors had actually experienced the sudden loss of an important account, whereas those managers not packaging private label brands could only speculate about such a possibility.

5) Managers were asked if they thought that a more stable market situation could be brought about through contractual agreements between processors and retailers. While processors generally agreed that variations in price and volume could be decreased, the number agreeing differed in the two

Table 3.—Net Change in Market Shares of Fluid Milk Processors in Selected Kentucky Markets Prior to and Following the Introduction of Private Label Brands.

	Market Shares (percent)*		
	Prior	Following	Reason for Change
Lexington Market (population: 131,000)			
Processors			
A	20	20	No change
B	10	35	Packaged the private label brand
C	20	30	Paper containers
D	15	10	Loss to private labels
E	25	**	Out of business
F	10	**	Out of business
G	**	2	Expansion of distribution area
H	**	1	New firm
I	**	1	Expansion of distribution area
J	**	1	Expansion of distribution area
Paducah Market (population: 34,000)			
Processors			
A	2	4	N/A
B	7	**	Lost counter space to private label
C	4	8	Packaged one private label
D	55	57	N/A
E	32	30	Loss to private labels
F	**	1	Expansion of distribution area
Bowling Green Market (population: 28,000)			
Processors			
A	25	35	Packaged private label
B	45	45	No change
C	20	**	Out of business
D	1	**	Out-of-state firm - retraction
E	9	**	Out-of-state firm - retraction
F	**	15	Expanded distribution area
G	**	1	Expanded distribution area
H	**	1	Expanded distribution area
I	**	3	Expanded distribution area

*Market shares were computed from a combination of primary data collected from processors and data from other sources. For the Lexington and Bowling Green markets, the comparison was made during the period of one year prior to and one year following the introduction of private label brands. Because of limited data for the Paducah area, the comparison was based on market shares two years prior and one year following.

**Processor either entered or left marketing area during the period under study.

Table 4.—Reactions of Managers to Statements Concerning the Impact of Private Label Brands of Milk on Market Structure, Kentucky Fluid Milk Processors, 1972.

Statement	Mean Score: With Private Label	Mean Score: Without Private Label	F value*
1. Private label contracts are advantageous to large processors	45.6	65.4	0.08
2. Private label brands of fluid milk have forced some small processors out of business	59.9	59.6	0.00
3. Private label brands of fluid milk have forced small processors out of some markets	44.2	58.2	0.58
4. Private labeling is one way for retailers to gain market power	59.8	57.1	0.03
5. Private label brands inject a greater degree of risk for the processor because business is in large lumps	79.4	51.7	5.02**
6. Private label brand contracts between retailers and processors provide stability in markets	34.6	59.0	0.66

*Analysis of variance was used to test for differences in responses by the two groups (those that packaged private label brands and those that did not) to each statement. An observed value of F greater than the value given in the F-distribution table at .05% significance (4.24) indicates a significant difference between the two groups.

**Significant difference at the 5 percent level.

groups. Evidently, fewer of those packaging private label brands had actually experienced any increased stability. This may be consistent with the type of contracts. Most processors handled private label accounts very similarly to their other accounts, rather than on any formal contractual basis.

EFFECTS OF PRIVATE LABELS ON COMPETITIVE BEHAVIOR

The increased use of private label brands of fluid milk during the past two decades has influenced the structure of fluid milk markets. Since market conduct is generally considered to be a function of market structure, concern has been expressed as to the effect of private labeling on buyer-seller relationships existing between fluid milk processors and retail food chains.

To determine the relationship between changing market structure and the competitive behavior of fluid milk processors (the seller),[2] an analysis was made of the effects on pricing policies, product policies and policies regarding competitive practices used in the marketplace.

Pricing Policies[3]

Two aspects of pricing policies associated with private labels should be noted. First, a majority of the firms packaging private label brands indicated that the wholesale price of the private label was less than that charged on their own processor brand. Part of this price differential may be accounted for in the type of services provided on private label brands. While most processors indicated that reduced service was a factor in the lower price, in many cases, the cost savings were far less than the price differential. Even when identical services were provided, the price of the private label was still less than that of the processor brand.

A second aspect of pricing private label brands involves behavior patterns in seeking out private label accounts and in negotiating price. Some evidence suggested that the nature and size of the accounts as well as the leverage held by food chains through the threat of either operating their own processing facilities or changing processor influenced the competitive behavior of the processor in negotiating a price.

Product Policies

Pricing policies for private label brands take on added emphasis when considered along with product specifications. While most retailers did require certain product specifications, processors indicated that these were basically the same as the minimums required for their own processor brands. Thus, while the private label brand was essentially the same quality product as the processor brand, in most instances the wholesale price was lower.

Competitive Practices

To further assess the effect of private label brands on market conduct, managers were asked to react to several statements regarding the effect of private labels on the competitive climate in which they operated. Again, they were asked to indicate agreement or disagreement with each statement by numerical scores ranging from -99 (strongly disagree) to +99 (strongly agree), with a zero score indicating no opinion.

For convenience in analysis, the statements were grouped into three categories: (1) general impressions with implications for the processor's own behavior, (2) behavior of retailers, and (3) behavior of competitors. An analysis of the responses of the two groups (i.e., processors with and without private label brands) is shown in Table 5.

General Impressions—As might be expected, responses varied between the two groups. While both groups agreed that private label brands have

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[2]For some indication of the effect of private label brands on this buyer-seller relationship from the buyer's side, see Fallert's study of central milk programs in Midwestern food chains [2, pp. 14-21].

[3]The pricing of fluid milk at both the wholesale and retail levels in Kentucky is regulated to some extent by the "Milk Marketing Law" (KRS 260.675 to 260.760). The legislation is classified as a trade practice law—i.e., its primary purpose is to regulate trade practices in the sale of milk and milk products. The major pricing provisions imposed on handlers prohibit selling below cost, price discrimination, rebates, discounts and free services. The law contains no price establishing provisions. Thus, any effect on pricing policies would be indirect. As such, the law would neither effectively deter nor encourage the use of private label brands.

Table 5.—Managers' Reactions About the Effect of Private Label Brands of Fluid Milk on Competition and Firm Behavior, Fluid Milk Processors, Kentucky, 1972.

Statement	Mean Score: With Private Label	Mean Score: Without Private Label	F Value
General impressions			
1. Private label brands have increased competition	46	39	.13
2. Private label brands have been beneficial to some processors	72	11	6.30*
3. The price differentials between private label and processor brands represent a savings to the processor in services provided	-16	-35	.73
4. The price differentials between private label and processor brands represent decreased costs of operating at higher capacity	10	-4	.34
5. Providing private label brands for some retailers is often necessary to retain display space for the processor's own brand	58	39	3.91
6. The availability of private label brands removes the need or desire for retailers to integrate into processing	17	-13	1.57
Behavior of retailers			
7. Private labels leave the processor in a poor bargaining position	43	50	.11
8. The threat of private label brands by retailers has been used effectively in bargaining for lower prices on dealer brands	50	61	1.08
9. Private label brands provide one way for processors to meet competition of the large supermarket chains	49	44	.07

Table 5—Continued

Statement	Mean Score With Private Label	Mean Score Without Private Label	F Value
10. Retailers too often use private label brands of fluid milk as price leaders	75	71	.16
11. Retailers are often unreasonable in bargaining private label brand contracts	40	40	.00
12. Supermarket chains pressure milk processors into providing private label brands of milk	61	45	.66
13. Supermarket chains demand excessive discounts on private label milk	39	48	.18
Behavior of Competitors			
14. Most processors are quite anxious to negotiate private label contracts	11	40	1.47
15. Private label contracting has led to unfair practices by some competitors	48	58	.21
16. Competitors often compensate for lower wholesale prices of private label brands by sacrificing quality	-17	0	.34
17. Some processors who do not package private labels have lowered the price of their own processor brand to meet the competition of private label brands	37	55	1.25

*Significant difference at the 5 percent level.

increased competition and that some processors benefited from the practice, there was a difference in the extent to which the two groups viewed the benefits.

Responses to statements 3 and 4 indicate that the private label is used as a price competitive device. In addition to the impact on price, private labels become important in retaining display space for the processor's own brand.

Behavior of Retailers—Managers agreed that private label brands and/or the threat of such gives the retailer a competitive edge in bargaining power. They can also provide one way for the processor to meet competition from food chains which have integrated into processing and packaging their own private labels.

Behavior of Competitors—There was agreement among managers of both groups that private labeling has led to unfair practices by some competitors. Responses varied with respect to the extent to which these private label accounts are sought, but the analysis showed that most processors are anxious to negotiate such.

While there was no strong feeling that competitors offset the lower wholesale prices of private labels by sacrificing quality, there was indication that private label brands have also influenced the pricing policies of those processors who package only their own brands.

Advertising and Promotion Policies

Private label brands have influenced advertising and promotion policies. For processor brands, most of the advertising centers on the quality and nutritional attributes of milk; in addition there is a certain amount of brand promotion. This type of advertising is sponsored by processors. For private label brands, however, advertising is aimed primarily at today's price-conscious consumer and tends to be price oriented. Advertising responsibility has shifted from the processor to the retailer. Processors generally give retailers an advertising and promotion allowance of 1.5 to 3 percent on private label brands. All of this represents a shift in both the type and location of advertising and promotion and is reflected in the advertising and promotional policies of fluid milk processors that package private label brands of milk.

FACTORS INFLUENCING THE DECISION TO PACKAGE OR NOT TO PACKAGE PRIVATE LABEL BRANDS

What factors influence a manager's decision to package private label brands of milk? Or why do some firms avoid the practice? To get an idea of the effect of certain factors on these decisions, managers were asked to indicate the importance of each of a set of factors in reaching the decision. A scale of 1 (no importance) to 99 (very important) was used. An analysis of managers' responses follows.

Reasons for Packaging Private Label Brands

Managers of fluid milk plants packaging priate label brands were presented with a set of 14 reasons why a firm might seek out private label accounts. Each responded on the basis of their importance in reaching that decision. Their responses, in descending order of importance, are found in Table 6.

By arbitrarily selecting factors with a mean score in the top two-thirds, some patterns appear. An important reason for packaging private label brands centered on reducing costs—either directly or through increased volume of operation. Being able to compete price-wise in the market was also an important consideration. A third less important reason was to hold accounts and retain display space for the processor's own brand in the retail outlets. In some cases, the processor was only responding to a special need of an individual retailer and was not making any concerted effort to expand private label accounts.

Reasons for Not Packaging Private Label Brands

Similarly, managers of plants without private label brands were asked to evaluate the influence of selected factors on their decision to package only their own brand. Their responses, in descending order of importance, are shown in Table 7. In this group, no single important factor or pattern emerged. This was expected since the norm has been to package one's own brand, while private labeling requires a management decision. Retaining consumer loyalty to a processor's own brand and

Table 6.—Managers' Responses to Reasons for Packaging Private Label Brands of Milk, Fluid Milk Processors, Kentucky, 1972.

Reason	Mean Score	Relative Frequency of Scores (1-39)	(40-69)	(70-99)
1. Increase volume of business	84	1	1	14
2. Compete price-wise in the market	61	5	1	10
3. Meet the needs of a particular retail customer	54	6	2	8
4. Reduce any desire by retailers to change processors	52	6	2	8
5. Keep space for processor brand display	43	8	3	5
6. Reduce plant operation costs	40	8	3	5
7. Obtain savings in distribution costs	40	8	3	5
8. Prevent retailers from processing and packaging their own private label brands	31	11	1	4
9. Obtain space for processor brand display	30	10	3	3
10. Cut costs by decreasing services offered with private label brands	27	11	3	2
11. Avoid some risk and uncertainty of day-to-day fluctuations in sales	24	12	2	2
12. Expand distribution area	21	13	1	2
13. Eliminate or reduce advertising and promotion costs	18	14	1	1
14. Reduce problems with trade practice regulations	12	15	0	1

Table 7.—Managers' Responses to Reasons for Not Packaging Private Label Brands of Milk, Fluid Milk Processors, Kentucky, 1972.

Reason	Mean Score	Relative Frequency of Scores (1-39)	(40-69)	(70-99)
1. Have built up strong consumer loyalty to processor brand and want to retain that loyalty	51	7	0	8
2. Volume of operation too small to adequately handle contracts in market	37	9	2	4
3. High risk of building volume on private label contracts	31	10	2	3
4. Reduced services on private label brands do not affect lower wholesale prices	31	9	1	5
5. Have not been approached by retailers wanting private label brands	30	11	0	4
6. No cost savings in processing and distributing private label brands	30	10	0	5
7. Unable to compete price-wise with competitors for contracts	28	11	0	4
8. Cannot sell private label brand cheaper than processor brand for equal volumes and types of service	25	11	0	4
9. Processor has little or no control over price (retail)	23	12	0	3
10. Processor has little or no control over display, advertising, and promotion	21	11	2	2
11. Retailers are too demanding on contract terms	21	11	2	2
12. No desire to increase volume of business	21	12	0	3
13. Retailer's sale volume in market too small to justify pursuing private label contracts	17	12	1	2
14. Private label contracts would lead to larger distribution areas and not equipped for such	15	13	1	1
15. Want to avoid contracts	12	13	1	1

inadequate capacity for handling private label accounts tended to weigh heavily in these decisions. While other factors were important to individual firms, many of these were closely associated with size of operation.

In summary, processors packaged private label brands of fluid milk to remain competitive in the market, reduce costs, retain accounts, and hold display space in retail outlets. Firms were not packaging private label brands because of inadequate capacity and the desire to build consumer loyalty to their own brands.

EFFECTS OF PRIVATE LABELS ON PLANT OPERATIONS

One objective of the study was to determine the effects of private label brands of milk on the operations of the processing plant. Included in plant operations were product line, product quality, type of delivery, procurement policies and per unit costs. This centered around changes in plant operations brought about because of private label accounts. These changes, along with the number of managers making each change, are listed in Table 8.

Table 8.—Changes in Plant Operations as a Result of Private Label Accounts, Kentucky Fluid Milk Processors, 1972.

Changes	Number of Processors
1. Types of products	1
2. Services (in general)	3
3. Milk fat content	0
4. Dated or returned merchandise	2
5. Number of routes	3
6. Type of delivery	9
7. Size and type of delivery vehicle	5
8. Method of paying salesmen	4
9. Labor requirements	6
10. Per unit processing cost	9
11. Procurement policies	0
12. Selling techniques or salesman's time allocation	5
13. Services for private label customers	2

Distribution

Home milk delivery routes have diminished in number and importance during the past decades as consumer purchasing habits have shifted from home delivery to retail food store purchases. Currently, about one-half of the fluid milk marketed in Kentucky moves through retail food stores. This shift in purchasing habits has undoubtedly provided some of the impetus behind the growth of private labeling. With this growth has come the need for additional wholesale delivery routes. At least three new routes were added by processors because of the increased volume from private label accounts.

Most of the changes in type of delivery took the form of reduced services. For example, some processors shifted to drop delivery, whereby the milk is left at the rear of the retail outlet or sometimes put inside a cooler. This was in contrast to full service delivery of the processor brand of milk in which the milk was brought into the store by the routeman who also placed it in the display area, stamped the retail price on it and removed any outdated product. Thus, in drop delivery, the retailer provided the labor necessary in carrying out these activities. In many cases, this was advantageous to the retailer in that store employees were usually paid less than the union wages of the routemen. This provided a basis for at least part of the differential found between wholesale prices of private label brands and processors brands. Some handlers reported reducing delivery to an even greater extent. Private label brands were picked up at the processing plant (dock delivery) by the retailer, who incurred all delivery costs. Although dock delivery was not used extensively, even for private label brands, type of delivery was one major change made by processors.

With the increased volume which usually accompanies private label accounts, comes the need for changes in the size and type of delivery vehicles. Those plants making a change in delivery vehicles indicated that the change was an increase in truck size, from 12-foot to 16-foot bodies with lifts or the purchase of tractor-trailer vehicles. About one-third of the processors listed this as one of the changes in plant operations resulting from private label accounts.

Salesman commissions usually increased following the introduction of private label brands. Some firms decided to pay hourly wages in lieu of commissions and others experienced an increase in commission sales. Perhaps this was due to the interest retailers have taken in private label brands, and the desire to have them in the stores.

Labor

As expected, labor requirements increased with the increased volume that accompanies private label brands. More equipment was needed and more people to care for and operate this equipment. Some firms increased their sales staff and others added routemen. One plant even hired a routeman to handle only private label accounts.

Processing Cost

Any change in volume and/or labor would most likely affect the unit processing costs. Sometimes these have offsetting effects. Almost two-thirds of those packaging private label brands experienced a noticeable change in per unit costs. A majority of those indicating a change reported that their unit processing costs had decreased because of the added volume. In some cases, unit costs had increased because of wage hikes.

Selling Techniques and Salesmen's Time Allocation

There are also alternations in selling techniques and in salesmen's time allocation. Some sales personnel started giving more time to private label accounts and some stayed longer when discussing business with them. Others used different approaches to selling and stayed closer or gave more attention to the private label accounts.

Other Changes

Change in product lines was minimal. One handler reported introducing cottage cheese and buttermilk after starting to sell private label brands. Similarly, changes in the services provided to retail customers were few. Some firms reduced their services generally, mostly in regard to delivery. Other managers decreased deliveries to only three days per week and introduced the requirement that clients preorder the quantity needed.

Individual firm policies regarding dated or returned merchandise were given little attention by managers. One firm would only give credit for merchandise returned by a retailer if the processor was at fault. Another stopped the practice of accepting returned milk if it had spoiled.

In short, there was some modification in almost everything associated with the day-to-day operations of processing plants. These changes varied from firm to firm, with only 20 percent of the firms packaging private labels reporting no changes in plant operations.

RISKS AND BENEFITS

Finally, managers were asked to enumerate some of the risks and benefits associated with packaging private label brands of milk. For the most part, processors packaging private label brands tended to list the good points, while processors not packaging private label brands tended to bring out the unfavorable aspects. Most processors had a choice to make when private labels were introduced into their particular markets and some agreed to provide the private label brands for retailers wanting them. Some have since made a concerted effort to expand their private label business, while others still refused to package private label brands. This latter group had insufficient capacity, no desire to expand their business, or wanted to retain consumer loyalty to their own brand.

Both groups, however, pointed out some of the risks and benefits involved. Table 9 shows some of the benefits and Table 10 shows some of the risks. The number of processors mentioning each is included in the tables.

Table 9.—Benefits Accruing to Those Contracting for Private Label Brands and Number of Managers Expressing Each Benefit, Kentucky Fluid Milk Processors, 1972.

Benefits	Number of Processors
Increase volume	8
Keep space for own brand	1
New markets	1
More efficient operation	1
Constant outlet	1
Reduce distribution costs	1

Table 10.—Risks Associated with Packaging Private Label Brands and Number of Managers Expressing Each Risk, Kentucky Fluid Milk Processors, 1972.

Risk	Number of Processors
Business is in large lumps	5
Lower profit margin	2
Loss of identity	2
Retailers taking over the market	1
Selling at or near cost	1
Lose control of business	1
Fosters more competitive bidding	1
Lower wholesale price	1
Lose independent business	1

Benefits

Increased volume was the benefit most frequently mentioned by processors. Private label accounts usually increased their volume, thus cutting costs and sometimes increasing profits. Very few handlers indicated that they were satisfied with their volume or the size of operations. Retailers desiring private labels usually operated more than one outlet. Thus, any processor who agrees to supply a private label can count on a substantial increase in volume.

Other benefits mentioned by handlers included: (1) retaining shelf space for processor brands, (2) providing new market outlets, (3) increased efficiency of operation, (4) constant market outlet, and (5) reduced distribution costs.

Risk

The risk mentioned most often was the fact that, in most cases, private label business tends to come in large lumps. Because of this, processors face a substantial drop in business if they lose an account. If this lost volume is not regained in other outlets, the business could suffer.

In order to compete for private label accounts, some handlers felt that they had to take a lower profit margin because of the lower prices usually associated with private label brands. As other parts of this study indicate, this lower price is only partially accounted for by reduced services.

Processors feared a loss of brand identity. Having built up consumer loyalty to their own processor brand, losing this was a risk associated with packaging private label brands.

Other risks mentioned include: (1) a retailer-controlled market, (2) selling at or near cost when packaging milk under another name, (3) losing control of the business, (4) having to engage in more competitive bidding to stay in business, and (5) the loss of independent store business.

A few managers who were not currently processing private label brands also expressed an opinion on this subject. Some complained of losing volume or business to other processors because of private label brands. Again, this was due to a retailer allowing only his private label brand and the brand of the processor supplying him to be on display. As a result, some were squeezed out of outlets.

CONCLUSIONS

Since the introduction of private label brands of fluid milk in some markets in the early 1950's, the practice has grown. This growth has been due, in part, to (1) lower retail prices and increasing acceptance of private label brands by consumers, (2) the fact that some processors actively pursue private label accounts and (3) the trend toward central buying programs by retailers. Private label brands will most likely continue to play an important role in the marketing of fluid milk.

Private label brands have influenced the structure of Kentucky's fluid milk industry through the loss of market shares by the smaller processors and a decrease in the number of firms in the industry.

Private labeling has had an impact on firm conduct in three major areas. First, there has been a shift in bargaining power from processors to retailers because of the importance of private label brands. Second, retailers have gained control over pricing as a result of their increased bargaining power. Third, the emphasis of advertising and promotion has shifted from the product to price.

Through private labeling, a changed role of brands *per se* has occurred. Historically, branding has been used as a means of product differentiation and, as such, a means for engaging in nonprice competition. Instead of this traditional role, private label brands are being increasingly used for engaging in direct price competition.

In the future, a high proportion of private label accounts will continue to be concentrated within the larger processing firms that have the capacity necessary to handle the contracts. This will tend to accelerate the rate of growth of these larger firms while decreasing the market shares of small processors.

Private label brands have affected individual firm operations because of the large volume usually associated with private label accounts. This increase necessitates a larger overall operation and requires adjustments in operational procedures.

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