



# Functional foods as a strategic area for food manufacturers

*– A study on the manufacturer/retailer interface in the French food industry*

*Sofia Berglund*



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## **Förord**

Det har varit oerhört intressant och utvecklande samt en stor utmaning att skriva detta examensarbete. Jag har beretts tillfälle både att lära mig mycket om dagligvaruhandeln och mejeriindustrin samt att fördjupa mina insikter om relationerna och konkurrensen dem emellan. I och med att studien berör franska förhållanden och aktörer så fick jag även möjlighet att vidga mina perspektiv till att omfatta livsmedelssektorn i en kultur utanför den svenska. Det har varit mäktiga spännande.

Jag vill tacka mina två handledare, professor Jerker Nilsson och doktor Cecilia Mark-Herbert, vid institutionen för ekonomi på SLU, Ultuna. De har väglett mig, givit mig många goda råd och delat med sig av sina erfarenheter till mig i många betydelsefulla avseenden. De har också igenom hela processen stöttat mig med tålamod och förtroende. Jag är glad att jag haft möjlighet att arbeta med er.

Internationella byrån på SLU har spelat en viktig roll i denna studie genom att ha beviljat stipendium för "Internationellt Examensarbete". Tack vare detta kunde jag genomföra projektet samarbete med den Franska handelshögskolan ESSEC i Paris. Där togs jag vänligen emot av utbildningsansvarige Frédéric Oble på institutionen "Management des Industries Agro-alimentaire".



## Sammanfattning

Den föreliggande studien omfattar en analys av hur franska mejeriproducenter använder functional food-produkter för att stärka sin position gentemot dagligvaruhandeln. Valet av den franska mejerisektorn såsom analysobjekt motiveras av att livsmedelsindustrin i Frankrike är omfattande, framstående och internationellt orienterad. Functional food är livsmedelsprodukter, som utöver näringsvärdet har ett mervärde i form av en dokumenterad hälsoeffekt. De är avsedda att konsumeras dagligen och är antingen en matvara eller en dryck.

Analysens teoretiska bas är Michael Porters strategiteori. Det empiriska underlaget kommer dels från ett stort antal butiksundersökningar i Parisområdet och dels från intervjuer med personer i ledande ställningar inom fransk mejeriindustri.

Studien pekar på att functional foods (pff, physiologically functional foods) kan vara ett värdefullt strategiskt område för industrin. Det finns en etablerad, växande marknad för pff, och denna domineras helt av livsmedelsindustrin. Producenterna är fullständigt överlägsna dagligvaruhandeln då det gäller att utveckla och marknadsföra pff.

Inalles 115 mejeriprodukter granskades i undersökningen, varav sju identifierades såsom pff. Mer än hälften av de 108 produkter, som inte är pff, säljs under livsmedelskedjornas egna märken, s. k. private brands. Ingen av de sju pff-produkterna är private brands.

Producenterna tycks kunna öka sin konkurrenskraft gentemot dagligvaruhandeln med hjälp av pff. I mejeridiskarna har producenterna en betydligt starkare ställning inom pff-området jämfört med andra mejeriprodukter. Kedjornas private brands har ungefär en fjärdedel av den totala försäljningen av mejeriprodukter i allmänhet, men alltså inte en enda pff-produkt.

Pff-produkterna är dyrare än motsvarande produkter utan ett mervärde i form av en hälsoeffekt. Prisskillnaden är större ju tydligare produktens hälsoeffekt kommuniceras genom produktförpackningar och kampanjer. Livsmedelsindustrin har alltså kunnat förhandla till sig högre priser för dessa mervärdesprodukter, vilka således har ett strategiskt värde för de tillverkande företagen.

Pff tillverkas av fyra producenter, nämligen Danone, Nestlé, Lactalis och Yakult Honcha. Alla dessa är multinationella företag, som antingen själva utvecklat sina produkter (Danone och Yakult Honcha) eller förvärvat produkter, som utvecklats av andra företag (Nestlé och Lactalis). Danones produkter Bio och Actimel är de klart största pff. Dessa säljs i alla de livsmedelskedjor, som ingick i undersökningen.

Livsmedelskedjorna visar stort intresse för denna produktkategori men har inte lyckats lansera någon pff-produkt. Flertalet kedjorna erbjuder däremot substitut till pff-produkterna bland sina private brands, men dessa är långt ifrån likvärdiga. Slutsatsen är att pff kan erbjuda livsmedelstillverkarna strategiska värden och stärka livsmedelsindustrins position gentemot dagligvaruhandeln.

## Summary

This study comprises an analysis of how French dairy producers use functional food products in order to strengthen their position toward the retail industry. Its considerable proportions, its excellence and its international orientation motivate the choice of the French dairy industry. Functional food is a group of food products that, in addition to their nutritional values, include a value added, consisting of a documented health effect. They are designed to be consumed as every day products and they are either a food product or a beverage.

The theoretical base in the analysis consists of Michael Porter's framework on strategic competition. A considerable number of stores have been investigated in the Paris area and interviews with executives in the French dairy sector have been conducted to account for the empirical material.

According to this study it seems that functional foods (pff, physiologically functional foods) may be a valuable strategic area for food manufacturers. There is an established and growing market for pff, which entirely is dominated by the manufacturers who are unequivocally superior to the retail industry in developing and marketing pff.

All together 115 dairy products were studied observed in the investigation, where of seven were identified as pff. More than half of the 108 conventional products are sold as private brands. However, none of the seven pff-products belong to any of the private brands.

It seems possible for producers to increase their bargaining power against the retailers by using pff. On the shelves in the stores' dairy sections, manufacturers' pff-products have a far stronger position than what their products have in the dairy segment as a whole. Retailers' private brands make up for about one quarter of the entire turn over in the dairy section, but not for one single pff-product.

Pff call for higher prices than corresponding products without a value added promoting health. The price difference is more prominent the more explicitly a product's health effect is communicated through packaging and campaigns. In other words, the industry has been able to negotiate higher prices for these value added products, thus they include a strategic value for the manufacturers.

Pff are produced by four manufactures; Danone, Nestlé, Lactalis and Yakult Honcha. These are all multinational companies that have developed their pff themselves in two of the cases (Danone and Yakult Honcha) or acquired the products from another company (Nestlé and Lactalis). Actimel and Bio by Danone are clearly the dominating pff-products. These are being sold in all retail chains, included in the investigation.

The retail chains show considerable interest in pff but have yet not succeeded in launching any such products. However, most of the chains present private brand substitutes to the pff, which are all far from being equally good, considering primarily the health value. The conclusion is that pff may offer to the manufacturing industry strategic values, and may strengthen manufacturers position toward the retail industry.

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# 1. Introduction

This study concerns the strategies of and the competition between food manufacturers and retailers. The first chapter offers an introduction to these subjects, a presentation of the research method and some perspectives on physiologically functional foods (pff). Chapter two, provides a presentation of the structure in the food sector and of the major actors. The kind of competition that originates from manufacturers, in this case food manufacturers, and retailers is called vertical competition. Vertical competition and its subsequent consequences are described in the theoretical framework introduced in the chapter number three. A number of hypotheses are also formulated at the end of the third chapter. The empirical findings are presented in the fourth chapter and in chapter number five these findings, seen in the perspective of the theoretical frame of this study, compose the base for the discussion. Finally, the sixth chapter summarizes the major findings and the reflections made by the author.

## 1.1 A perspective on food and health

Health and well-being are closely related topics that concern people from all cultures. The striving for health is one of the eternal human strivings in life which ultimately reflects the fundamental striving for survival. No wonder there is a lot of interest for these issues – would there be anyone who does not wish to be healthy and well?

Among a variety of factors affecting health, food is nowadays generally given great importance. Food is considered part of the cause for a number of diseases and health conditions, and thereby the choice of food has become important not only to satisfy preferences of flavor, quality and price, but also in order to promote health. People take more responsibility for their personal health and consumers are getting more and more health-conscious, also when buying food. It has become more common to think in terms of prevention instead of curing illness (Heasman, 1998).

This development has paved the way for a new group of products into the food market; physiologically functional foods (pff). These products are designed to be consumed as every day products and that also include a proven health effect. Consumers' objectives, when consuming pff, may differ widely, and possible causes for a preventive attitude could be sought for from a number of perspectives. Some incentives to use pff may be the increasing risk of welfare illnesses. It could also be a response to raising costs for health care or even the mere accessibility of information and means to prevent diseases. Whichever, many people have taken the concept of health promoting foods to their hearts, and health aspects and healthy attributes of foods have become some of the most important global marketing trends in food supply over the last two decades (Heasman, 1998).

As this trend evolved, we first learnt to eat “sugar-free” and for a long period “fat free” or “fat reduced” food. The food manufacturing companies presented one healthy eating product after the other, containing less sugar and no fat. In the mid nineties a new way of thinking about health food emerged. Instead of “keeping the bad things out” many ideas of healthy food involved “putting the good stuff in”, into common everyday products such as dairy products or bread (Heasman, 1998). High value added products with positive health benefits, added to their normal nutritional value, became the new fever of the global food industry and these products are sometimes called physiologically functional foods.

## 1.2 Background

Changes in food consumption patterns and in food related behavior are to a large extent responsible for the changes of products that take place in the food industry (Traill, 1997). Actors in the industry observe consumption patterns, and takes actions in order to meet, and even to anticipate, consumers' wants as accurately as possible. With less time for buying, cooking and consuming food, consumers expect a lot from food products. They want tasty products that have built-in convenience, come in small portions and offer a lot of variation. Products are also expected to meet high health, safety and animal welfare standards.

Though several patterns of behavior among consumers with different life styles can be distinguished, some common global trends in consumer behavior are distinct (Personal message, Oble, 1999). One important trend is the increasing interest for high value added products. These products are characterized of a high degree of transformation and they are tailored so to satisfy a particular consumer want. Responding to consumers' health concerns, manufacturers in Europe, as well as in the US, have been eager to develop and incorporate advanced aspects of nutrition into their products, marketing strategies and business development (Heasman, 1998).

In addition to developing appealing products, food manufacturers must handle competition from other companies that compete for market share and for profit. An indispensable aspect of this task is to find distribution channels and to reach out to the consumers. Manufacturers of food sell their products to retailers, which sell the products to consumers. Consequently, retailers' strength and behavior are of great importance for food manufacturers.

Important structural changes have taken place in the European food business since the middle of the 90ies, affecting the general situation for individual companies to survive (Hansen, 1999). Numerous mergers among retailers have led to concentration of retailers' power and decision-making. The retail chains, which used to be regional or national small and medium sized businesses, have turned into powerful multinational giants and in fact, some of the retail chains are in terms of turnover among the biggest enterprises in Europe (Personal message, Chain, 1999).

The ongoing concentration of retailers has made the retailing structure highly concentrated and there are only five almost equally sized buyers in France. This evolution has sprung out of several underlying factors. Initially an important reason for retailers to search for volume was the big size of its counterparts in the food manufacturing industry. A number of pan-European companies have been dominating the food sector for decades, but size is also one of the fundamentals in the modern retail and allows retailers to offer consumers products to attractive prices and to diffuse large quantities of industrial products.

Through centralized buying retailers have almost eliminated the role of wholesalers, and become the gatekeepers to the consumer markets. Consequently they have grown more powerful when negotiation terms of trade with food manufacturers (Hansen, 1999). With fewer alternative distributors, manufacturers might be forced to accept lower prices and include more services with sold products in order to assure that their products stay of the shelves. A manufacturer's product is most likely to be accepted and kept by retailers if the price is relatively low, if the product introduction is followed up with a marketing campaign and if there is not a distributor's brand in the product category (Hansen, 1997).

The primary food retailers in France are hypermarkets and supermarkets. Even as these are extending their product- and service- mixes to include more products and services, food is still the most important product category comprising many articles. The lower the price on any of the articles, the lower the overall price for the product category, wherefore retailers

give great importance to shop for the best price possible on any of the food articles (De Gaumont, 2000).

Due to the centralization retailers can sometimes play manufacturers against each other and find manufacturers to their private brands; retailers' own product lines. National brand products earn retailers relatively low profit on average compared to private brand products, wherefore retailers have reason to encourage manufacturers to produce private brands. As manufacturing firms in the food industry rarely can alter their production capacities easily, the manufacturers have great incentives to keep capacity filled. With few alternative buyers they might choose to produce private brands in order to achieve full capacity instead of, or in addition to, producing their own products (Personal message, De Gaumont, 2000).

However, the private brands replace manufacturers' brands on the store shelves. It is a first step for retailers to integrate backwards and allow retailers to be less dependent on the products and services of manufacturers to branded products. Once retailers get access to private brands, new sources of information, about the manufacturing industry, become available to retailers. This information may be used both to cut prices when negotiating terms of trade, to affect the final consumers' purchasing decisions and to increase its overall influence on the food sector. In other words, the traditionally heavy-weighters of the food business, the multinational manufacturing companies of branded products, have lost considerable influence on the overall food system in favor to the retailing industry (Traill, 1997).

### **1.3 Problem area**

#### **1.3.1 Objectives**

In the new relation between retailers and manufacturers, the manufacturers are losing profits as well as market share in favor to retailers, who successfully exploit the structural changes that the food sector has been going through. Some manufacturers fear they might be reduced into simple tools in the hands of the retail chains, or even absorbed as manufacturers replace more of the manufacturers' brands with private brands of the shelves. This creates strong incentives for the players in the manufacturing industry to develop new strategies that enforce their positions towards retailers and assure a viable situation on the competitive arena.

A possible way of accomplishing this could be to develop products and brands that retailers not are able to imitate with their private brands. Through such strategies, a manufacturer might be able to create a competitive advantage and avoid being engulfed by the retailers.

An example of a group of foods where manufacturers possibly could create such a competitive advantage is physiologically functional foods, further on referred to as pff. These are food products with a scientifically proven prophylactic effect on consumers' health (Mark-Herbert, 1993) Pff are high value added products, in the twilight zone between food and medical products and the principal idea of pff is to enhance the consumer value of a daily consumed food product to also include a specific health benefit.

This thesis is intended to reveal the potential for food manufacturers to create strategic value, in the aspect of vertical competition, when producing and marketing pff. When identifying and assessing the value of pff as a strategic area, the following questions will guide the reader, before reaching the final conclusions.

- 1) What fundamental factors create strategic value in vertical competition?
- 2) How do private brands affect vertical competition?

- 3) What characterizes food manufacturers producing pff for retailers?
- 4) How can food manufacturers enhance their bargaining power toward retailers by creating pff?

### **1.3.2 Demarcations**

Special interest is in this study given to the relation between manufacturers and retailers, wherefore competition between manufacturers is described in more general terms.

For successful marketing of a product, communication is generally of great importance. This is true also for pff. Nevertheless, regulations and the particular complex of problems concerning the communication of these products are not treated in this thesis as a consequence of limited resources available for the study. However, since communication constitutes an important part of the product, different communication strategies have been observed in the store inventory.

To evaluate bargaining power between two actors, or groups of actors, on a market, a number of parameters can be observed and studied. The suitability of the different parameters in a particular study depends on the formulation of the objectives, of chosen approach and methodology as of practical aspects such as resources, time available and accessibility to information. Examples of parameters could be how price margins are divided between manufacturer and retailer, delivery conditions, how products are promoted by the retailer and the abundance of private brands in the product category. Here the relative abundance of private brand products within the measures of a store inventory is observed. This choice is based on the accessibility to information that has been considered as high if choosing this criterion.

The products studied are ultra fresh dairy products and ultra fresh dairy products with health related communication. These have been found in the dairy section, containing packaged milk, ultra fresh milk products, cream, butter, milk powder and cheese. The ultra fresh milk products, that is various kinds of yogurts and fermented milk, fresh cheese and fresh milk desserts, was chosen for this study since it, at the time of the study, was estimated to be the section the most abundant in pff-like products. This category is also one of the richest in private brands, in the entire food sector (IAD, no. 50, 1999). At an early stage of the study, it was discovered that no pff or pff-like products were found among the fresh milk desserts, wherefore these products have not been considered in the study.

The empirical study has been located to France since France is the number one food producer in Europe, referring to both the production of commodities and the manufacturing industry. France is also an interesting choice because of its retail structure. French retail is one of the most concentrated and powerful in Europe. Some of the largest European retail chains are French and they are also represented in France.

### **1.3.3 Definitions**

#### *Strategic area*

The identified value of pff is in the study as a strategic area. The term strategic area should therefore be explained. Strategic, from strategy, refers in this study to the goals (objectives) combined with the chosen way in which someone intend to achieve its goals (objectives) (Porter, 1980). The term strategy refers to how companies take actions for product or business development in order to extend their competitive base. The word area implies that the

approach taken to meet this end is not an already known tool or a well-known path, but something rather unexplored and/or diffuse, due to the lack of experience (Mark-Herbert, personal message, 1999). It underlines uncertainty. The concept of strategy involves the perspective of actions taken over a period of time, in order to meet certain purposes or goals. It is concerned with conditions, intentions, policies and outcome (Personal message, Nyström, 1998). Here the interest is aimed at the outcome, to be measured in the store inventory.

A strategic area is built upon an understanding of basic and underlying characteristics of the competitive situation. Actions that are made as a response to short-term conditions, threats or opportunities, may have tactical significance, but those are not strategic (Porter, 1980).

#### *Industry and industrial sector*

The definition of an industry follows as “a group of firms producing products that are close substitutes”, how close substitutes is not specified though. The industrial sector is here used as a wider term, including “all firms involved in the activities necessary to produce a group of products”. The industrial sector includes an industry, its providers of production factors, its buyers, potential new entrants to the industry and substitute products, not considered as close substitutes.

The definition of a supermarket, in France, is a physical store with a size of 500-2500 square meters, where equally or more than 85% of the merchandise consist of food products. In a hypermarket food represents more than 50% of the merchandise and the store covers more than 2500 square meters (Personal message, Dailly, 1999).

## **1.4 Physiologically functional foods**

### **1.4.1 Describing pff**

Pff is a diverse group of foods, without necessarily having much in common apart from something that might be called a medical effect. Generally, pff, foods or beverages, are intended to be consumed as every-day products. A pff product contains one or several substances that increase the value of the product to include a scientifically documented medical benefit. The substances are either naturally existing or manufactured and the obtained benefit can be a positive influence on the consumer’s health state; on it’s ability to physical performances or to its state of mind (Sveriges Tekniska Attachéer, 1996). Patents, to protect them from imitations and copies, support many of the products.

The term Functional Foods was first introduced in Japan in the mid 1980s when a major research program, financed by the Japanese government, was started. Within the program a frame, for recognizing this type of products and related health claims, was developed parallel to the development of the products themselves (Mark-Herbert, 2000).

Approved products are called Kinoseishokuhin. These are foods for specified health use, FOSHU, and eligible to bear a seal of approval form the Japanese Ministry of Health and Welfare. In Japan legislation is thus used to define pff according to the following (Sveriges Tekniska Attachéer, 1996):

1. It is an aliment, neither a capsule nor a pill, based on naturally existing ingredients.
2. It can and should be consumed as a part of the daily diet.
3. It has a specific function, when consumed, to regulate a person’s metabolism. This function can for example be to enhance the biological immune mechanisms, prevent the onset of a specific disease, contribute to recovery from a specific disease, control physical or mental states or to control the ageing process.

Several European countries are investigating what the pff area could result in. Some of many yet unanswered issues are if this is about transformation, modification or additives, and whether these products should improve performance or just promote health.

#### **1.4.2 Producing pff**

The category of pff products can generally be divided into two groups, in reference to the production process. (Mark-Herbert, 1993) One group consists of products naturally containing the active substance and does not need to be processed. Products in the other group have in some way been processed to include the specific health benefit, either through modification or through fortification.

Methods for modification (Poulsen, 1999):

1. Manipulating the basics product itself, for example in the processing procedure of the final product,
2. Modifying the animal foodstuff, so to change the product produced by the animal, or using
3. Genetic engineering to modify the genetic blueprint of plants and animal.

Methods for fortification (Poulsen, 1999):

1. Upgrading; addition of more of a substance already presents the product.
2. Substitution; one substance in the product is replaced by a similar, healthier substance.
3. Enrichment; the addition of a substance that is not present in the basic product.
4. Elimination; the elimination of unwanted, unhealthy ingredients.

Many foodstuffs may have qualities that potentially could make them qualify as pff, for example certain fruits and vegetables. However, they are not *intended* to be used as such, wherefore they are not sold with health related argument and consequently such products are not pff. In order to relate pff to other groups of foods, they can be placed in a continuum ranging from what can be called normal food to medicine, see figure 1.1.

Food sold as health nutrition or medical nutrition could give manufacturers the best from two worlds. The products contain exceptional value added, that normally only can be obtained through prescribed or OTC (over the counter) drugs, wherefore it can be sold at prices yielding considerable margins to the manufacturers. At the same time, they can be distributed through channels with very high coverage, where the vast majority of the population freely do their shopping every week, and the possible sold volumes for these products are highly superior to what is possible in traditional distribution channels for medical drugs.

## Strategic functional foods categories

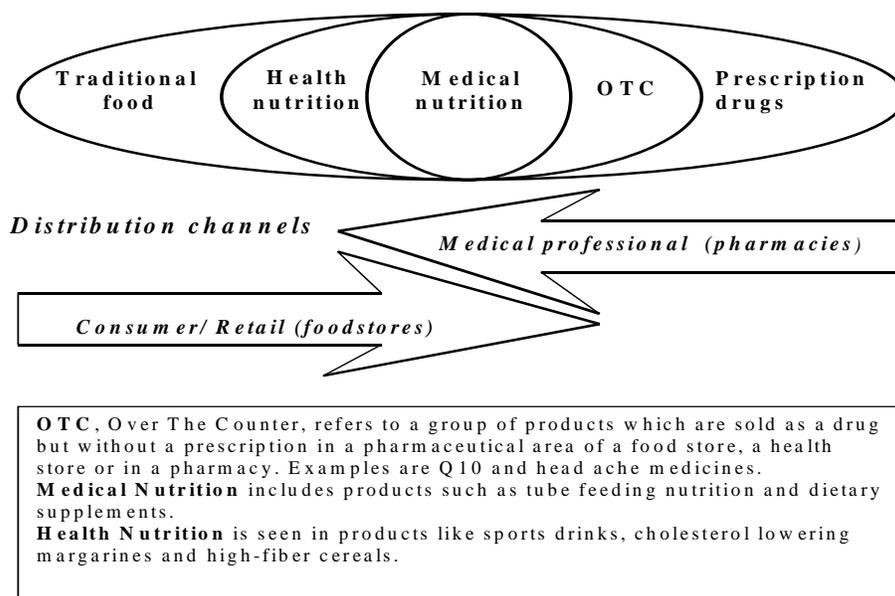


Figure 1.1 Marketing strategies for functional foods. Depending on the strategic position the business chooses to take, the marketing, sales and distribution channels will vary (Mark-Herbert & Nyström, 2000).

### 1.4.3 Definition of pff

Pff is a product category surrounded by vague definitions and insufficient legislation. There is no world wide legal recognition of pff and Japan is the only nation having a legal definition for this food category (Mark-Herbert, 1993)

In this thesis pff is defined by a non-legislative definition. This may be captured in *the role* of this diverse group of foods (Mark-Herbert, 1993). Like any other normal foods they fill energy, nutritional and social needs as well as needs of enjoyment of flavor. Generally, a pff, food or beverage, is intended to be consumed as an every-day product. They differ, however, in that they also have a scientifically documented medical benefit, such as to delay the onset of a disease. Pff products are sold as value-added products to a premium price, with a health-related image and marketing arguments. The substances responsible for the medical benefit can be naturally existing or added, but it is the health effect that distinguishes pff from other food.

## 1.5 Approach

### 1.5.1 Structure

In this section a general description of the author's approach is given. The chosen method is presented and the way to relate to the research assignment is discussed. A description of the line of actions ends the presentation of the market investigation.

The objective of this thesis is accomplished by the employment of a qualitative methodology; a literature study and a market investigation are conducted. The aim of the literature study is to find out about the factors creating strategic value and affecting the competitive situation between an industry and its buyers. In this thesis those are represented by the food

manufacturing businesses and the retail chains. The market investigation aims to estimate to what extent competitors have been able to manipulate these factors when marketing pff.

### 1.5.2 The author's outlook and method

My outlook throughout the study falls between a hypothesis testing, deductive approach and an explorative, inductive approach (see figure 1.2). It is neither all through deductive, nor truly explorative, I find myself, in this assignment, as qualitative hypothesis testing. I have chosen to approach some matters with a high degree of openness, i.e. what parameters will be of interest to measure and evaluate in the empirical market investigation. I have also intended to collect as much information as possible, about the companies producing or selling the products, as about the products that could be defined as pff. Moreover I have been open to new sources of information that I didn't know about at the beginning of this process, such as press review centers and associations gathering and treating information about these two competing industries. These choices are the consequence of my estimation that the area of research questions surrounding pff is relatively unexplored and I find it useful to approach this part with open eyes and with an open mind.

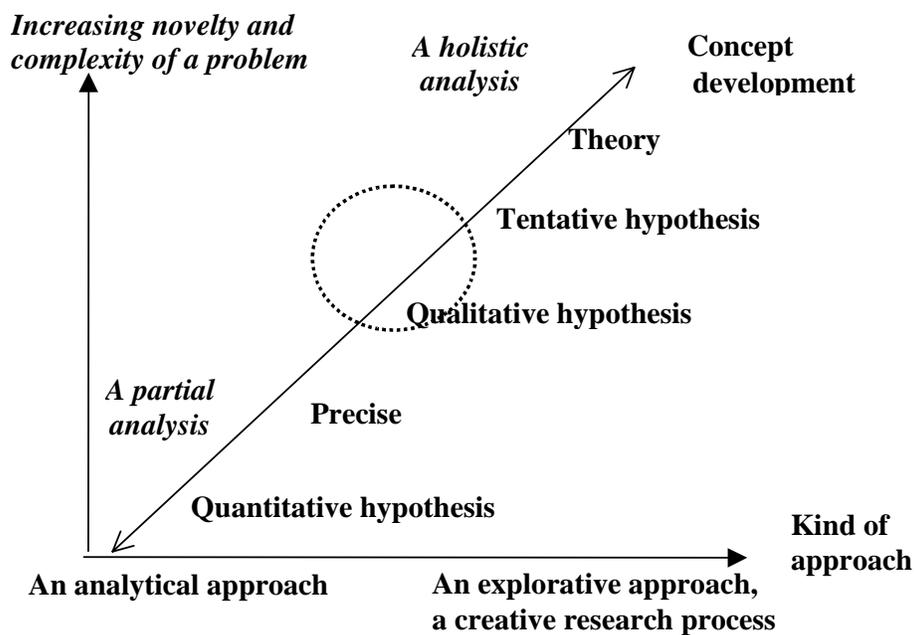


Figure 1.2. How increasing novelty and complexity of a problem affects the research approach and desired research contribution (freely after personal communication Nyström, 1998, in Mark-Herbert, 2002).

Other decisions have been taken with a more deductive and precise approach. Those are generally the basic assumptions and constraints that constitute the substantial frame for this study. One example of this is to, more or less from the beginning, have chosen the theoretical outlook to be based on one paradigm; the paradigm of the five competitive forces (Porter, 1980). Moreover I have chosen to place a certain amount of collected facts as background information. The consequence of not considering these pieces of information as results from

the empirical study is that the number of parameters to analyze and the amount of risk to consider is kept on an appropriate level. Even though many more parameters could be investigated and taken into account, I have chosen to proceed with a limited number, and let the resulting assumptions and unexplored areas make part of the frames for this masters' thesis.

### **1.5.3 The investigated market**

Information in the market investigation was collected during the months of December 1999 to February, year 2000. It consists partly of a press review and partly of a store inventory of pff-products in the dairy section. The store inventory was conducted in February 2000, after having collected background information and having built up an idea of what parameters would be of importance to observe. It covers 21 supermarkets and hypermarkets in the Paris area, in France.

The market investigation was conducted in the Paris area since this is the most important region for food retailing and food consumption in France. It hosts approximately 12 million habitants.

When choosing stores for the investigation, the aim was to let all the retail chains be represented and to cover every kind of store and all retail concepts within the chains. In order to find the store locations the yellow pages were used. Paris was divided into a number of areas with different profiles; suburb areas, city commercial areas and city inhabited areas. The stores were identified as suburb hypermarkets, suburb supermarkets, city hypermarkets in commercial areas and city supermarkets in inhabited areas.

Before each visit, I called the store to make sure I would be allowed to take notes in front of the shelves. None of the managers refused to let me take notes, but I was rarely allowed to take pictures of the fronting. I took all notes myself. Three store managers agreed to be interviewed. The information collected through interviews serves in giving me a stronger understanding of the empirical data.

## 2. The food sector in France

In this chapter some of the circumstances and the conditions prevalent in the French food sector are described. Three sections describing the manufacturing industry, the retail industry and the development of a market for pff follow an initial overview of the structure of the whole food sector.

### 2.1 Structure

The food sector is the largest industrial sector in France, nearly twice as big as the second largest one, the chemical sector. In the European Union, the French food sector corresponded to one fifth of the net sales, and made France the number one food sector in Europe in 1998. A turnover of 803 billion French franc (Ffr) was realized in 1998, and over the last twenty years, the turnover has been fourth fold doubled. (ANIA Annuaire, 2000)

Altogether the sector consisted of 4250 companies in 1999. It is the third most important industrial employer, employing 401 500 employees. The great majority of the companies are small and medium sized businesses, however, there are twenty-nine French groups on the top 100 chart over European food companies. Companies employing 200-499 people, employ 5% of the total work force and companies with 500 employees or more, employ 2 % of the total food sector's manpower. (ANIA Annuaire, 2000). From July 1997 to April 1999 the number of new start up companies was constantly diminishing, a sign of decreasing dynamics in the sector but at the same time the number of liquidations was sinking, bringing a compensating effect to the evolution and stabilizing the economic situation. (ANIA, no 4 1999)

In the food sector, manufacturers of commodity products, equipment and other food ingredients mainly represent industry suppliers. Some of the commodity producers have integrated forward, also owning manufacturing industry and thereby represent both suppliers and the manufacturing industry. The manufacturing industry produces food, beverages, industrial products and animal feed sold as local and national brands but also, to an increasing extent, as private brands, for retailers (IAD, 1999). Retailers represent buyers, and the main distribution channels are supermarkets and hypermarkets.

On the French bourse in Paris, the stock value of the 22 largest food-manufacturing companies was summed up to 41,6 billion Euros the first semester in 1999 (ANIA, no 4, 1999). Among the eight highest valued companies listed, there were four food manufacturers, three producers of alcohol, champagne and wines and one producer of pet food. A comparison between the value of retailers and manufacturers at the bourse reveals that Carrefour-Promodès, 49 billion Euro, is valued more than twice as high as the value of the largest manufacturer, Danone, 18.5 billion Euro.

Products on the food market may be divided into four major markets; Grocery, Deep-frozen products and ice cream, Fresh produce and finally Liquids. Further segmentation is shown in figure 2.1 "Food markets and segments".

The segment called *Ultra fresh milk products* of "fresh produce" is in focus in this study. This segment includes fresh dairy products such as yogurts, and fermented milk, curd cheese and fresh milk based desserts. The two segments "Ultra fresh milk products" and "Milk and cream" form a segment called Fresh milk products. This segments contains over 300 references, commercialized in hypermarkets and supermarkets (LNE, 1994).

<b>MARKETS</b>	
<b>GROCERY</b>	<b>DEEP-FROZEN PRODUCTS AND ICE CREAM</b>
Coffee	Deep-frozen products
Tea and herbal tea	Ice cream
Cereals	<b>FRESH PRODUCE</b>
Sugar and sweeteners	Butter and margarine
Jam, honey, spreads	<i>Ultra fresh milk products</i>
Powdered chocolate	Milk and cream
Dry and pre-packaged bread	Cheese
Chocolate bars	Fruit and vegetables
Chocolate confectionery	Sea food products
Confectionery	Meat, poultry and rabbit
Pre-packaged pastries	Cold cuts
Sweet biscuits	Catering products
Savory aperitif products	<b>LIQUIDS</b>
Pasta	Alcohol
Rice and cereals	Champagne and sparkling wine
Canned products	Wine
Industrial soup	Beer and cider
Oils	Bottled water
Condiments and culinary aids	BRSA and fruit juice
Cold and hot sauces	
Pet food	

*Fig. 2.1 Food markets and segments (Sécodip, 2000).*

## **2.2 Food manufacturers**

The French food industry is constituted by 401 500 companies. Among these companies there is a number of giant manufacturing companies and groups with an annual turnover of more than one billion Ffr (L'entreprise, 1999). These giant manufacturers of multinational brands are present on the European markets as well as in the US. Some companies are specialized in one single or a just few markets, like Lactalis and Danone, whereas others are present in a vast number of food markets and even in other consumer goods markets, i.e. Nestlé and Unilever.

Among the eleven largest food-manufacturing companies in France, five companies producing fresh dairy products are represented. The eleven groups are shown in table 2.2 "The largest food manufacturing groups", followed by the value of each company's net sales and its major market segments in 1998.

The concentration of retailers and of the purchasing centers has made it expensive and difficult for manufactures, especially for smaller manufacturers without strong brands, to get their products listed at the purchasing centers. (Linéares, 1999). Many companies experiencing this declare that they are interested in developing partnerships with the retailing industry and a number of manufacturers announce that private brands have been or may be of help to them when entering new markets.

Other manufacturers look at the situation differently and fear the threat to become simple tools in the hands of the retailing industry, or even absorbed as this evolution proceeds (Les marches, 1999). The retail chain "Intermarché" is capitalistically present in the meat industry, in the charcuteries and in the seafood industry. This gives the manufacturing industry strong incentives to use their know-how and their particular skills in food product transformation, in order to hold the stakes against the retailing industry and avoid being marginalized.

Table 2.2 The largest food manufacturing groups (L'Entreprise, 1999)

Name of group	Turnover <sup>1</sup>	Primary markets
Groupe Danone	84,8	Fresh dairy products, Bottled water, Biscuits
Groupe Lactalis	30,0	Yogurts, Cheese
Bongrain SA	22,7*	Butter and cream, Cheese, Industrial products
Nestlé France	24,4	Fresh dairy products, Chocolate, Coffee, Ice cream, Deep frozen products etc
Pernod-Ricard	20,6	Alcohol, Wine
Unilever France	20,2	Teas, Ice cream, Oils, Spreads, Personal hygiene products, Detergents, Professional cleaning etc
Groupe Soufflet	19,8	Collection and transforming of cereal, Wine supplier
Sodiaal	17,8	Milk, Fresh dairy products, Cheese, Industrial products
Mars	13,0	Confectionery, Snack foods, Pet food, Rice, Drinks, Electronics
Kraft Jacobs-Suchard	9,0	Confectionery, Chocolate, Convenience meals
Best Foods France	3,1*	Mayonnaise, Dressings, Mustard,
Senôble	2,6	Yogurts, Fruit compotes, Desserts, Curd cheese

<sup>1</sup>) Turnover in billion French francs (Ffr).

### 2.2.1 Presentation of milk product producers

The segment of ultra fresh dairy products is dominated by three competitors; Danone, Nestlé France and Sodiaal. These three groups respond together for 60 % of the consolidated production of milk products in France (ONILAIT, 1997). Danone, with its brand Danone, is the world leader in fresh dairy, with the biggest market shares in all the three product groups that constitute the segment in France; yogurts including fermented milk, fresh cheese and fresh milk based desserts. Since 1997 Danone has focused on three primary markets, bottled water, biscuits and fresh dairy products, with health and well-being throughout its core strategy (Personal message, Muget, 1999).

Sodiaal is the largest milk-cooperative in France, producing fresh dairy products, drinking milk, cheese and industrial products. It was created by 6 regional cooperatives in 1964 and today its primary market is France but it also exports to 40 other countries (Sodiaal, 2002).

In the fresh dairy segment Sodiaal produces and markets the brand Yoplait, with which it competes side by side with Nestlé France for the second biggest shares in the fresh dairy segment (ONILAIT, 1997). While Nestlé France is slightly stronger in fresh milk based desserts, marketing the brand Nestlé, Sodiaal is the stronger in yogurts (fermented milk) and curd cheese.

Nestlé is a Swiss company present on many markets world wide, primarily in the food sector. Its vocation is to provide the best food to anyone on any occasion throughout the world (Nestlé, 2002).

Behind the three leading fresh dairy producing groups, there are Lactalis and Senôble. Lactalis produces the yogurt brand B'A and Senôble produces curd cheese, yogurts and desserts with the brand name Senôble (ONILAIT, 1997).

Lactalis was created from Besnier in 1999. The company's primary market is cheese where its flagship is the Camembert "President", sold in more than a 100 countries. Its other markets are butter, cream, ultra fresh dairy, dry products and meat. It is run by M. Besnier, as the family owned business Besnier it has been since its creation in the 30ies (Lactalis, 2002).

Senôble is specialized in fresh milk desserts, in light products and in the production of private brands, in France. It produces the brand Weight Watchers on a license since 1998. It is a 99% family owned business created in 1918 with its primary market in France (Senôble, 2002).

Altogether 8 groups represent 95 % of the national production. Sodial and Lactalis are together with Bongrain, the leading milk-collectors, collecting 40% of the total milk production in France (ONILAIT, 1997).

The penetration rate for yogurt is 95% in France, highly superior to that of fresh cheese and fresh milk based desserts (IAD, 1999). Competition is severe in the entire segment and three kinds of brands compete for market share:

- National brands, representing 31% of the volumes sold,
- Private brands, 32% of the volume corresponds to 27% in value, and divers
- Local brands, 24% (ONILAIT, 1997).

The manufacturers of private brands are highly concentrated, as those of national brands. For the two product groups “Ultra fresh milk products” and “Milk and cream”, the five principal manufacturers realize together 44% of the private brand references. Those are Lactalis, called Besnier before 1999, Senôble, GUF, Sodial and ITM/Saint-Père. (Linéares, 1999)

Industrial prices depend to a great extent on retailer’s pricing to consumers (ANIA, no 4, 1999). The global increase for products sold to households was 0,7% in value from June 1998 to June 1999 but in many of the segments, this progress was inferior to that in volume. This is the result from promotional activities adopted by the retailing industry and of the growth of the private brand segment. If this occurrence continues as a trend, the average value of products could sink despite of product improvements and innovation. In a longer perspective such an evolution constitutes a threat to manufacturers’ profit, which could be gradually watered down by the retail chains.

The segments to progress the most in value, relative to volume, are baby food, ultra fresh milk products, condiments and culinary aids (ANIA, no 4, 1999). The turnover in the ultra fresh segment grew by 2,8% in 1998 and the value grew by 1,7% more than the volume. Compared to all segments in the food industry, this positive difference between value and volume was high, inferior only to that of baby food (+6,8%).

### **2.2.2 Development of the pff market in France**

The French market for pff is difficult to estimate since the nomenclature of pff and other similar products is very vague and imprecise. The first product with a specific effect on the consumers’ health was launched in the late 80s but it was not until the mid 90s that several pff were launched on the French food market.

The growing interest in health related products could be exemplified by the fact that in 1996, 18 new products out of 100 belonged to the sphere of health and shape. The following year, 1997, the same sphere was estimated to concern 31% of the new products in France (Le Monde, 1997). Some observers of the food sector believe that the growth potential for such health related food products, including pff, will be extraordinary, and predict chances for great profits for those who succeed in developing them (LSA, 1999).

However, in addition to the fact that pff are value added products that demand important investments, maybe for a long time before the products can be launched on the market, there are two obstacles that may inhibit industry actors from investing in pff-projects. The

legislation concerning communication of food products' influence on consumers' health is restrictive and it is therefore problematic to communicate pff-products' specific qualities. Secondly, products that have a proven effect on the consumer's health are subject to the drug legislation, and must for example be distributed through specific distribution channels.

In order to overcome these obstacles and to benefit from the different kinds of expertise in product development and marketing, a number of alliances and joint ventures between the food and the pharmaceutical industry have been created. Béghin-Say and the Japanese Meiji Seika have developed and launched a hypo-caloric sugar called Actilight that has been proven to improve the state of the intestinal flora through its pre-biotic properties. Moreover, Unilever and Johnson & Johnson have developed a margarine, which is claimed to lower the rate of cholesterol in the blood of consumers.

The market for healthy eating includes several groups of products and the products are to a certain extent divided differently by different actors. However, an often-used concept is "food for health and well-being". The consumers adherent to this group of products have in common is that they ask themselves questions about how to feed themselves in order to stay healthy (LSA, 1999). The categories that generally are considered to belong to health food are:

- 1) "Healthy nutrition"; Including pff and pff-like products, which also are called "aliments". This is food with a positive effect on the consumer's health; cereals enriched with vitamins, probiotic yogurts etc. Food with lower contents of fat is also included to this category.
- 2) "Food supplements"; Including vitamins, minerals, medical herbs etc. in the form of pills, capsules or powders,
- 3) "Specialized nutrition"; For example food for diabetics, baby food and low calorie products to help controlling the weight. This group is subject to strict regulation. (Les Echos),
- 4) "Biologically produced products"; The reason for including biologically produced products to the health food group is that those products are produced in a more natural way and contain less or no additives that may jeopardize the consumer's health and the state of the environment than conventional products.

Biologically produced products and healthy nutrition are the most fast growing sub-categories, with the highest penetration rate, constituting the bones in the health food group (LSA, 1999).

The aliments belong to a market with the spectacular growth rate of +92% in volume between February 1998 and February 1999 (AGIA). In February 1999 this market reached a value of 6000 metric tons in volume and 182 million Ffr in value with four actors on the market. These are Danone, Nestle, Lactalis and Yakult. All products except for Yakult are produced in France. Yakult, that in being introduced in France during 2000, is produced on a license from the Japanese company by its subsidiary company in the Netherlands (yakulteurope).

### **2.3 Retailers**

Hypermarkets and supermarkets are the most frequented retailers by French households. These two categories attract 83% of the households, who spend 68% of their food expenditures in the stores. Sales in hypermarkets and supermarkets continue to grow faster than in the smaller superettes and in the specialized stores (Les Marches, 1999). On average,

the French consumers shop twice a week in hypermarkets and supermarkets and they also do some complementary purchases in hard discounts and in smaller so-called superettes, see table 2.3 "Store size" (personal message, Dailly, 1999).

Those reluctant to visit hypermarkets and supermarkets shop their food in the smaller and more convenient superettes, situated closer to residential areas. They are generally over sixty years old and are also the most loyal customer segment for specialized food markets, such as fish markets, charcuteries and butchers. Fresh produce shelves in hypermarkets and supermarkets compete quite successfully with the traditionally very well established specialized food markets when it comes to households with two active persons.

Food retail is generally categorized in to four groups of stores, described in table 2.3 "Store size". These are hypermarkets, supermarkets, superettes and hard discounts. The first three are categorized by size, while the hard discounts constitutes the fourth group due to its stringent low price policy. The French definition of a hypermarket is a store with a size superior to 2500 square meters, where 50% or more of the merchandise consist of food products. In a supermarket food represents 85% or more of the merchandise and the store covers between 400 and 2500 square meters. Food stores smaller than 400 square meters are called superettes.

*Table 2.3: Store size and number of units, in the four major retailing concepts (personal message Dailly, 1999)*

<b>Type</b>	<b>Size per unit</b> m <sup>2</sup>	<b>Total size</b> m <sup>2</sup> , -99	<b>Units</b> -98 (-99)
Hypermarkets	> 2500	6 488 340	1 095 (1 118)
Supermarkets	400<X>2500	6 611 137	7 984 (5 938)
Superettes	< 400	945 000	4 353
Hard Discounts	660 (average)	1 380 720	2092

Each of the four categories meets different expectations among consumers. Hypermarkets count on their large spaces and wide assortments to create living centers, where the household buyers spend more time to do their weekly shopping, than in a supermarket. Supermarkets bank on proximity and soon convenience, and so do the even smaller superettes, "just around the corner". Hard discounters combine proximity with a low price policy. Most of the retail chains include stores of all four formats, though all stores not necessarily carry the same name.

Hard discounts have not seen the same success in France as in other European countries (personal message Dailly, 1999). The concept of hard discount, low prices and lower level of service, was introduced to France in 1994. First in 1999 a significant growth in market share could be observed, when both the total number of stores and the penetration rate increased. The hard discount has now acquired distribution channel status and the national brands have been forced to give in to the low price practices of this channel.

The number of supermarkets decreased between 1998 and 1999 (personal message Dailly, 1999). Some of them were turned into hypermarkets but the decrease is mainly explained by the law "Loi Raffarin" created in 1996. It demands permission to open stores larger than 200 m<sup>2</sup>, as opposed to 1000 m<sup>2</sup> before. However, during 1999, the number of supermarkets grew again. Adjustment of price levels, the ageing of the population, recovery of vitality of certain supermarket chains and the noted progression of hard discounts are some of the factors

explaining this increase. The distribution of turnover between the four major concepts is illustrated in figure 2.2 and in figure 2.3.

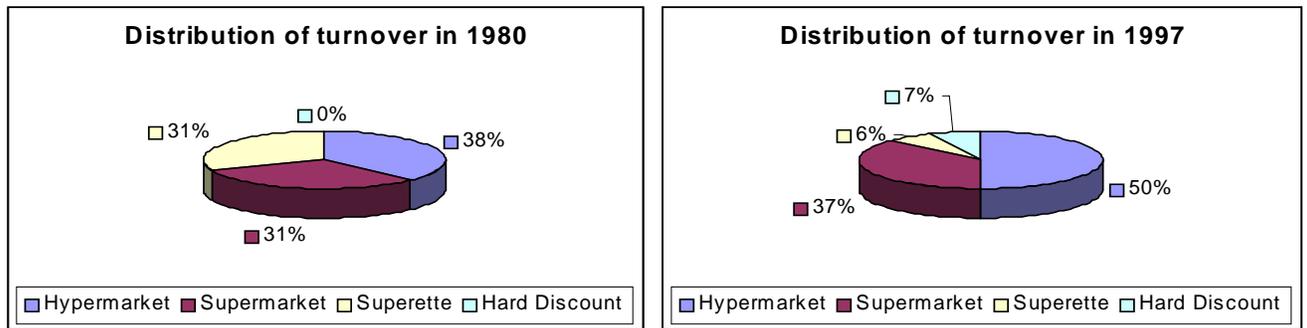


Fig. 2.2 Distribution of turnover in 1980 and in 1997 (personal message Daily, 1999).

Over a period of seventeen years, from 1980 to 1997, hypermarkets have greatly increased their yearly turnover to represent 50% of the total value created in the retail industry. This has largely been on the expense of the superettes, which have lost approximately three quarters of their business.

### 2.3.1 Presentation of food retail chains

The most pertinent feature of the food retail in France is an ongoing process of centralization. There is a dozen national and multi national retail chains plus some two dozens of regional chains that gradually concentrate their activities through mergers and acquisition, see table 2.5. Some of these chains contains hypermarkets other supermarket and some both. All of them have developed their own private brands. As of year 2000, 92% of the purchasing power in the French retailing industry was controlled by five buying centers. Ten years ago there were thirty centers. (Les marches, January 2000)

By the end of 1999, Carrefour and Promodès merged and became the second largest retailer in the world (ANIA, no 4 1999). The group alone thereby controls more than one fourth of the purchases in France. (Les marches, January 2000). In 2000, Auchan sold a number of proximity shops to Casino. Also, the group Auchan obtained the entire ownership of the bank “La Banque Accord” (Annual report Auchan, 2000). Intermarché is the name of the buying center providing the independent group of retailers called “Intermarché les Mosquetaires” with products. Lucie and Opera were created by Système U and Leclerc respectively Casino and Cora a few months before the merger of Carrefour and Promodès. (Les marches, January 2000) From each of the centers, a number of retail chains buy their merchandise, illustrated by table 2.4 “Buying centers and their purchasing power (Les marches, January 2000)”.

The purchasing power of each of the five centers is specified next to the name of each buying center. The volumes purchased by the respective centers are important to the manufacturers. If Opera, for example, after negotiations decide not to carry a manufacturer’s product, that means a loss for the manufacturer of 15% of the entire market in France. In return, after a successful negotiation, the retailer offers the manufacturer national coverage.

Table 2.4 Buying centers and their purchasing power (Les marches, January 2000)

<b>Auchan</b> 13%	<b>Intermarché</b> 14%	<b>Opera</b> 15%	<b>Lucie</b> 23%	<b>Carrefour- 27% Promodès</b>
Auchan, including Atac, Maximarché, Rapidmarché, Docks de France	Intermarché les Mosquetaires	Casino and Cora, including Match, Monoprix, Prisunic, Franprix, Leader Price, Géant, Ralley, Coop de Campagne	Système U and Leclerc, including Norma, Aldi, Lidl	Carrefour-Promodès, including Shopi, Ed, Continent, Champion, 8 à huit,

Two new laws have had a certain effect on recent evolution of the food sector (Les marches, January 2000). The laws Raffarin and Galland were created in 1996 and in 1997 respectively, in order to regulate the competition between the manufacturing industry and the retailers. Shortly, Raffarin restrains the possibilities to open new retail stores and Galland prohibit retailers to sell with loss, in order to differentiate its prices, and thereby destroy the image of the national brands.

Since the beginning of modern retail, the French retail chains have been charging manufacturers a fee by the end of every year for divers promotional activities (Les marches, January 2000). These activities include participation to advertising costs, promotional activities, catalogues and fronting fees. The charged amounts are negotiated in advance, at the beginning of the year independently of the results of the promotional activities, wherefore the manufacturers carries the risk of un successful campaigns. After the creation of the above-mentioned laws, the prices charged by retailers rose in general from 15% to 30% of the turnover realized with manufacturers. In professional language this practice is called backward margins (marges arrière) and have become the retail's means to compensate for losses when not being allowed to sell at loss. Table 2.5 presents closer the major retail chains in France 1999.

Table 2.5 The largest retail chains in France 1998 (personal message Dailly, 1999)

Name of group	Hypermarkets	Supermarkets	Superettes
Groupe Carrefour-Promodès	168+106	871+1295	348+913
Intermarché	81	1954	105
Leclerc	358	157	0
Groupe Auchan	126	299	14
Groupe Casino	123	1767	959
Système U*	51	727	68
Cora-Match	72	192	74
<b>Total</b>	<b>1085</b>	<b>7262</b>	<b>9743</b>

\*= Système U is not represented in Paris wherefore it has not been included to the store inventory.

### 2.3.2 Retailers' private brands in France

Private brands' market share is growing in France, in value as well as in volume. The value grew annually by one percent per year between 1996 and 1998 and reached 19,1%, which

corresponded to 22,2% of the volume. (IAD, 1999) On four out of five major European food markets; Belgium, Great Britain, France and Germany, private brands increased in market share considering value as well as volume in 1998. In the Netherlands private brands fell by 0.2%.

In France, private brands are taking on a new role in the retailing industry (LSA, 1999). They have become the strategic key elements for the retail chains, which all confirm that they want to build real, strong private brands through creativity, packaging and publicity. The objective is to differentiate themselves from other retail chains and increase the loyalty among the chains' customers.

Retailers are replacing the private brands of the 80s, just as good and less expensive, and intend now to present the right product at the right time rather than any products only less expensive (IAD, 1999). All the national and multinational chains carry their own private brands, see table 2.5, and they have recently entered two new markets; biologically produced products (Casino), which is the fastest growing food market in France, and prepared dishes, in their efforts to create original products that keeps customers loyal to their chains (LSA, 1999).

The laws Galland and Raffarin, limits retailers' means to differentiate prices of national brands simultaneously as it holds back the number of new openings (Les marches, January, 1999). Retailers can no longer sell products at loss, in order to attract customers and they are forced to find new ways to compete and reconstitute their margins. Differentiation, of the chains and its image, is one means to do so and by developing private brands the retailer is both free to set the prices it wish and to position its brand so that it potentially can be use to increase customer loyalty.

However, this objective has not yet been obtained (LSA, 1999). Only 10% of clients in hypermarkets and 15% of clients in supermarkets acknowledge going to their principal store to buy its private brand products in 1999 and Secodip, one of the leading French marketing research institutes, has only found, in one single study, that one private brand, Reflets de France by Promodès, has created an over average consumer loyalty. They also found that the loyalty is growing with time, but Secodip has not been able to decide whether it is the brand or the chain that is the cause for higher loyalty. French consumers have in general a positive image of the private brands of their principal retail chains. Approximately four out of five French consumers estimate the private brands to be of the same quality or better (4%) than the manufacturers' brands. Nevertheless, another study, made by Institute Fournier shows that two thirds of the inquired consumers would not mind if the private brands were suppressed. The global result of the study is that in general, consumers still buy private brands rather due to habits and for the lower price, than due to true preference and loyalty.

Some private brands carry the retailer's name, for example "Auchan" (IAD, 1999). The image of these products is strongly related to the image of the entire chain, and the image of one influence the image of the other. There are also private brands with independent names, such as "Reflets de France", by Promodès. The customer attraction of these products do not depend on the image of the chain, instead these brands, separated from the chain's name, can be used to attract customers for a specific product with a strong image of creativity, quality or whatever brand strategy has been chosen. Customers might choose going to Promodès because they want products of the brand Reflets de France, instead of deciding to buy Auchan products, when they are already inside Auchan. How to name a brand depends among other factors on the degree of implication in the product. Weather it is the product itself that attracts customers or if it is the chain that makes customers want to buy its products, should be reflected when choosing name strategy for a new private brand.

Auchan has abolished a dozen of products carrying other brand names than Auchan, in order to create a chain-brand, like that of IKEA or Marks & Spencer (LSA, 1999). Auchan also aims at finding a common base in all their products, something that includes quality, handiness and value added, even for more specific lines, such as biologically produced and regional specialties, that they might be able to launch. Système U's products have always been signed with the chain's name. The strategy has been to make consumers attribute the same values to the products, as to the chain, utility for example.

Carrefour-Promodès has created, among others, two brands that carry names without any reference to the chain; Reflète de France and the adherent Destination Saveurs. Reflète de France is a product line of regional French products and Destination Saveurs are products originating from places outside France, slightly recomposed to please the European flavor. E. Leclerc have launched a private brand called "Nos régions ont du talent", meaning "our regions are talented". The idea is the same as that of Carrefour-Promodès, to offer locally produced specialties from every corner of France, all over the country.

Important about private brands with other names than that of the chain, is that they can be used for TV commercials (LSA, 1999). Retailers are prohibited to appear in TV commercials, but without mentioning its own name, Intermarché have effectuated numerous campaigns for their most well known brands; Pâturages and Monique Ranou.

### 3. Theory

This chapter aims at providing an understanding of how competition, especially vertical competition, is created in an industry and what effects it has on the actors in an industry. It also aims to highlight how competition through strategies is handled by the food manufacturing industry and by retailers. At the end of the chapter, the theoretical framework is summarized and related to the issues raised in section 1.3.1, and a number of hypotheses, which will be tested in the empirical study, are stated. Where there are no other indications, the contents are derived from a theoretical base presented in "Competitive Strategy. Techniques for Analysing Industries and Competitors" by Porter (1980).

#### 3.1 Background

Strategies are essential for all firms that compete within an industrial sector. A competitive strategy is, as the term implies, used when handling competition. Whether it is explicit or implicit, every firm has a competitive strategy, which is a combination of goals and policies; goals, for which the firm is striving, and policies by which it seeks to reach its goals. Formulating a competitive strategy means relating the company and its qualities to its environment. It is important to ensure that the policies of the firm are coordinated and directed at a common set of goals.

The firm's environment encompasses social as well as economic forces. These forces set the frames for the firm activities. In this study, the key aspect of a firm's environment is the industrial sector in which it competes, which sets the economic forces; the possibilities as well as the constraints for activities and prosperity. An industrial sector consists of different actors, and the collective strength of these actors determines the level of competition and the ultimate profit potential in the industry. The level of competition can range from mild to intense, but whatever the total profit in a sector sums up to, the more profit won by other actors, the less is to be left for the firm.

A competitive strategy aims at creating a defensible position against the competitive forces. When identifying the crucial features and the nature of competition in an industry, the approach to the structural analyses can be taken with different intentions: positioning, influencing the balance or exploiting change.

- *Positioning*: This approach takes the structure of the industry as given and matches the company's strengths and weaknesses to it. The strategy can here be seen as a defense or as finding the position where the competitive forces are the weakest. Knowledge about the company's capabilities and the competitive forces will highlight the areas where the company should confront, and where to avoid, competition.
- *Influencing the balance*: This strategy is designed to do more than merely cope with the competitive forces, it is meant to alter their causes. Innovation in marketing can for example raise brand identification or differentiate a product. Analyses can here be used to identify the key factors driving competition in the industry and thus the places where strategic action to influence the balance will yield the greatest payoff.
- *Exploiting change*: Industry evolution is important strategically, because it brings changes in the structural sources of competition. The product life cycle pattern of industry development is also of great importance; trends such as growth rate changes affect the sources for competitive forces. Strategic analyses can be used to forecast the eventual profitability of an industry.

### 3.2 Elements of competition

Competition affecting a firm comes from a number of different actors, constituting the elements in the structure around the industry. These actors can be divided into *five groups*:

- 1) Other firms,
- 2) Buyers,
- 3) Suppliers,
- 4) Potential entrants to the industry and
- 5) Substitute products.

In the five-factor model, shown in figure 3.1, the relations between the five elements that form competition are illustrated. (Porter, 1980) The five forces; threat of entry, threat of substitution, bargaining power of buyers, bargaining power of suppliers and rivalry among current competitors illustrate the fact that competition and rivalry among competitors goes beyond the industrial players and, depending on the industrial sector's internal structure, any of the five groups can be the most powerful and present the toughest competition.

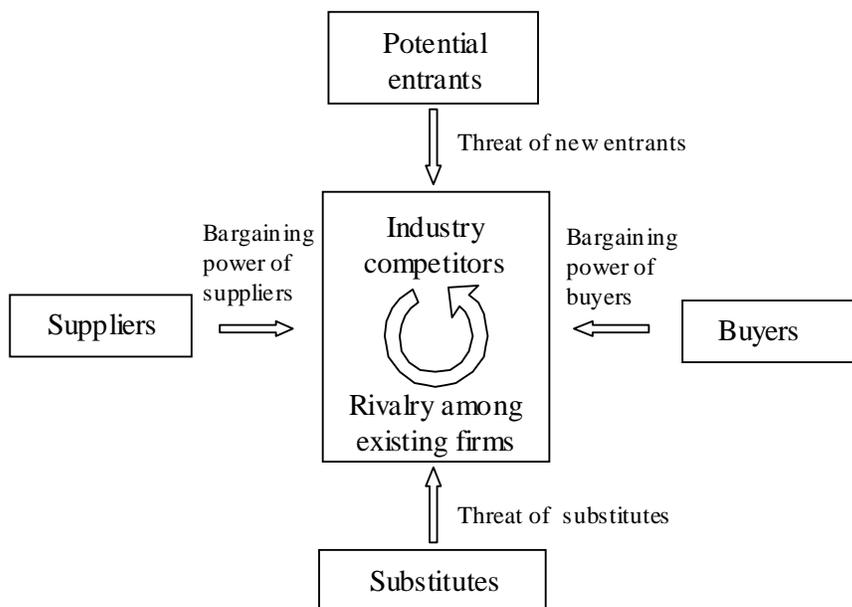


Figure 3.1 The five factor model; Forces driving industry competition. (Freely after Porter, 1980, p.19)

*Other firms* are here referred to as the companies offering the same kind of products or services, creating the (intra-) industrial competition. *Buyers* are companies buying products or services from the firm. Those are not necessarily consuming what they buy but can transform it further or group products together and sell them on to its own buyers. An example of buyers is the retail chains. *Suppliers* are the companies selling production factors or raw material of which the firm manufactures its products or services. Suppliers can for example be commodity-producing cooperatives. *Buyers and suppliers form the competition that here is called vertical competition*. Possible *new entrants* are companies that potentially could enter the industry and compete for market shares. Those can be new firms or already existing once,

operating in another field. *The substitutes* are products that are similar to the original product. They can be used to replace the original product but the products are not the same

In this study, as indicated above, *competition between manufacturers and buyers* is given special interest and the forces between them are thoroughly presented in section 3.4. However, before taking a closer look at the relation between industry and buyers, four generic strategies, for handling competition is presented in section 3.3.

### 3.3 Generic strategies

#### 3.3.1 Strategy classification

To handle competition from the five competitive forces, firms use many different ideas and techniques to position themselves and develop their own competitive strategies. From all possible approaches to this end, four generic strategies can be identified (Porter, 1985). These four strategies are used by firms to create their own long run position and to outperform competitors. Below, figure fig. 3.2 "Generic strategies" illustrates the four strategies; *overall cost leadership, differentiation, cost focus and differentiation focus*. Effectively implementing of any of these generic strategies usually requires total commitment and supporting organizational arrangements. If there is more than one primary target, those are likely to be diluted. In return, it gives above average profit.

The figure contains two variables, each with two possible outcomes, forming four possible strategies. The first variable concerns the kind of strategic advantage the firm is aiming to attain. It can be "by the customer perceived uniqueness" or "a low cost position". The second variable has reference to the size of the firm's customer target, in other words to how many consumers it intends to attract. The first option is an industry wide target the second is a particular segment only.

Each of these strategies, successfully fulfilled, provides a defense against all competitive forces, but there are two fundamental risks about them all. Firstly, the risk of failing to attain or sustain the strategy, and secondly, the risk that the competitive advantage provided by the strategy would be eroded with industry evolution. In both cases, the firm risks to get stuck in the middle. Then it has no competitive advantage and is almost guaranteed low profitability.

		Strategic Advantage	
		Uniqueness perceived by the customer	Low cost position
Strategic Target	Industry wide	Differentiation	Overall cost leadership
	Particular Segment Only	Differentiation focus	Cost focus

Figure 3.2: Generic strategies. (freely after Porter, 1985, p. 12)

### **3.3.2 Overall cost leadership strategy**

The overall cost leadership strategy means a low-cost profile strategy aimed at an industry wide customer target. It permits domination by costs and scale economics, which often only will be generated by a high market share. The most important product characteristic is the low price, satisfying price sensitive customers with little or no demand for product specificity.

This strategy demands an aggressive construction of efficient-scale facilities and minimization of costs in all areas such as R&D, customer services, and sales forces. Low cost relative to competitors becomes the theme running through the entire strategy, possibly even effecting quality. Apart from a high relative market share, other advantages like favorable access to raw materials can be the explanation for developing this strategy.

The firm's lower costs mean that it can still earn returns after its rivalry competitors have competed away their profits. Moreover, a low-cost position defends the firm against powerful buyers because those can exert power only to drive down prices to the level of the next most efficient competitor. There are specific risks of overall cost leadership; technological change can nullify past investments and learning. This can be a very costly and even an irrecoverable setback to a firm. Newcomers or followers can get low-cost learning by imitation or through their ability to invest in state-of-the-art facilities and the firm risks not to see required product or marketing change because of the attention placed on cost.

### **3.3.3 The differentiation strategy**

The differentiation strategy allows the firm to create a product or a service that is perceived industry-wide as being unique. Approaches to differentiation can take different forms. The uniqueness can be in the design or in the brand image, for example Apple doing IMac or Coca-cola, or in technology and features (Bang & Olufsen) as well as in customer service (Ariat) or distribution networks. Ideally the firm differentiates itself along several dimensions. The differentiation strategy does not allow the firm to ignore its costs. Rather, uniqueness is instead of costs the primary strategic target.

Differentiation is a more costly strategy. It demands strong market abilities and generally offers less synergy than does the overall cost leadership strategy. Extensive research, product design with high quality materials, and intensive consumer support are likely to be required. Sometimes the differentiation strategies hinder gaining a high market share if the perception of exclusivity and uniqueness is incompatible to high market share. Even if customers industry-wide avow the excellence of the firm, not all customers will be willing or able to pay the required higher price for its products and/or services.

Differentiation creates brand loyalty by customers and results in lower price sensitivity. The customer loyalty also positions the firm better towards substitutes, than its competitors and it provides entry barriers. As differentiation increases the margins, and prevents the need for a low-cost position it aids dealing with supplier power and it clearly lessens buyer power, since buyers lack comparable alternatives and thereby are less price sensitive. Risks involved with differentiation are that the cost differential between low cost competitors and the differentiated firm can become too great for differentiation to hold brand loyalty. Buyers thus sacrifice some of the features possessed by the differentiated firm's products for cost savings. Buyers' interest for the differentiating factor can also fall. This may occur as buyers become more sophisticated and imitations may also narrow perceived differentiation. This is common as industries mature.

### **3.3.4 The focus strategies**

The two focus strategies are generic strategies where the firms somehow strive to satisfy a particular buyer group, a segment of the product line or a geographic market. The focus strategies are built around the idea of serving a certain, more narrow target very well, on the premise that the firm is thus able to serve it more effectively or efficiently than competitors competing more broadly. Focus can, just like differentiation, take many forms. Even though the focus strategy does not achieve low cost or differentiation from the perspective of the whole market, it may still acquire one of these positions towards its narrow target.

#### Cost focus

This strategy can be used in a segment where competitors are the weakest. The skills, the resources and the organizational features commonly required for a low cost focus position are the same as in the perspective of the market as a whole. The firm with a cost focus position is protected from each of the competitive forces and consequently the cost focus strategy yields opportunity for above average returns. There risk involved with the cost focus strategies is that the cost differential between broad-range competitors and the focused firm may widen to eliminate the cost advantage of serving a narrow target.

#### Differentiation focus

Differentiation focus can be achieved by offering a product or a service perceived as unique and desirable to a particular target segment. When accomplished, a differentiation focus position provides protection from each of the competitive forces. Differentiation focus may for example be used to select targets the least vulnerable to substitutes. The skills, the resources and the organizational features required for a differentiation focus position are the same as in the perspective of the whole market.

Risks involved with the differentiation focus strategy are that the difference in desired products or services between the strategic target and the market as a whole may narrow and finally, as for cost focus, competitors can find sub markets within the strategic target and out focus the focuser.

## **3.4 Competition between industry competitors and buyers**

A closer look at the forces between industry competitors and buyers shows that firms selling to and buying from each other are directly affected by the strength of its opposite, see figure 3.3. Buyers can be either powerful or weak, relative to the selling industry. If powerful, buyers can exert bargaining power; play industry competitors off against each other, force prices and seller margins down and demand higher quality and more services.

Two principal characteristics influence the competitive intensity between buyers and sellers; bargaining leverage and price sensitivity. Bargaining leverage determines the relative power between the industry competitor and the buyer, given their respective cloth and alternative sources of supply and demand. Price sensitivity expresses the propensity of the buyer (or the industry) to exert its power. The power of each buyer or each group of buyers depends on a number of characteristics in the market situation presented in sections 3.4.1 and 3.4.2.

### 3.4.1 Power raised through bargaining leverage

There are six situations where buyers become powerful through bargaining leverage.

1. *The buyer is concentrated or purchases in large volumes relative to seller's sales.*

If there are few and equally sized buyers, or if some of them buy particularly large volumes, the business with the buyers will be of great importance to the seller's result. Large-volume buyers are particularly potent forces if heavy fixed costs characterize the industry. This raises the stakes to keep capacity filled since no savings are done, only losses, when there is no activity. The manufacturer might then be forced either to accept the buyer's offer, or take the risk of losing sales though still facing heavy fixed costs.

2. *The products the buyer purchases from the industry are standard and undifferentiated.*

If there is no or little difference between products from different suppliers, as for commodity products, buyers' choice is largely based on price and they can be very price sensitive without losing other values. The buyer, sure to find alternative suppliers, might also play firms against each other, when negotiating term of trade and when looking for producers for private brands. Standard products consequently raise the bargaining leverage of buyers and it also increases the price sensitivity since there are less or no incentives to pay a premium price.

3. *The buyer has full information.*

The more information about demand, actual market prices and even supplier costs, the better equipped a buyer is to assure that it gets the most favorable prices on the market. Information can raise both bargaining leverage and price sensitivity.

4. *The buyer is capable of influencing the final consumers' purchasing decisions.*

If a buyer can direct the interest of the final consumers and favor or disfavor the sales of a manufacturer's products its bargaining leverage is particularly strong.

5. *Buyers pose a credible threat of backward integration.*

If buyers are or might become backward integrated, buyers' are in a position to bargain important price concessions. Buyers producing some of their needs in-house, and the rest from outside suppliers are particularly powerful. They get detailed information of costs and can often pose greatly credible threats of further backward integration to become its own supplier and make the manufacturer's superfluous.

6. *The buyers are facing few switching costs.*

Switching costs are costs facing the buyer of switching from one supplier to another. Examples are need for technical help, employee-retraining costs, psychic costs of serving a relationship and costs for ancillary equipment. If no negative consequences appear to the buyer when shifting supplier, the supplier must engage more resources to keep the buyer.

### 3.4.2 Powerful through price sensitivity

There are five situations when buyers' power is raised through price sensitivity. Three of them are described below and two are described in the section concerning bargaining leverage (situations numbered as 2 and 3 above).

1. *The product the buyer purchases represents a significant fraction of buyers' costs.*

It is worth the effort for the buyer to search for favorable prices and purchase selectively if the buyer spends a lot of money on a product. Where the product is a small fraction of buyers' costs, buyers are usually much less price sensitive.

2. *The buyer earns low profits.*

If the buyer's profit is low, there is a great incentive for lowering the purchasing costs. Highly profitable buyers are generally less price sensitive, and can take a longer run view toward preserving the health of their suppliers, unless the item represents a large fraction of their costs.

3. *Impact on quality or performance.*

When the quality of the buyers' products is not affected by the industry's product, buyers might be very price sensitive, but if malfunction can lead to great losses and embarrassments or if *the industry's product saves the buyer money*, buyers are rarely price sensitive, but rather interested in quality.

Most industries sell their products or services to a range of different buyers and it is rare that the buyers are homogeneous from a structural standpoint. They often differ widely when it comes to the different features determining buyers' strength and competitiveness, wherefore buyer selection, the choice of target customers, is a crucial strategic decision. Buyer selection may improve the firm's competitive position and minimize its vulnerability to buyers' disruptive power.

The quality of a buyer is determined by its growth potential, by its intrinsic bargaining power and propensity to exercise it, by its purchasing needs relative to the firm's capabilities and by the cost of serving the particular buyer. However, these four criteria do not necessarily all move in the same direction. A buyer with great growth potential may also be the most powerful and/or ruthless in exercising its power. Thus the ultimate choice of the best target buyers is often a balancing process among these factors, measured in relation to the firm's business strategy.

### **3.5 Forces between industry competitors and new entrants**

New entrants can be entirely new companies or companies that are reaching out to new markets. Retailers launching private brands are examples of the existing companies that enter new markets. A new entrant brings new capacity, the desire to gain market shares and substantial resources to an industry. If a retailer poses a credible threat of backwards integration or if it is in a position where it can play manufacturers against each other, *private brands may strengthen the retailer's bargaining leverage*, toward the manufacturing industry. The seriousness of threat from new entrants in an industry depends on the entry barriers present and on the reaction from existing competitors that an entrant can expect. If barriers to entry are high and sharp retaliation can be expected from the entrenched competitors, newcomers cannot pose any serious threats of entry. The most common entry barriers follow in table 3.1.

In addition to entry barriers, the potential rival's expectations about the reaction of existing competitors will influence its decision on whether to enter or not. A company may hesitate to enter a market if incumbents have previously attacked new entrants or if the incumbents possess substantial resources to fight back, or if industry growth is slow, affecting its ability to absorb the new arrival and probably causing the financial performance of all the parties involved to decline.

Table 3.1 Entry barriers

<i>Economies of scale</i>	Economies of scale deter entry by forcing the aspirant either to come in on a large scale or to accept a cost disadvantage.
<i>Product differentiation</i>	Product differentiation, building brand identification, creates an entry barrier by forcing newcomers to spend heavily to overcome customer loyalty. Advertising, customer services, being first in the industry and product differences are among the factors fostering brand identification.
<i>Capital requirements</i>	The need to invest large financial resources in order to compete creates a barrier to entry. This is particularly true if the capital is required for unrecoverable expenditures in up-front advertising or R&D.
<i>Cost disadvantages independent of size</i>	Entrenched companies may have cost advantages not available to potential rivals, no matter what their size and attainable economies of scale, such as effects of the learning curve, the experience curve, proprietary technologies (i.e. patents) or access to the best raw materials.
<i>Access to distribution channels</i>	Newcomers need to secure distribution of the product or the service. Food, for example, must displace other products on the supermarket shelf via price breaks, intense selling efforts etc. The more limited the channels are and the more existing competitors have these tied up, the tougher entry to the market.
<i>Government policies</i>	The government can limit or even foreclose industries with such control as license requirements and limits on access to raw materials. The government also can play a major indirect role by affecting entry barriers through controls such as air and water pollution standards and safety regulations.

### 3.6 Hypotheses

#### 3.6.1 Pff as a strategic instrument

In a situation where the retailers are getting more concentrated, where they show credible threat of backward integration, have access to important information and are capable of influencing the final consumers, at the same time as they are highly price sensitive, manufacturers could protect themselves through differentiation, producing highly differentiated products, that are difficult for retailers to replace or to produce as private brands. This could furnish manufacturers with a defense against price sensitivity, against situations where they are being played against each other and if the product also is important to the buyers' results, manufacturers could also gain bargaining leverage.

Against the perspective of the ongoing concentration of retailer power and an increasing share of private brands in the food industry, the following hypotheses are deducted from the background information and the theoretical framework presented above.

#### 3.6.2 How can food manufacturers enhance their bargaining power by marketing pff?

1. It can be assumed that the *brand structure* in the ultra fresh dairy segment is different among the pff products than in the entire segment.
  - There are probably less private brands in the pff-segment, since pff -products are highly differentiated and require substantial amounts of R&D to develop. This

brings about a situation where retailers, regardless of size, have few opportunities to play manufacturers against each other.

- Due to higher entry barriers, the pff are probably better protected against competition from private brands, the more advanced the pff-feature is. Products protected by patents are not likely to be found as private brands at all, since it would be unlikely that retailers have developed and manufactured their own high value added products and there are no incentives for manufacturers to make private brands of products protected by patents.
  - If pff-like private brand products are found, those are likely to be either substitutes with more or less pff-like qualities or imitations of pff, a kind of “me too” products, rather than state of the art products.
2. It can be assumed that manufacturers *demand higher prices for pff* than for regular products.
- Pff are probably sold at premium prices as they include a high value added and a high level of uniqueness. There would also be little risk for threatening and aggressive pricing policies from competitors or substitutes as retailers have few or no alternatives that can replace the pff products. Moreover, as retailers pose a less credible threat of backward integration concerning pff they probably have little access to information regarding pff, compared to standard and undifferentiated products wherefore their bargaining power can be assumed to be lower.
  - The cost for pff represent a limited share of retailers’ total costs for food wherefore, presupposed that the product itself is important to the retailer, the manufacturer of pff can demand higher price for pff.
  - Private brand pff like products are probably sold at prices between the original pff and a standard product. The more similar a private brand is to the original pff, the closer should the price of the private brand be to the pff price. However, even as identical products, the private brand is likely to be sold at a lower price than the original pff, since the private brand product probably supports less consumer loyalty than the original pff, if the private brand is a copy.
3. Since *retailers differ in profile*. Pff are likely to be more abundant in certain retail chains. Pff is probably a *successful strategic area toward retailers with a differentiation strategy*. Such retailers would stress on offering their customers a wide range of quality products with high service and provided that manufacturers are capable of matching those chains needs, pff could be an importance group of products to these retailers. Concept stores, with *focus differentiation strategies* such as health products, would possibly be another good buyer target.
- Hard discounts have a strong growth potential but are on the other hand the most price sensitive buyers. Retail chains could be expected to keep few or no pff in their assortment if they have an undifferentiated profile with only standard and low price products, wherefore hard discounts unlikely are good target buyers.

### **3.6.3 What characterizes food manufacturers producing pff?**

4. It could be assumed that *smaller companies* without strong market positions have developed pff and that the companies or the products later on have been acquired by more established companies with access to distribution channels, strong brands and substantial resources for the product launch.

## 4. Empirical findings

This section accounts for the results from the store inventory. These results are first presented in a general manner, aiming at giving an overview of the category ultra fresh dairy products. In chapter 5, the results are related to the hypotheses presented in section 3.8.

### 4.1 Brand structure

In the investigated segment, 54 brands were observed and altogether 115 different products. The segment is dominated by brands containing a wide range of products. Examples of such are Danone, Nestlé, Yoplait and the private brands. Other brands are rather narrow, including only one or a few products, such as Yakult and Vrai AB. Out of the 54 brands and the 115 products, there were 18 private brands enclosing 62 products. Altogether, eleven manufacturers were observed; Danone, Lactalis, Nestlé France, Senôble, Sodiaal, Savoie Yaourt, Triballat-Noyal, Valrhona, Yakult Honsha, Baïko Laiterie and Alpro soja. The manufacturers are all French companies except from Yakult Honsha, a Japanese company, and Alpro soja, a Belgian manufacturer.

The observations were made in 21 stores representing 10 retail chains. In the hypermarkets, the offer was more differentiated than in the supermarkets, in the sense that they carry a higher number of brands and more varieties of each brand. In most of the chains (9 out of 10) a range of basic private brand dairy products with a simple design were observed. Some of these brands are named after the chain and the products are called “Greek yogurt Leader Price” for example. In other chains the products are simply named according to what they are, for example “plain milk yogurt”, “white curd cheese” etc. The only chain where this kind of products was not observed is E. Leclerc. Instead, the two private brands that were observed in E. Leclerc carry specific names not explicitly indicating that they belong to the chain.

The ratio between manufacturers’ brand products and private brand products ranges in the ultra fresh dairy segment from 2,33 in Leader Price to 8,30 in G20. Table 4.1 shows this ratio in all the investigated chains, and it can be noted that Leader Price, a hard discount (HD), has the lowest ratio of national brands. G20, with the highest ratio of national brands, is a superette (Sup). Intermarché, with the second lowest ratio, is a supermarket (Sm) with a strong low-price policy and image. Its logotype includes the musketeers, who are meant to protect consumers from high prices.

*Table 4.1 Ratio of national brands in the retail chains*

<b>Chain</b>	<b>Profile</b>	<b>Ratio Nb/Pb</b>
Leader Price	HD	2,33
Intermarché	Sm	2,42
Monoprix	Sm	2,77
Atac	Sm	3,22
Champion	Sm	3,42
Carrefour	Hm	3,71
Casino	Sm	4,00
E.Leclerc	Hm	4,14
Auchan	Hm	4,70
G20	Sup	8,33

## 4.2 Subcategories

Products in the category “ultra fresh dairy products” are grouped into subcategories, in several manners by retailers and the number of subcategories varies greatly. There is no such thing as a standard when naming the subcategories, nor when dividing the products into subcategories, but a general approach is to group similar products of different brands together into a subcategory. The higher the number of subcategories, the more specific are the names of the subcategories. In table 4.2 the most common categories are listed to the left, and supplementary less common groups are listed in the two columns to the right. Pff products are present in some of these subcategories, and some of the less common are entirely constituted of pff-like products.

Table 4.2 Subcategories in the ultra fresh section

Common subcategories	Less common subcategories	
<i>Plain yogurts</i>	Plain yogurts with bifidus	Flavored yogurts for children
<i>Flavored yogurts</i>	Flavored yogurts with bifidus	Drinkable yogurts
<i>Fruit yogurt</i>	Fruit yogurt with bifidus	Cottage cheese
<i>Fermented milk</i>	Bifidus	Velouté
<i>Curd cheese</i>	Plain yogurts, low fat	Sweetened yogurt
<i>White cheese</i>	Fruit yogurts, low fat	Full cream-milk yogurt
<i>Bio*</i>	Healthy yogurts	Yogurt from sheep milk
<i>Crème fraîche</i>	Lighter products	Meal substitutes
<i>Fresh milk</i>	Soya	Baby products
<i>Fresh cream</i>	Milk Drinks	
<i>Desserts</i>	Petit Suisse plain	
<i>Petit Suisse</i>	Petit Suisse fruit	

\*= *Biologically produced products*

Stores in chains with a wide range of brands and products, tend to subcategorize the sections into a higher number of subcategories, this has been observed in Carrefour and in Auchan two of the hypermarket chains. In figure 4.1, it is further illustrated that E. Leclerc, a retail chain with both supermarkets and hypermarkets employ more subcategories in the hypermarket store than in the supermarket store. The supermarkets all employ between three and six subcategories, with the exception of Monoprix, employing eight subcategories in the investigated stores. Monoprix is a “general store” chain where the store space is divided into two sections; one general area for clothes, beauty articles, hygiene products for example, and one supermarket area.

In most of the chains, products positioned in the health-universe are grouped together within the subcategory they belong to. Generally this means that products with particular ferments, such as bifidus actif are grouped together and products claiming to be rich in vitamins and minerals are grouped together. This results in that, particularly the pff but also many of the pff-like products, have been found next to each other in most of the stores. Carrefour has taken this one step further and subcategorized a number of products into subcategories including the word “bifidus”. The observed Carrefour hypermarkets have in one case created segments called “plain yogurts with bifidus”, “flavored yogurts with bifidus”, “fruit yogurt with bifidus” and in another case all the bifidus products are grouped under “bifidus”. In these cases pff-like products without bifidus were consequently excluded from the subcategory.

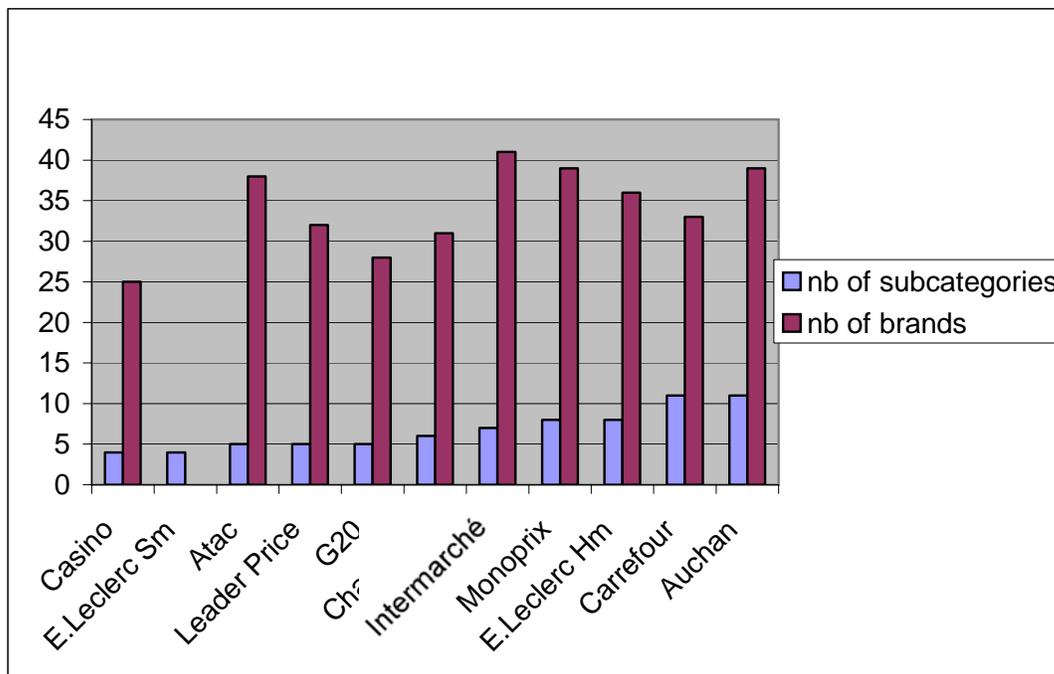


Figure 4.1 Number of brands and subcategories.

Those products having been identified as pff-like products but lacking strong health communication have more rarely been grouped with other pff like products. This is most obvious if the product belong to another group of products with a strong identity, for example traditional products such as the “petit suisse”. These products, claiming to be naturally rich in calcium, are often separated from the other products that communicate some kind of health messages, and constitute its own subcategory.

### 4.3 Description of observed products

A number of pff and products with pff-like characteristics were found on the shelves during the store inventory. There are seven products, from four brands, that have been identified as pff. In addition to the seven pff there were seventeen products, from eight brands, including characteristics that make them pff-like and thereby of interest in this study. These products are referred to as “pff-like products”.

Among the seven products with adequate characteristics to be identified as pff; the pff-characters are clearly specified and the manufacturers claim some scientific evidence, documenting that a specific health-related effect is related to the product.

The other products are not pff, but they include qualities that make them similar to pff. The products are substitutes or complements to those in the first group, but their pff-characters are blurred and vague. In seven out of the ten retail chains, private brand pff-like products were observed, but no private brand products has been identified as a pff.

Four kinds of communication strategies were observed in the store inventory:

- 1) A few national brands communicate health benefits from consuming the particular product.
- 2) Other national brands communicate health benefits from consuming an ingredient or an active substance present in the product.
- 3) Some national brands and some private brands communicate the presence of an ingredient or an active substance, generally known as important in a well-balanced and healthy diet, without further explaining the benefits from consuming the ingredient/substance.
- 4) Some private brands don't communicate any health arguments at all.

An overview of the observed products in the two groups, and a coarse estimation of their relative value as pff is presented in figure 4.2.

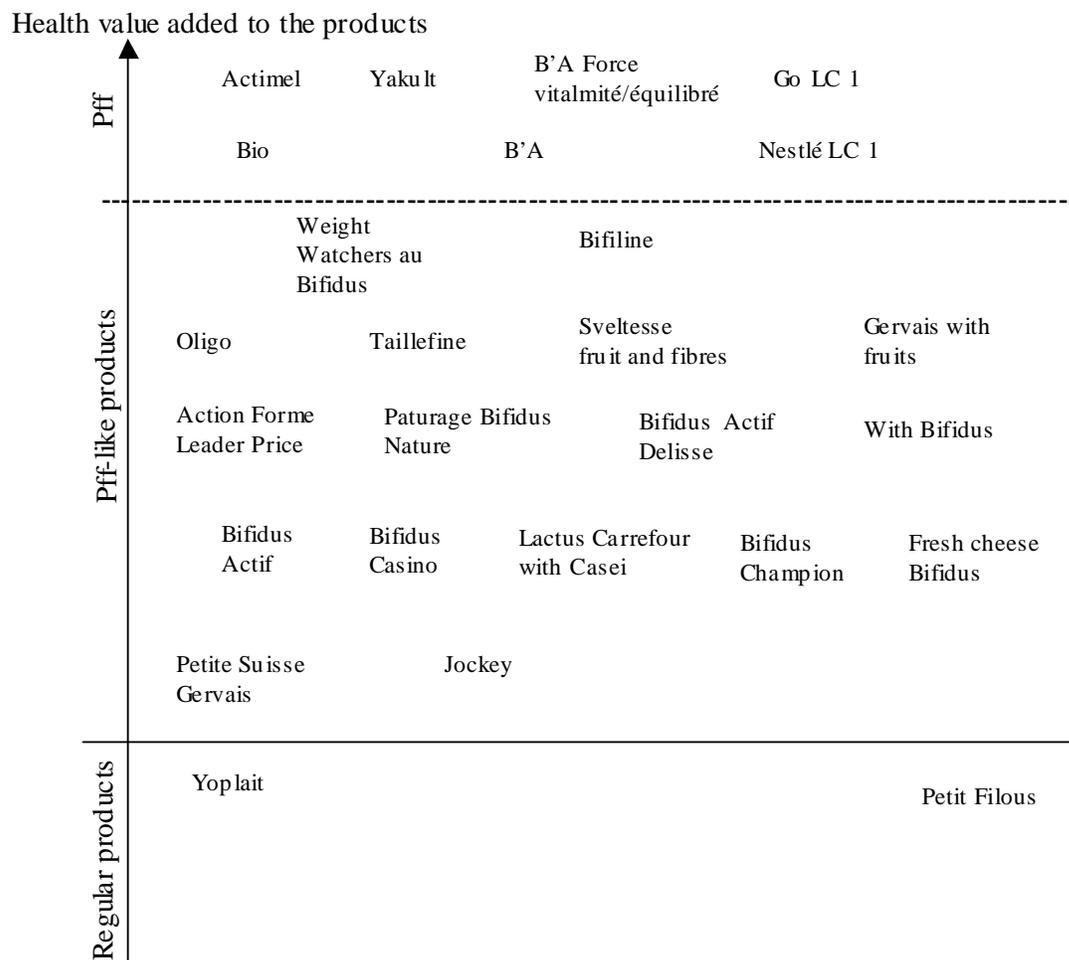


Figure 4.2 "Pff and pff-like products."

### 4.3.1 Products identified as pff

In figure 4.2 Pff and ppf-like products, the seven pff are the uppermost products above the dotted line; Actimel and Bio by Danone, Go LC 1 and LC1 by Nestlé, B'A Force and B'A by Lactalis and Yakult by Yakult Honsha Co. Among these seven products, four are semi-liquid fermented milk drinks, two are yogurts and one is a yogurt-like product. They all contain a specific live bacteria culture, a so-called probiotic. Different probiotics are used and they have all been chosen for its scientifically documented positive effect on the intestinal flora, and the manufacturers claim that the effect the bacteria has on the intestinal flora in turn enhances the well-being on the consumer.

Communication around the national brands is abundant and information about the specific live culture is given on the packing in all seven cases. The brands are also communicating benefits from consuming the products and the how the live culture benefits in the body.

#### Actimel

Actimel by Danone is a fermented milk drink, lightly sweetened with sugar and packed in plastic bottles, in groups of six or twelve, each containing 67,5 ml.

The active ingredient is *Lactobacillus casei* Imunitass. Slogans used to explain the product follow “Actimiel reinforce the organism”, and on the plastic wrapping, holding the six bottles together it is explained that, and “Actimel helps our natural defenses”. One bottle of Actimiel contains 10 billion lactic ferments *L.casei* Imunitass. This is how Actimel helps the organism to defend itself against the small external attacks.” The address to a web site “Actimel” is provided on the plastic, where further information about the product can be found.

On the web site, Actimel is claimed to reinforce our organism thanks to the three lactic ferments it contains. One of the ferments has been chosen after years of research, for its proper qualities and it is exclusive to Danone (*L.casei*).

In addition, an over view of the human immune defense is given and it is stated that Actimel reinforce this defense. Actimel is also explained to be a delicious every day product that can be consumed on a regular basis. The consumers are advised to, for example, integrate one bottle of Actimel in their breakfast routines but also informed that whenever they feel like, they can have another bottle of Actimel.

#### Go LC1

Go LC1 is a semi-liquid fermented milk drink sweetened with sugar, developed and launched by Chambourcy (Nestlé). It is one of two products in the brand LC1; milk products fermented with *Lactobacile acidophilus 1* (LA1). Go LC1 is positioned as health promoting milk drink that can strengthen the body's natural defenses. Communication around the brand inform that Go LC1 encourage the production of antibodies. The active ingredient is a living organism naturally present in the intestinal flora, wherefore it cannot be patented. However, Nestlé has patented the bacteria strain's properties. Nestlé states further in the communication that researchers at the Nestle Research Center have analyzed 3500 strains of lactic ferments and LA1 has been chosen since for its biological properties to reinforce the natural defenses and that it has been discovered that it forms an important barrier against non desirable pathogenic bacteria. Go LC1 is sold in packs of 4 bottles, containing 150g each. Go LC1 has been observed in one flavor, nature lightly sweetened.

## LC1

LC1 is a yogurt-like fermented milk product fermented with the same strain of lactic ferments as Go LC1 (LA1), and it is available in one flavor; LC1 nature (plain). LC1 was developed by Chambourcy that has been bought by Nestlé. On the pots it is informed “It was when thinking about your health, the researchers at Nestlé designed LC1. Its lactic ferments helps your body every day to resist against more.” LC1 has been observed in two varieties of packing.

The launch of the brand LC1 included a massive publicity campaign but Nestlé was forced by the French ministry of health to modify its slogans in the communication around LC1. Claims that consumption of LC1 could strengthen the immune system and help in preventing the development of AIDS were found false (INC Hebdo, 1994).

## Yakult

Yakult is a semi-liquid milk-based drink containing the bacteria *Lactobacillus casei* Shirota. The product is sold in plastic bottles, twelve in one package, each containing 65 ml. According to communication on the bottle and on the plastic wrapping around the twelve bottles, Yakult is for a good start of the day. It is further explained on the wrapping that *L. casei* Shirota is unique for Yakult and was isolated by Dr. Shirota (1899-1982) more than 65 years ago and further that *L. casei* Shirota contributes to a good functioning of the intestinal flora. The intestinal flora is also claimed to play an important role in the digestion and for the general well-being. 23 million people over 17 countries consume Yakult on a regular basis. Yakult, being introduced in France during 2000, has been observed in one flavor. It is the one single product that has been observed from the Japanese company.

## B’A Force

B’A Force is a semi-liquid fermented milk drink developed and produced by Lactalis. It is a product that belongs to the brand B’A, described below. B’A Force exist in two varieties; B’A Force Equilibre, rich in calcium and B’A Force Vitalité, rich in vitamin C. Both varieties are fermented with Bifidus actif and are claimed to “help you feel really good”, but the principal idea about the product is that it contains a quantity big enough, of a specific ingredient, to ensure intake of a certain percentage of the daily recommended intake. The percentage is communicated on the bottles, containing 67,5 ml, and on the carton wrapping around the bottles. A bottle of B’A Force Equilibre contain 25% of the RDI for calcium, and B’A Force Vitalité contains 15% of the RDI for vitamin C. Lactalis has positioned B’A Force as alicaments, hybrids between a foodstuff and a medicine, and claims that B’A Force improves and balances your intestinal flora. B’A Force Equilibre has a touch of vanilla and B’A Force Vitalité is flavored with orange. A package contains 4 bottles of one of the varieties.

## Bio

Bio is a yogurt from Danone fermented with Bifidus Actif. Communication around the product inform that Bifidus Actif, the active ingredient in the yogurt Bio, has been chosen by Danone for its ability to improve the balance in the intestinal flora and to help regulate the intestinal transit. Danone further states that sometimes our rhythm of life and divers activities disturb our internal balance. A slogan presented with reference to the previous statement follows: “Actif on the inside, shows on the outside.” Bio has been observed in eleven flavors and four varieties of packing.

## B'A

Besnier, the pioneer among health promoting yogurts, which in 1999 became Lactalis, acquired B'A in 1987. The yogurt is fermented with Bifidus Actif and the brand contains a wide range of varieties. There are both fruit yogurts and flavored yogurts. B'A has been observed in ten flavors and eleven varieties of packaging. Communication on the products explains, "B'A contribute to your vitality and brings you all the goodness of Bifidus Actif. Bifidus Actif participates to an efficient assimilation of nutrients in your intestinal flora and revitalizes your body." In 1998 products from the brand B'A were sold for a value of 1,1 billion Ffr.

### **4.3.2 Products identified as pff-like**

Below the dotted line, in figure 4.2 "Pff and pff-like products", the products are very inhomogeneous considering their pff-like properties and how those are communicated. Some products can be thought to strongly resemble the pff, others have been enriched with ingredients that are generally known as necessary in a balanced and satisfactory diet other are claimed to be naturally rich in certain ingredients such as fibers and/or minerals. Though a number of products in this group are surrounded by health communication neither the products nor the ingredients are claimed to provide a specific health benefit, and some products lack any kind of health arguments.

Due to the divers nature of the products identified as pff-like, they have been grouped into five categories. The most pff like category consist of yogurts fermented with bifidus. These products potentially carry the same properties as some of the pff but the medical benefits are not well specified and no scientific evidence of the medical benefits have been observed concerning the products. Further, another important difference between these products and the pff is that no defined strain within a type of bacteria is specified.

#### Weight watchers with bifidus and fibers

Weight watchers with bifidus and fibers is a yogurt produced by Senôble and positioned as a light and natural product that also offers the benefits of bifidus and fibers. It's contents of bifidus is mentioned in the name and on the packaging but there are no further explanations specifying what benefits from bifidus the product brings in the communication. This product has been observed in two varieties of flavor and packing.

#### Bifiline

Bifiline is a yogurt fermented with bifidus actif produced by the Danone. Communication on the product claims, "Bifiline rejuvenates the body from the inside" without reference to any scientific studies and without specifying how the product works. Bifiline has only been observed in one variety on one occasion, wherefore it is not included in the comparison and reasoning of median prices.

The second category consists of products with strong health communication but where the communicated medical benefit is vague.

#### Taillefine

Taillefine is a curd cheese from Danone positioned as a delicious product that helps you stay in shape, even if you are a glutton. Communication around Taillefine is abundant and the Danone web site informs that the body needs a well balanced diet to stay in shape. In order to function well, the organs must have the appropriate amounts of essential vitamins and mineral. Taillefine is claimed to bring an efficient and tasty solution, including vitamins,

mineral salts, fibres and calcium to every glutton who wants to reconcile shape and vitality. “Taillefine, a daily source of vitality for your body” is the slogan used for this product.

### Sveltesse

Sveltesse is a yogurt from Nestlé, existing in three products. Two of them are positioned as food for health and well-being; Sveltesse Calci-N and Sveltesse fruits et fibres 0% fat. Sveltesse Calci-N is a plain yogurt enriched with calcium particularly recommended for people in a certain state of life when they need to be careful to get enough of this mineral. Sveltesse Calci-N ® is a registered trademark. Sveltesse fruits et fibres 0% fat is positioned as the new concept of healthy delights of few calories. Both the name and the packaging tell consumers that the product is made from milk with 0% fat and that it contains fibers. Communication around the product on the Nestlé website states that “Fibers from barley, oat and wheat in Sveltesse Fruits et Fibres contribute to good functioning of the intestinal transit. Each cup contains more than 4 grams of fibers. Sveltesse Fruits et Fibres is also naturally rich in Calcium and a source of vitamin B12, often in deficiency in our alimentation.” There is further information about the daily-recommended intake of fibers and on how the consumption because of various reasons during the 20<sup>th</sup> century has declined. It has been observed in four flavors and two sizes of packing.

### Oligo

Oligo is a yogurt from Yoplait, produced by Sodial. It is positioned as a health-promoting yogurt rich in Oligo elements. Through communication on the package the consumers are asked if they know about the benefits from iron and zinc, which are added to Oligo. The question is followed by the answer that iron contributes to the transportation of oxygen to the muscular cells. It is further informed that Zinc participates in the stimulation of the natural defenses and in the cell division. Oligo has been observed in one variety.

### Gervais aux fruits

Gervais aux fruits is positioned as the yummy “petit Suisse”, a curd cheese, for children that include the nutritional elements indispensable for children’s growth and development; proteins, calcium and vitamins (Vitamin B12 and Vitamin D). Danone produces Gervais, and communication around the product explains that calcium is important for the construction of bones and teeth, and that vitamin D helps fixing the calcium on the bones. This product has been observed in four flavors and two varieties of packing.

The third category consists of private brand products fermented with specific bacteria. These products are particularly similar to each other in design and contents. With the exception of “Action Form Leader Price” that is a milk drink, they are all yogurts indicating the presence of specific bacteria through its name. On the packing the products are further explained as

“Milk fermented with

- Lactobacillus casei” (Action Form Leader Price),
- Bifidus acidofilus and Lactobaciles” (Bifidus Actif Delisse by E. Leclerc),
- Bifidobacterium, Lactobacillus acidophilus”(Paturâge Bifidus Nature by Intermarché) and
- Bifidus and Acidophilus” (With Bifidus by Intermarché).

These products all exist in one variety, as plain yogurt, but “Bifidus Actif Delisse” and “With Bifidus” have also been observed with a flavor of prune respectively vanilla.

In the fourth category there are five more private brand yogurts and one curd cheese, fermented with Bifidus or with Casei, indicated through the name. These products do not provide any further communication about their health properties and they have only been observed as plain yogurts and as plain curd cheese.

- Curd cheese with bifidus (Carrefour)
- Lactus Carrefour with Casei
- Bifidus Champion
- Bifidus Casino
- Bifidus Actif (LeaderPrice)
- Bifidus Actif (Monoprix)

The fifth category of products consists of curd cheese products where their natural content of calcium is indicated on the cups.

#### Petiti Suisse Gervais

Danone produces petit Suisse Gervais. This traditional product is a plain fresh cheese “naturally rich in calcium”.

#### Jockey

Jockey, from Danone, is a curd cheese positioned as a treat of pleasure, naturally rich in calcium. A symbol saying “naturally rich in calcium” is added to each pot to indicate significant contents of calcium in the product. Jockey exists in three varieties; Jockey half skimmed milk, Jockey full milk and Jockey flavor Vanilla.

## **4.4 Prices**

The prices of dairy pff-products are unequivocally higher than the prices of similar products without a pff-feature. The four pff with the strongest health promoting profile; Actimel, B’A Force, LC1 and Yakult generate the highest prices among the pff in this study. The price span observed for the four products; Actimel, B’A Force, Go LC1 and Yakult range from 24 Ffr to 41 Ffr per 100 centiliters of product. There is also one private brand product that is somewhat similar to these four products; Action Forme from Leader Price. As described above, no health communication follows this products though the texture and the name indicates that the product is similar to the other fermented milk drinks. Action Forme is sold at a price, per 100 cl, that is inferior to any of the other products, regardless of retail chain and size of packing. The left column in figure 4.3 illustrates the difference in median price between these five products.

The comparison in price between yogurts with or without pff-qualities shows that pff yogurts are sold at higher prices than yogurts with a health image, which also are sold at higher prices than yogurts without health image, if other parameters such as texture and ingredients are equal. Among plain yogurts Bio, B’A, LC1, Weight Watcher Bifidus, enriched yogurts and the private brand bifidus yogurts, are products that fairly well can be compared according to this reasoning. The texture and contents of fat differ between the brands but the products belong to the same product category, plain yogurts.

Comparison of data in this study shows that the pff yogurts Bio, B'A and LC1 are more expensive than Weight Watcher Bifidus, and all other yogurts in this group. Weight Watcher Bifidus in turn cost more than the private brands fermented with bifidus or casei and more than the Calcium-rich yogurts. The median price for Sveltesse Calci-N is also higher than the median prices for private brand yogurts fermented with Bifidus or Casei, of which Casei is slightly more expensive. The basic plain yogurt from Danone without any health communication; Danone nature, is sold at the same median price as the private brand Casei-yogurts and Yoplait's Oligo (Sodiaal) is sold at the same price as the private brand Bifidus-yogurts. The least expensive product from the health sphere is Taillefine from Danone.

Flavored and fruit yogurts are priced in a similar way. However, the fruit yogurts are more heterogeneous concerning the basic product. The right column of table 4.3 shows that the pff brand "Bio" is the fruit yogurt that has generated the highest median prices. "B'A" and a yogurt positioned in the universe of "pleasure" without health communication; "Panier de Yoplait" (basket of Yoplait), follow on the second place. The fourth highest median price is generated by "Weight Watchers Bifidus". "Danone et fruits" (Danone and fruits), the pleasure of fruit yogurt from Danone has the fifth highest median price in this study and private brand flavored and fruit yogurts fermented with bifidus (two observations) are price below all other similar yogurts fermented with bifidus, generating the sixth highest price among fruit and flavored yogurts. "Sveltesse fruit et fibres" and "Taillefine" are sold at the same median price as the private brands fermented with bifidus.

Table 4.3 Median prices for pff, pff-like and conventional plain and fruit yogurts

Milk drink	Median Price	Plain yogurt	Median Price	Fruit yogurt	Median Price
Yakult	41	Bio	14	Bio	21
Actimel	31	B'A	14	B'A	17
B'A Force	30	LC1	14	Panier de Yoplait	17
Go LC1	24	Weght Watcher	13	Weght Watcher	16
Action Forme	22	Bifidus		bifidus and fibers	
		Sveltesse Calci-N	13	Danone et fruits	16
		Private brands	12	Private brands	15
		Casei		Bifidus	
		Weght Watcher	12	Sveltesse	15
		bifidus and fibers		Fruits et Fibres	
		Danone nature	12	Taillefine	15
		Private brands	11		
		Bifidus			
		Oligo	11		
		Taillefine	10		

Two yogurts-like health positioned products generate as high or higher medium prices per 100 cl product than the pff that have been observed. These are soy based yogurt-like products positioned as vegetarian alternatives to milk based products. The two brands are Sevea from Danone and Sojasun from Triballat dairies. Their median prices are 27 Ffr for Sevea and 20 Ffr for Sojsun.

Also products designed for children, containing toys or toy-like packages generate higher prices, per 100cl of product than the pff.

## 4.5 Occurrence of pff

Products from the brands identified as pff occur in all stores visited in the study. The two products that most frequently were found on the shelves are Actimel and Bio, both from Danone and both observed in all the retail chains. B'A and B'A Force were observed in most chains but not in Leader Price and E. Leclerc. B'A Force was also absent from the shelves in Casino, Carrefour and in G20. Go LC1 and LC1 were observed in only three chains each. The milk drink Go LC1 was present on the shelves in E. Leclerc, Auchan and Carrefour whereas the yogurt LC1 could be observed in E. Leclerc, Monoprix and Carrefour. Yakult were observed at two occasions, in Monoprix and in Carrefour.

The occurrence of pff and private brand pff-like products is illustrated in figure 4.3 in the observed retail chains. The table shows that Carrefour is the richest chain in pff where as LeaderPrice is the chain where pff are the least abundant. Both these chains, and Intermarche, have two pff-like products that belong to their own brands, copied from some of the pff-products. LeaderPrice is further the only chain to have a substitute to the national brand fermented milk drinks.

After the hypermarket Carrefour, the supermarket Monoprix has the widest offer of pff. Two of the supermarket chains, Atac and G20, did not present any private brand pff-like products during the observations.

	Monoprix	E.Leclerc	Intermarche	Champion	LeaderPrice	Casino	Carrefour	Atac	Auchan	G20
Actimel	x	x	x	x	x	x	x	x	x	x
Bio	x	x	x	x	x	x	x	x	x	x
B'A	x		x	x		x	x	x	x	x
B'A Force	x		x	x			x	x	x	
Go LC1		x					x			
LC1	x	x					x		x	
Private Brand bifidus/ casei	1b	1b	2b	1b	2b	1b	1b+1c		1b	
Yakult	x						x			

Figure 4.3 Occurrence of pff and pff-like private brand in the observed retailing chains.

Eleven pff-like private brands products were observed from eight of the ten retail chains. However, the number of facings in the stores of private brand pff-like products is significantly inferior to the total number of national brand pff products. On a few occasions the number of private brand pff-like products equaled the number the products they compete with, but in most of the observations only one of the pff products alone outnumbered the pff-like private brand products. The highest number of facings on the shelves have Bio and B'A followed by B'A Force and Actimel.

## 5. Discussion

The results from the store inventory demonstrate that there is a market for pff and pff like products. It also shows that manufacturers are superior to retailers in producing and branding pff, considering product innovation and market share as well as building strong brands with their own identity. This chapter comprises analyses, meant to shed light on the hypotheses presented in section 3.6. The main hypotheses are:

1. It can be assumed that the *brand structure* in the ultra fresh dairy segment is different among the pff products than in the entire segment.
2. It can be assumed that manufacturers *demand higher prices* for pff than for regular products.
3. Since *retailers differ in profile*, pff are likely to be more abundant in certain retail chains than in others. Pff is probably a *successful strategic area toward retailers with a differentiation strategy*. Such retailers would stress on offering their customers a wide range of quality products with high service and provided that manufacturers are capable of matching those chains needs, pff could be an importance group of products to these retailers. Concept stores, with *focus differentiation strategies* such as health products, would possibly be another good buyer target.
4. It could be assumed that *smaller companies* without strong market positions have developed pff and that the smaller companies or the products have later on been acquired by more established companies with access to distribution channels, strong brands and substantial resources for the product launch.

### 5.1 Brand structure

It seems as if manufacturers can enhance their bargaining power when producing pff both by altering the brand structure and by obtaining higher prices for their products. The brand structure in the investigated segment is clearly different from the one in the dairy segment as a whole. There are seven pff, and a range of pff-like products, but none of the products identified as pff belong to a private brand, though 62 private brand products out of 115 totally, were observed in the fresh dairy segment.

The pff are differentiated in several dimensions, both between and within the brands, for example through the specific pff features. Different ways of intended consumption and additional health related features, such as contents of fibers, vitamins and minerals have also been observed. Most of the pff exist in more than one variety, altering the flavors available and the size and design of packing. During the study new varieties in flavor appeared among the products, indicating that the segment is growing.

Though the pff features are similar in that they all concern the intestinal flora, the obtained effect is formulated differently for the consumers from one product to another. (“For a good start of the day”, Yakult and “Reinforce the organism”, Actimel) The claims are somewhat vague though, probably because it is forbidden in Europe to directly claim that a foodstuff cures a sickness. The solution several manufacturers have chosen is to both explain the role of the intestinal flora and then suggest that the product affects the flora in a positive way.

Retailers also show interest in the health related segment. A total of ten private brand pff-like yogurts and one milk drink were observed in eight of the ten retail chains. Retailers have been able to create both products with bifidus and products with casei. Still their products include far less health value added than the pff and are sold at significantly lower prices. They also

appear less frequently in the investigated stores with fewer facings than the pff throughout the investigation and not one of the products qualifies as state of the art products. They have instead been classified as pff-like products, since they could be substitutes to and compete with the original national brand pff products.

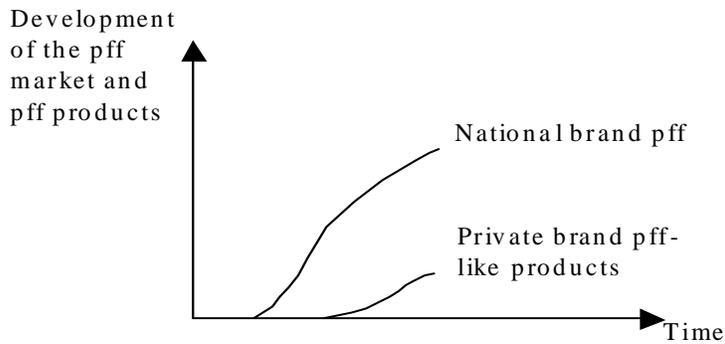
There are several similarities between these two groups of products, and the pff-like private brand products were often found next to or below the pff on the shelves. This might lead consumers to assume that a private brand pff-like product offers the same or a similar benefit as a pff and it is clear that these products compete with the national brand pff.

There are important and obvious differences though, between the pff-like private brands and the national brand products defined as pff. The private brand products resemble each other considerably and are less differentiated than the pff; without elaborated product design and with few varieties of packing and flavors. Moreover, and more important is that communication concerning the products' health features is rare among the private brands. Even as the ingredients in these products appear to be the same as in the pff, the health values is much lower due to the private brands' lack of scientific evidence about a specific health benefit. No claims or information about the products' or the bacteria's properties is presented, and none of the eleven private brand products containing probiotic bacteria suggest that health benefits could be achieved from the product.

There was no observation of advertising campaigns highlighting a specific pff-like private brand product. This might be explained by the fact that, as opposed to the national brand pff and pff-like products which all are the core products of their respective brands, all private brands pff-like products are part of the store wide brands.

Among the national brands with a health image, the most advanced and elaborated, the pff, seem to be better protected against competition from private brands than those with less distinctive properties. The former generate higher prices and/or are more abundant in varieties and facings. Due to the lack of specific health arguments, the yogurt "Weight watchers with bifidus and fibers" for example, is less distinguished from private brand yogurts fermented with bifidus, than the pff even as "Weight watchers with bifidus and fibers" has a strong health image. It does not generate a price difference as high as the pff, and there are only two flavors. A second pff-like national brand product was observed, Bifiline by Danone, but only on the very first occasion of observance throughout the whole investigation and it does not seem to be part of Danone's regular product line after that occasion. The only manufacturer that successfully produces a pff-like dairy product fermented with bifidus is Senoble, the leader in private brands, producing "Weight watchers with bifidus and fibers". Other manufacturers have either developed products with a higher health value or chosen not to enter the health related dairy segment. In this study it seems as if pff offer manufacturers more success the more advanced they are.

Retailers make significant efforts to differentiate their products and to build strong brands. Examples are the regional product brands "Reflets de France" (reflections of France) and "Nos regions ont du talent" (our regions are talented), but concerning the development of health related products they are far behind manufacturers. Presenting poorly defined copies of pff, retailers have not been able to create pff, not even pff-like products with strong identities, despite the potential characteristics they include. The private brands pff-like products can be described as a *second generation* of health related products, launched in a second stage of the development of the pff market, as vague and quality weak copies of the original pff products. Figure 5.1 illustrates the relation between the two groups of products on the French market from a time perspective.



Figur 5.1 Two generations of yogurts with probiotic ferments.

## 5.2 Prices

The median prices for pff are higher concerning all products in all retail chains, when compared to products of the same base as the particular pff. The milk drinks, generating the highest prices of all products in the study, has the widest spread of prices but for the two most frequently observed products Actimel and B'A Force, the differences in median price is only one Ffr. According to this study Actimel, Bio and B'A are the products that generate the highest turnover to their producers considering price, frequency in the stores and number of facings on the shelves. Yakult is sold at a much higher price, than the rest of the products, but it was only observed on few occasions (2) and not estimated to have much market share. Go LC1 on the other hand is sold at a considerably lower price than the other national brand pff, only two Ffr more expensive than the pff-like Action Forme from LeaderPrice. It was observed only on three occasions and is hardly a great success for Nestlé.

The reason for this might possibly be sought in the communication policy that promotional campaigns surrounding the product at launch. The claimed health effects from consuming the product presented by Nestlé were considered questionable and even untruthful by French authorities. The claims had to be reformulated and it could be that an innovative effort to stretch the limits of what could be claimed, concerning food products properties, undermined and eroded the credibility of the product. It seems that the brand loyalty was too damaged to hold a premium price and maybe it has not been completely recuperated ever since. One of the most difficult aspects of developing successful pff is probably to ensure that consumers really have confidence in the products. It might be that Nestlé, traditionally not positioning their products as healthy, miscalculated the risk of losing consumers confidence, from the start, and then have not been able to reestablish it, wherefore this pff has lost much of its power to hold a higher price and thereby also some of its strategic value.

This could be seen as an example of how delicate the trustworthiness of these products is. If a product, with a competitive advantage that is built on a very specific value, fails in delivering this particular value the whole product seems to lose its *raison d'être*. In a longer run and a wider perspective it can be important for the evolution of the pff market that manufacturers are sincere and that they carefully manage consumers trust for manufacturers' ability to create truly health promoting products. Deducted from the possible logic in the example above, it could even have been reasonable to spend more time and resources assuring every detail around a product before launching it, rather than adventuring the future of the whole market.

Concerning the yogurts, all fruit yogurts with some kind of health image are sold at median prices higher than any of the plain yogurts, indicating that the pff-feature does not hold an unlimited value for consumers. However, among the plain yogurts the national brand pff are all sold at higher price than the pff-like private brands. Even a calcium enriched yogurt, Sveltesse calci-N, without probiotics hold a higher price than both kinds of private brands containing probiotics and Danone's generic plain yogurt generates the same median price as the private brands fermented with Casei, which are one Ffr more expensive than the private brands fermented with Bifidus. Among the fruit yogurts, Bio from Danone is sold at a median price superior over all other yogurts and B'A is the second highest priced yogurt. The private brand pff-like fruit yogurts fermented with bifidus are sold at the same price as calcium-rich fruit yogurts, indicating that national brand yogurts with a non-specific generally healthy food image generate the same price as the most advanced private brand products, concerning health feature and flavor.

It is remarkable that Actimel and Bio were observed in all the investigated chains. Since the volumes sold of this kind of products are relatively low, the total market for pff only represent a few percent of the total food market, it does indicate that retailers are keen on presenting these products despite of costs for handling another item, which does not represent an important share of the total income. For Danone, the leader in the fresh dairy segment and all subcategories, pff seem to have been a successful strategy and a natural part of its overall orientation towards health and well-being.

B'A, the second pff brand according to this study, was observed in retail chains from all purchasing center with the exception of Lucie where, at least at its launch, it also was accepted. B'A is a well-established product with ten flavors and eleven varieties of packaging. It was launched in 1988, when Besnier acquired the brand. B'A is the only brand that Lactalis produce in the ultra fresh dairy segment and it seems for Lactalis, considering obtained price for the products and abundance in the stores, that this strategy has been successful.

LC1 was observed in four of the five purchasing centers, though only in four retail chains. Go LC1 was observed only on two occasions despite considerable communication around the products and a lower more accessible price. Maybe this weak result obtained by Nestlé to a certain extent can be explained by the difficulties surrounding the promotional campaigns, described above.

### **5.3 Retailers**

It can be noted that in the hard discount LeaderPrice, only Bio and Actimel were observed among the pff. Further, two pff-like private brand products were observed in this hard discount. It is interesting that the hard discount LeaderPrice, Carrefour, with the highest number of subcategories in the segment - alone in employing one called bifidus, together with Intermarché, the retailer presenting the highest number of brands in this study, are the only retailers to carry two private brand pff-like products. None of them belong to the same purchasing center but despite difference in profile, they all carry much private brands; LeaderPrice is the retailer with the highest ratio of private brands in the study, Intermarché has the second highest ratio of private brands and Carrefour has the highest ratio among the hypermarkets. This indicates that both diversified and low price retailers make efforts to create health related private brand products. However, they may do so for different reasons and in different ways; the diversified Intermarché and Carrefour may want to offer their clients a range of private brand products as wide as the range of national brand products, whereas LeaderPrice rather have substituted the original national brands with its private

brands. LeaderPrice is the only retailer to carry a milk drink pff-like private brand; Action Forme, fermented with *L. casei*, and it can be concluded that the pff have been a more valuable strategic area for the manufacturing industry towards the diversified retailers with emphasis on customer service and product quality, than towards retailers with a low price policy.

Figure 4.3 further strengthens this reasoning and shows that all pff were observed in Carrefour. The products were observed on specific shelves for products with bifidus, even those that are fermented with something else. There were also two private brand pff-like products, both were yogurts, but fermented with different bacteria. Carrefour has invested both shelf space for this category of products and created pff-like products themselves. However, the pff-like yogurts are sold like all the other private brand pff-like yogurts, as products somewhere between normal food and healthy food, and the pff are much more abundant in the stores.

Monoprix is one of the most differentiated supermarkets, according to the results presented in figure 4.1. It also presents most of the pff among the supermarkets, all but Go LC1. Referring to Monoprix as the most diversified retailer and LeaderPrice, the retailer where the private brands are the most abundant, it seems as if pff is a more successful strategic area if the efforts to commercialize such products are made with reference to buyer selection, where the best suited and least powerful buyers are targeted for the products.

#### **5.4 Manufacturers of pff**

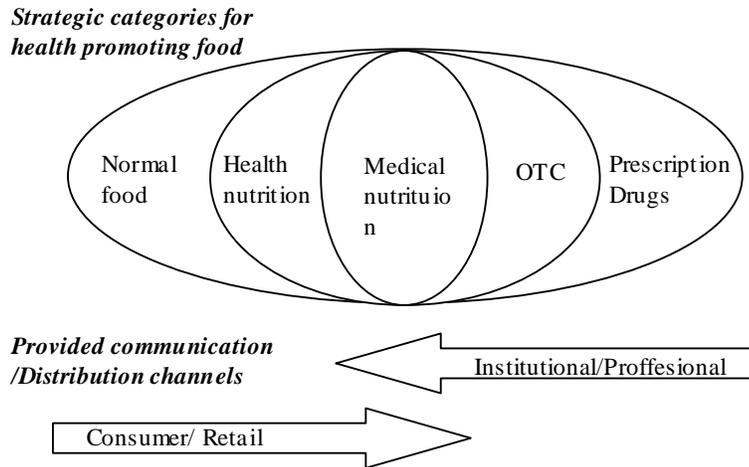
Concerning the manufacturers that produce pff, there are four actors on the market. Three of them are among the four largest food-manufacturing companies in France, and also among the four largest actors in the ultra fresh dairy segment. The fourth is a relatively small actor on the French market, a Japanese multinational manufacturing company called Yakult Honcha. The French companies are two multinational giants Danone and Nestlé France (Nestlé), and the multinational dairy Lactalis.

Danone, that has incorporated the health aspect of food into its core strategy, has developed its two pff products in-house. The Japanese company has also developed its own product, whereas Nestlé and Lactalis (Besnier at the time) have acquired the smaller companies that ones developed their pff brands. Valmont once developed the brand B'A and Chambourcy developed LC1.

A fifth actor on the fresh dairy market, Senôble, is the second manufacturer of private brands in France, after Lactalis. It also manufactures one of the most pff-like products, "Weight Watcher Bifidus and Fibers", on a license. Senôble is a national company.

#### **5.5 Positioning of healthy food**

Health promoting food can be positioned and sold in different strategic categories. Among the pff-like products in the study, some products contain properties that potentially could be exploited and used to create pff, with a guaranteed health value added to consumers. These products are, like the pff, yogurts fermented with *Bifidus Actif* or *Lactobacillus Casei*, described in the groups; one, three and four in figure 4.2. It could be that the national brand pff-like and the retailers' pff-like yogurts have the same qualities as the pff, but unless they are presented with scientific documentation demonstrating some medical effect, the products would not be perceived as pff. The difference between retailers' pff-like products and the pff can be described in figure 5.2.



*Figure 5.2 Possible positioning of health promoting food (freely after personal communication Nyström, 1998, in Mark-Herbert, 17).*

Products positioned in one of the three categories distributed by the retailing industry, in figure 5.2, are in this illustration separated by how the products are positioned. Packaging solutions, pricing policies and the different kinds of communication that follow the products separate them even if they appear to contain the same ingredients. When a product with a pff potential is sold with health arguments documented by a scientific institution, the product correspond to what here is called medical nutrition and it matches the criteria for pff. Pff-like products including some health arguments, without specifying a documented medical benefit are here categorized as health nutrition. In this study, retailers' pff-like private brands that only indicates the presence of a certain ingredient fall somewhere between the health nutrition category with explicit health arguments and normal food, sold without particular health communication. This results in a perception of the private brand products as less value added substitutes to the national brand pff.

As all retail chains claim they want to create strong brands with products generating strong consumer loyalty, it could be assumed that the pff-like private brand yogurts are intended to fully compete with the national brand pff. However, the results from this study indicate that retailers despite their size have not yet been powerful enough to make manufacturers produce full value pff product to their private brands. For the time being manufacturers are superior in producing and marketing these products. However, these products do not seem to be of such importance yet that they unequivocally can be used as a strategy to influence the overall power balance between a manufacturer and the retailers.

## 6. Conclusions

The objective of this master thesis is described as to identify and assess the value of pff as a strategic area for food manufacturers in vertical competition with retailers. This section accounts for responding to the four questions presented in section 1.3.1, and the identified and assessed strategic value of pff as a strategic area is concluded.

- 1) What fundamental factors create strategic value in vertical competition?
- 2) How do private brands affect vertical competition?
- 3) What characterizes food manufacturers producing pff for retailers?
- 4) How can food manufacturers enhance their bargaining power toward retailers by creating pff?

### *1) What fundamental factors create strategic value in vertical competition?*

Strategic value in vertical competition is created by factors affecting the bargaining power between competitors. Some of the factors increase or decrease buyers' bargaining leverage, see figure 6.1, whereas other affect buyers' price sensitivity, see figure 6.2. Bargaining leverage and price sensitivity are the two compounds forming bargaining power.

Figure 6.1 Factors affecting bargaining leverage

Buyer concentration
Product differentiation
Buyer information
Capability to influence purchasing decisions
Threat of backward integration
Switching costs

Figure 6.2 Factors affecting price sensitivity

Product differentiation
Buyer information
Purchases' representation of buyers' costs
Buyer profits
Impact on buyers' quality or performance

### *2) How do private brands affect vertical competition?*

Private brands bring new capacity to the market. They extend the supply, and compete with other brands for market share. In the store inventory private brand products were often placed on the shelves next to the national brand products they compete with, offering a substitute to a lower price. They also give retailers control over new activities and new markets in the food industry and strengthen retailers' structural position. Retailers can create private brands either through backward integration or in partnership with a manufacturer, if the retailer is in a position to find someone to produce its private brand. Especially in the first case, the retailer gains important information about conditions in the production process, which may be used both to reinforce its bargaining power when negotiating prices and other terms of trade, and to affect the consumers' purchasing decisions. Private brands thereby enhance retailers' overall power in the food sector.

Retailers take out higher margins on private brands than on national brands, still private brands are consistently less expensive. This indicates that some costs for the products not are

covered in the price paid to manufacturers and it can also be assumed that thereby some of the product characteristics are excluded. However, this practice can erode manufacturers' profitability if they are unable to sell their products with full coverage for the costs of producing them.

The private brands seem to often be purchased for its price and by habit rather than by preference of the product itself. Private brands might somewhat dilute the power of branded products if retailers' private brand copies are blurred and vague, and as in this study resembling the original products but not surely containing the same differentiating properties. From certain aspects the products are very similar, but from others they are more or less different. This may possibly confuse consumers when evaluating the products' qualities and even erode the consumer confidence for the original products as the effect may dilute the credibility of and the loyalty to the branded products. However, this would have to be verified in further studies before such speculations can be confirmed.

### *3) What characterizes food manufacturers producing pff?*

All the four manufacturers present on the pff market in the ultra fresh dairy segment in France are multinational companies. Three of them are French; Danone, Nestlé France and Lactalis, and one is a Dutch subsidiary to a Japanese manufacturer; Yakult Netherlands. None of the two multinational giants Danone and Nestlé France have been found among the top five producers of private brands. However, Lactalis, a somewhat smaller dairy but with sales of its cheese in over a 100 countries, is the leading producer of private brands in France.

The national dairy, Senôble, producing the pff-like products "Weight Watchers bifidus and fibers" (license from Weight Watchers) is the second largest producer of private brands. It looks as if this national company lacks the strength to create its own strong brands and also to create state of the art pff. Within the frames of this study, it has not been possible to find out whether it has been forced to this strategy due to its inferior size, or if it is the result of its own initial intentions. It can be noted though, that the only company to produce national brand pff-like products, without investing enough to create real pff, is a smaller company that has been attracted by the idea of private brands and chosen to produce for the retailers instead of its own brands.

### *4) How can food manufacturers enhance their bargaining power toward retailers by creating pff?*

All manufacturers of pff have been able to increase the consumer prices for pff compared to comparable products without the pff qualities. To a certain extent, even pff-like products seem to generate higher prices than products without health characteristics, though this is less significant.

The retail chains all proclaim they want to enter a new era of private brands with innovative and differentiated products. However, in the most fast growing segment of ultra fresh dairy category; health related food, not one of them has been able to create any state of the art products and the brand structure in the pff segment is very different to other parts of the food and the dairy sector.

Danone has chosen to include the creation of health and well-being in to its core strategy and has become the leader in this pff segment. Its pff-activities could be seen as a positioning strategy where the company has matched its competences to its environment in order to find a position where it is strong in comparison to other competitors. Danone's and the three other manufacturers' efforts to create a new segment, where retailers at present are absent and

incapable to create competitive products, could also be seen as a strategic area, intended to influence the balance of the competitive forces, where Danone is highly successful.

Nestlé's efforts in the segment are less successful than those of Danone. With less convincing products, maybe due to careless launch procedures with unapproved slogans, Nestlé's products LC1 and Go LC1 are less abundant in the retailing stores and support significantly lower median prices than the other pff in the category, despite considerable resources spent to support the products.

Lactalis has also been successful in creating its pff brand B'A with two products and a number of varieties in flavor and packing. Though this manufacturer produces a great number of private brand products, it has been able to persist producing products with the pff qualities.

Yakult is the smallest pff in this investigation, but sold at the highest price. The manufacturer has chosen to position the product as the premium price probiotic milk drink and this should be a contributing factor to the low volume. However, it has been noted after the period of the empirical study that a light version of this product, Yakult light, has been launched. This is also the case of Actimel, where a product called Actimel light was launched some time after the collection of empirical data.

Pff as a strategic area is still quite narrow, as only four manufacturers out of eleven, and only seven products out of 115, are present in the pff segment of the ultra fresh dairy category. Despite strong growth predicted in the segment, pff products represent rather limited volumes and it could be assumed that pff generally is an investment with a return on investment over a considerable period of time. Pff also demands substantial resources to develop, but for those manufacturers successful in developing pff products, it seem pff constitute a strategic area providing protection against retailers' power. All manufacturers present in the segment, with the exception of Nestlé's with the brand LC1, have been successful in marketing its products after the launch.

The manufacturers are outstanding in creating and marketing pff. Retailers have presented vague, low value added copies of the state of the art health related products to compete with the pff, but these products are less frequent and sold at lower prices than the pff. None of the manufacturers with capacity of producing pff, not even Lactalis; producing both private brands and its own multinational brands, has been forced or tempted to produce any pff for retailers and it seem as if pff are well protected against retailers' bargaining power.

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