AN EMPIRICAL ANALYSIS OF THE DETERMINANTS OF RETAIL MARGINS: THE ROLE OF STORE BRAND SHARE

by

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Executive Summary

This paper examines the determinants of margins earned by retailers on national brands and store brands, and the impact of store brand share on these margins. The authors address three research questions. First, what are the determinants of retail margins across categories? How do factors like manufacturer concentration, advertising, distribution, and store brand share affect retail margins on national and store brands? Second, retailers earn higher percent gross margins on store brands than on national brands, but how and why does this margin differential vary across categories? Does the differential hold up for net and dollar margins? Third, how does store brand share affect the total dollar profit of the retailer? Do heavy users of store brands contribute more or less to the total profit of the retailer than light or non-users? Sales, share, and margin data from two major retail chains are supplemented with category characteristics from other sources to answer these questions.

The main findings are as follows. First, retailers obtain significantly higher percent margins on national brands in categories where they have a high store brand share, even after controlling for the endogeneity of store brand share. The authors’ econometric model also highlights some other interesting factors like distribution, advertising, and promotion, all of which have a negative impact on retail margins from national brands.

Second, percent retail margins are significantly higher for store brands than for national brands, even after accounting for the retailer’s direct product costs. However, this percent margin differential varies substantially, being highest in categories with strong and heavily advertised national brands and smallest in “commodity” categories. Further, given the
substantially lower retail price of store brands relative to national brands, the retailer’s dollar margin is often lower on store brands.

Third, there is an inverted U-shaped relationship between consumers’ store brand share and their contribution to the total dollar profit of the retailer. Dollar profit is highest for medium store brand users. Consumers who do not buy the store brand at all are not loyal to the retailer. Their total number of trips and their total purchases from the retailer are very small. Heavy store brand users certainly buy more than non-users from the retailer but they buy much less than light users. They may operate under financial constraints and simply buy and consume less or have fewer requirements. However, this is not enough to explain their substantially lower purchases. They may cherry-pick at multiple stores and therefore buy less from any one retailer. Their loyalty may be to store brands in general, not to the store brand of a particular retailer.

Overall, the authors conclude that having a high share store brand does improve retailer margins on a percentage basis, but pushing store brands too much at the expense of national brand offerings is not advisable. It is important that retailers retain a balance between store brands and national brands in order to attract and retain profitable customers who buy some store brand items but not too many.