Private Label Alcohol

SHORT REPORT

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Introduction: This is a brief report on a topic that is of concern for public health. Private label products are a way to reduce prices in a highly competitive environment. Because youth seek alcohol primarily for intoxication, they could be readily drawn to such products. This report will describe the state of private label products, explain the concerns and urge regulators to examine the issues in light of their regulations.

What is the problem with private label alcohol?

- Private labels are designed to sell products at a deep discount. Such discounts are a concern because research has shown that low prices increase alcohol consumption. This could mean greater availability of cheap products attractive to youth and alcohol abusers. Experience in U.S. history and in the United Kingdom suggests that when large chains dominate local markets, they engage in aggressive sales practices to increase purchase of alcohol products.

- Most private label products require an ongoing direct business agreement between the retailer and supplier for production and supply of a product that is ostensibly not available to any other retailer. This kind of "exclusive" arrangement serves to weaken the three-tiered system because it reduces the middle tier to a mere pass-through. The middle tier was designed to reduce market domination by suppliers and retailers that merged their functions in one way or another. The middle tier typically prevents such arrangements by offering all products to all retailers on the same or similar terms. This provides a fair and level playing field for large and small operators. The regulatory system is able to keep prices balanced so extreme market domination does not occur and sales practices remain moderate.

- Price discrimination, as well as exclusive and "tied" arrangements, has long been recognized as practices that can lead to reduced competition. For example, the US Clayton Antitrust Act considers such practices "impermissible activities" if they lead to monopoly or substantially reduce competition. Similarly, the Robinson-Patman Act of 1936 identifies price discrimination by a manufacturer against equally-situated distributors as "anti-competitive." These laws apply to alcohol businesses and communities benefit when markets are fair and balanced.

- A private or store label gets favorable treatment because the retailer has invested time, money and effort in the product's development. But, that process allows the retailer to skirt laws that ban slotting fees and special treatment for one product over another. This threatens to undermine laws that foster fairness and a level playing field.

- Private label products allow large, national chains to undercut small, local operators who cannot afford to develop and purchase private label products. Once again, this promotes local markets dominated by a few large, national chains.

History of Private Label Products

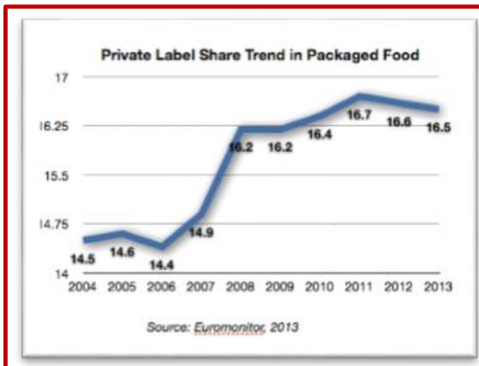
Until recently private labels represented a cheap, poor quality alternative to national brands. Many customers shunned private label products due to their poor quality image. That has changed.

During the recession years of 2007-2009, retailers faced high commodity prices and weakened consumer demand.

Private labels enabled retailers to compete with lower prices and allowed consumers to pay less. According to a report from The Hartman Group, Inc., private label sales of consumer packed goods (CPG's) grew steadily from 2006 to 2011.[1]

While the growth of CPG private labels stalled in recent years, they continue to be more acceptable to the consumer. In a recent global survey by The Nielsen Company, North American respondents exhibited very positive opinions about private labels. A total of 75% said "private labels are a good alternative to name brands."[2] And, 69% said the "perception of private-label quality has improved over time." Clearly, the driver of private label sales is price as 81% said "I purchase private-label products to save money."

Private label penetration in the marketplace varies dramatically around the world. The global average dollar share for all private label goods (not just consumer packaged goods) is 16.5%, according to The Nielsen Company. But, it varies from 45% in Switzerland to 1% in China and other Asian countries. The US and Canada are at 18%. Generally, European countries have the highest percent of private labels with Spain and the UK at 41% and Germany and Portugal over 30%.



This suggests there is potential for growth in the US.

These days, store brands are packaged in bright colors with striking graphics, sometimes similar to national brands. Some stores have several lines of private label brands including: premium store brands, brands that mimic national brands, bargain store brands and organic store brands. Brand loyalty is created for store brands, some of which give no indication that they are exclusively sold at a particular store. Grocery chains like Trader Joe's and ALDI sell a limited number of products which are predominantly made up of their own private label items.

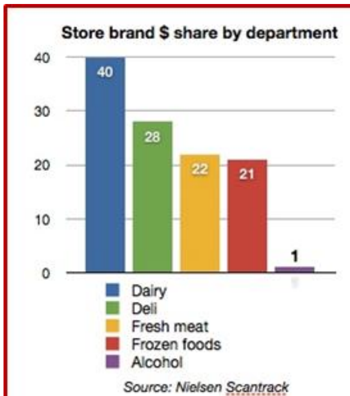
Distinctive white labels and bold black lettering of generic foods of the past.

Where do alcohol private label products fit in this scenario? Private label alcohol can be sold at low prices that are attractive to price sensitive youth and problem drinkers. Walgreen's private label beer, called "Big Flats 1901", sells for less than 50 cents per 12 ounce can, at 4.5% alcohol by volume. Albertson's store brand vodka sells for as little as 25 cents a drink. These are some of the lowest-priced products on the market. Studies show that lower prices increase consumption.[3]

At this point in time, private label alcohol products represent a very small percentage of all alcohol products in a store's department. Private labels are heavily concentrated in other product types such as dairy. Whether this will change in the future remains to be seen.

In looking at five countries' growth of private label alcohol products versus brands, only Italy showed substantial growth of private labels between 2013 and 2014. The UK showed negative growth. Germany and France showed around 4% growth and Spain's growth was only 1.7%.[2]

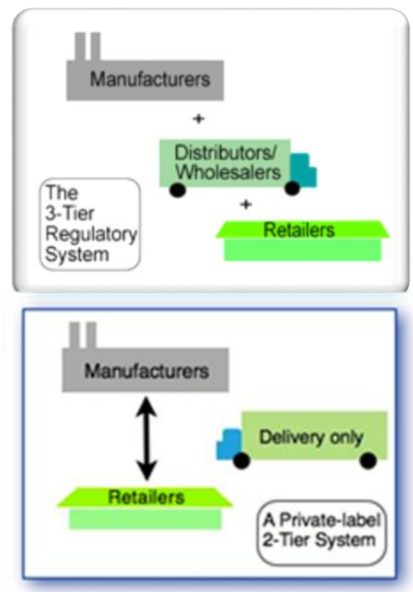
Private labels have difficulty competing when a branded product is heavily supported with marketing and promotional support. People are more likely to buy private labels when they don't perceive much difference. This is often true with basic ingredients such as rice or oats. But for alcohol products there is often considerable difference between high end and "craft" products. Another factor is the innovation rate. New products are a major part of the alcohol market which requires constant innovation. It is hard for private labels to do that.[2]



A Breech in the Three-Tiered System

Before Prohibition large manufacturers dominated the alcohol marketplace by owning chains of retail establishments where they had an incentive to sell aggressively to make high profits. These practices fueled the kind of rampant alcohol abuse that led to Prohibition.

When Prohibition ended, laws were put in place to foster moderation among drinkers and encourage less aggressive business practices. One of those was the three-tiered alcohol control system which requires a separation between manufacturers, distributors and retailers. This system prevents vertical integration where retailers are owned or tied by financial agreements to another tier member. Such arrangements often lead to price wars and deep discounts designed to dominate a market. While low prices may be good for other commodities, they encourage excess consumption for alcohol, especially for youth. This is exactly what has happened in the United Kingdom where four large grocery chains all deal directly with suppliers, are engaged in frequent price wars which, in turn, has fueled an alcohol epidemic. [4]



As a result of these safeguards, we don't usually see the kind of sales practices that make booze cheaper than water.

But private label products usually require a direct business agreement between the retailer and supplier. Whether or not such an agreement is lawful depends on the details of the agreement itself and the laws of the state where the product is sold.

These kinds of arrangements benefit large chains and are not available to smaller operators. In-store promotions and advantageous shelf placement result in an uneven playing field.

Cut rate prices for private label products are attractive to youth and alcohol abusers

Cheap alcohol has always been the subject of regulation because it attracts vulnerable populations such as kids and abusive drinkers. Until recently, you rarely saw private "store" labels on the alcohol shelves. But, that is changing. Recently, in Arizona a coupon for $7.99 was offered for a 1.75 liter, or "handle" bottle of Albertson's Vodka. Since a bottle that size contains 39.4 shots that equal about $.20 per drink. (One shot is 1.5 ounces.)

Price is one of the most powerful tools available to reduce social problems with alcohol.[3]

How Stores Display Private Labels

According to a USDA study, private brands are priced an average of 23% lower than national brands and are put on sale more often. During the recession private labels became a larger part of the market as consumers searched for ways to reduce food costs.[5] And large chains upgraded the quality of "store brands" and began to directly compete with the leading national brands. As a result, private labels are no longer a small part of customers' purchases. According to the Private Label Manufacturers Association,[6] "store brands' share of America's shopping carts are at record highs. In grocery stores, private label brands' unit and dollar shares rose to 23.4% and 19.4% respectively."

Are they skirting the law?

If private label alcohol products are developed just like other commodities for large national chains, it is difficult to see how the practice does not violate some federal and state laws. To create a private label, the retailer must work with a supplier to specify the product and agree to a label design and a price. Unless it is merely a "one-time buy," a retailer would need an understanding or agreement about quantity and price that is on-going. Even one-time buys may be problematic if the retailer continues to make these buys month after month or buys a small operator's whole product supply year after year.

It is unlikely that any national retail chain or supplier would invest in a private label venture that does not obligate the retailer to some level of on-going purchase. And, while it may be technically possible to make the private label product available to other retailers, it is unlikely that a retailer would buy and promote a competitor's private label product, particularly if it has the competitor's name on it.

The Federal Alcohol Administration Act (FAA) and implementing rules prohibit a contract or agreement, written or unwritten, which has the effect of requiring a purchase beyond a single sales transaction when the products are excluded from sale to others. Furthermore, the FAA Tied House law prohibits any supplier from inducing a retailer to purchase products from the supplier to the exclusion of others.[7]

Finally, retailers that work with a manufacturer to design and develop a unique alcohol product may be operating outside their license privilege. Retailers are usually only licensed to sell products at retail. Design and development are manufacturer's functions. In some cases, the retailer is intricately involved in the process of developing a new alcohol product that will be sold exclusively in their stores. This would seem to be a mixing of licensed functions. Some states may permit operation outside licensed functions and others may not.

Most states require all products to be sold by a licensed distributor who typically offers all products to all retailers. Private labels skirt this system or use distributors as a mere pass-through. Private brands may have an unfair advantage against their small, local competitors. Small liquor and grocery stores do not have the financial ability to invest in a "store brand" and, thus, can be undercut on price. Because the 21st Amendment gave each state the responsibility to regulate alcohol, each state market has its own regulations.

Potential industry conflicts

It's hard to see how private labels are good for the supplier. The manufacturer of a national brand develops the product, pays for the advertising and promotion and then gets undercut by a private label that is very similar and sits next to it on a shelf. Furthermore, the three-tiered system was designed so that distributors work with retailers to develop national brands, not store labels. In many ways, private labels threaten to undermine our three-tiered regulatory system. Private label products will usually receive favorable treatment by the retailer in terms of shelf space and promotional placement. Several factors allow retailers to sell private label products at lower prices. For example, the private label manufacturer does not have promotion and advertising costs. And, it is unlikely that a retailer would invest in a private label product if the price were not favorable.

A healthy alcohol industry with a fair and even playing field is important. Not only does it reduce the incentive to cheat, it reduces the kind of market domination that can lead to business practices which induce consumption through deep discounts and aggressive marketing.

When Prohibition ended, the task of regulating alcohol was turned over to the states, with the idea that communities should have some say in regulations. The profit motives of a few national chain stores may overrule what communities feel is appropriate and may be at odds with the need to foster moderation. Profits may be global, but problems occur at the local level.

Will private labels become a serious problem in the future?

It is unclear. In general, private label growth in grocery stores has stalled as the US economy recovered.[1] The favorable price differential has also narrowed as chain stores moved to develop premium product private labels. Private label alcohol products have never constituted a large percent of total alcohol products. However, in Europe private label alcohol products are more available in large grocery chains. Sometimes, the US grocery market follows trends begun in Europe.

In its report on the "State of Private Label Around the World," the Neilsen organization identified five factors that are important when a name brand prevails: high innovation rate, high product differentiation, strong marketing support, strong brand equity and a longer purchase cycle with heavy promotional activity."[2] Typical alcohol products possess many of these qualities. There is a high innovation rate and new products are sometimes as much as 1/3 to 1/5 of sales. Alcohol products are heavily advertised with major brands providing heavy promotional support. Alcohol brands promote their unique qualities—particularly the "hand crafted" products leading to a belief that there are major differences in brands. These factors suggest that many national brand alcohol products may not face substantial competition from store brand.

Increasingly, large chains will likely feel the difficulty of competing with national brands that are innovative and heavily supported with marketing. As these chains covet increased profits from these brands, they strive to become as good or better than the national brand. However, according to Jesse Edelman, a food brokerage expert, "Imagine the requirement to manage, develop and force the ongoing innovation of private label in every category in the store. Imagine that every manufacturer you compete against, especially the larger ones, have dedicated teams to that product and that category. Consider the task of trying to match that level of innovation across so many categories in the store. It can be overwhelming."[8]

It is the low end that is the concern. The Neilsen report identified three factors where private labels prevail: minimal differentiation/low brand equity, high price sensitivity/high purchase frequency, and low innovation rate. Youth are price-sensitive and little interested in product quality. They drink for the intoxication effect and most drinking is binge drinking.[9] These factors are also a concern for abusive drinkers—such as public inebriates and alcoholics. They are frequent purchasers and they don't always care about product quality.

Because of the issues noted in this report, it would be desirable to gain clarification from state and federal regulators concerning what is lawful and what is not.

Sources:

1. Hartbeat EXEC, "The Future of Private Label Food", Volume 4, Issue 1, 2014, Growth of private label data was obtained from Euromonitor for this report.

2 "The State of Private Label Around the World, Where it's Growing, Where it's Not, and What the Future Holds," November 2014, Nielsen.

3. "Effects of beverage alcohol price and tax levels on drinking: a meta-analysis of 1003 estimates from 112 studies," Alexander C. Wagenaar, Matthew J. Salois & Kelli A. Komro. University of Florida, College of Medicine, Department of Epidemiology and Health Policy Research, Gainesville, FL, USA.

4. "The Danger of Alcohol Deregulation: the United Kingdom Experience" and "The Dangers of Alcohol Deregulation: The United Kingdom Experience", 2012 Update by Pamela S. Erickson, a report available at healthyalcoholmarket.com

5. "The Relationship Between National Brand and Private Label Food OProducts, Prices, Promotions, Recessions, and Recoveries," Richard Volpe, United States Department of Agriculture, Economic Research Service, Economic Research Report Number 129, December 2011

6. Private Label Manufacturers Association as quoted in "Name Brands? Consumers Like 'Em Less Than Ever," by Sarah Mahoney, Saturday, May 3, 2014 12:12 PM

7. See 27 USC 205 of the Federal Alcohol Administration Act and TTB regulations (27 CFR parts 6 and 8).

8. "Retailers Seek to Offer Store Brand for Every Consumer," by Kristen Cloud, October 29, 2014, The Shelby Report, Gainsville, GA.

9. Fact Sheets – Underage Drinking, Centers for Disease Control and Prevention, www.cdc.gov/

Also see: Expert witness report of Pamela S. Erickson submitted to the Texas Alcohol Beverage Commission, January 15, 2014.

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