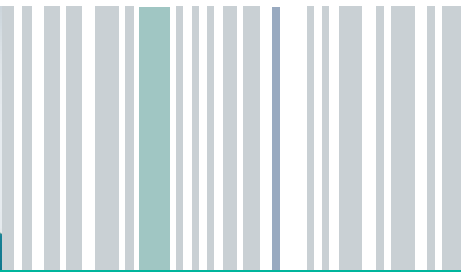


## Management Summary

Study: The bargaining power  
of commerce and industry



## Management Summary

### Aims

The brief for this study was to examine the relationship between commerce and industry in Germany on a scientific basis in order to answer, in particular two interrelated questions: Can one speak of commerce having, in general, excessive bargaining power? And what is the market situation regarding the respective power of industry and commerce to influence supply and demand? The survey focused on the following key aspects:

- Structural conditions both on the side of the producers and on the side of the commerce sector: In the present study, for the first time, a comparison was made on the basis of empirical data to determine the respective positions of large producers and retailers as well as of small and medium-sized enterprises (SMEs) in a total of 22 segments (product groups) of the food sector.
- The influence of consumer requirements on the bargaining process between industry and commerce: The study investigates to what extent industry is able to influence – through the strength of its brands – customers' expectations concerning product range.
- The benefits and advantages of own-brands in retail: A theoretical analysis was carried out to determine to what extent own-brands are the necessary complement to producers' brands and to what extent they enhance the benefits of the division of labour in a national economy, thus contributing to social welfare.
- The state of discussion in the European Union: In addition the study makes reference to the current European debate on the issue of bargaining power.

### The term “bargaining power”

The study regards bargaining power and market power as distinct issues. “Bargaining power” refers to the ability of persons in economic organisations with a demand for products or services to introduce a bias in the conditions of the transaction so as to advance their own corporate goals vis-à-vis their counterparts in the supplier organisation.

It is essential to distinguish the term “dominant market position” and/or “market power” from the term “bargaining power” as defined above. The latter refers to individual bilateral relations between a demander and a supplier. On the other hand, the term “market power” refers to the general position of a supplier or demander in a given market.

**The term “bargaining power” must be defined precisely.**

### No need for further regulations

In Germany, the Law against Restraints of Competition (“Gesetz gegen Wettbewerbsbeschränkung” – GWB) regulates the relationship between commerce and industry by prohibiting the abuse of a dominant market position and/or preventing company mergers which would lead to a dominant market position.

The debate on the “bargaining power” of commerce in Germany includes consideration of the aim of establishing a “Code of Conduct”. Furthermore, discussions at EU level have a bearing on the issue of the supposed “bargaining power” exerted by the German food retail sector. In this context the following developments are of particular importance:

- The development of a Code of Conduct as a basis for enhancing cooperation between commerce and industry;
- The establishment of an ombudsman;

- The partial introduction of vertical price fixing in the run-up period, the establishment of price information systems, and determination of the profit margin for products at different stages in the value-added-chain (e.g. in the case of milk);
- The determination of market shares with special consideration of the delimitation of the relevant market;
- A check of the negotiation of terms and conditions concerning the rules applicable to slotting fees;
- A study of the development and impact of own-brands.

**As regards the debate on the introduction of new regulations, the present study comes to the conclusion that there is no need for any such measures. The existing legal requirements are sufficient.**

### **Commerce as the intermediary between industry and consumers**

As a further basis for discussion, we must consider those functions of commerce which concern three key aspects: the flow of goods, the flow of communication and the value stream. In this context, the role of commerce in the formation of product ranges must be underlined. Bearing in mind customer needs, retailers bundle the products supplied by producers. Thus, the number of necessary direct contacts (i.e. without an intermediary) between industry and the end consumer is reduced considerably and so are transaction costs, which in many segments frequently amount to over 50% of the total costs (Baligh-Richartz effect).

**The commerce sector fulfils a key function as an intermediary between producers and consumers and therefore makes an important contribution to the economic efficiency of the market. Furthermore, the commerce sector is the conveyor of customer needs and expectations.**

### **Definition of markets in the food retail sector – alternative distribution channels available to industry**

In order to perform an effective analysis of competitive conditions, it is essential to define the relevant markets. The sheer magnitude of the sales potential available to industry outside the commerce sector, also for central product segments, then becomes apparent. Food services catering for businesses in the so-called “away-from-home” consumption market (e.g. restaurants, cafés) have higher growth rates than the stationary food retail sector. A similar picture is found in the export sector. In the case of various product groups, only a small percentage of the available quantity of goods is sold through stationary retail outlets. For a large proportion of the products, other distribution channels are used. Thus, producers can cater for demanders outside the mainstream food retail sector (i.e. other than hypermarkets, consumer markets, supermarkets, discount stores, chemists). More specifically, the following categories of demanders must be taken into account:

1. Specialised retail outlets and other businesses in the retail sector (e.g. beverage markets, greengrocers, petrol station shops, kiosks, etc.);
2. Food services catering for consumption away from home (e.g. restaurants, canteens);
3. The food processing industry;
4. Exports.

**Defining the markets concerned is of paramount importance in determining “bargaining power”. In addition to the different types of businesses found in the retail sector, the study takes account of away-from-home-consumption as well as of the food processing industry and the export sector.**

### Structural analysis of the food sector

An analysis of the market structure of industry and commerce shows, first of all, that a sweeping comparison of medium-sized food industries with food retailers in Germany basically jumbles together very different realities. The vast majority of businesses in the food industry (with the exception of large multinational "multi-brand" and "multi-product-group" companies) limit themselves to a single product group or a small range of product groups. It is therefore up to the retail sector – through its "product group function" – to bundle different product groups.

**In view of the above, a comparison between food businesses with turnovers worth billions and food producers operating on a much smaller scale lacks coherence.** If we look at individual product markets (e.g. alcoholic beverages, confectionery, or washing and cleaning products), we find the following situation: The five largest producers often account for more than half of the total amount of products available (domestic market availability) in the respective product group. In contrast, the market shares of the five largest retail companies are to be found outside the "critical area". This aspect was investigated for all important product groups in the food market and partly also for individual types of products. **It was found that the market shares are on the whole balanced.** Thanks to these largely balanced relationships, consumers can rely on stable and – by comparison with other European countries – relatively low food prices.

### Consumer expectations

The results of the consumer survey show that retail businesses must fulfil the expectations of consumers when compiling their product ranges. Thus, they are obliged to include numerous so-called "must-stock products", i.e. products whose exclusion from the product range would have negative consequences for the business results of the retailer, because consumers expect those products to form part of the range. By means of diverse advertising measures and/or the introduction of numerous new products, producers strengthen consumer loyalty and therefore improve their position in the bargaining process with retail businesses. The producers of must-stock products are mostly large, international companies with several brands; but some small and medium-sized enterprises also have must-stock products. Furthermore, consumer expectations about the depth of product ranges are generally high. Even when an individual customer requires only a limited selection for a given product group, the brands he or she expects to find are often different from those required by other customers. In consequence, the retailer is obliged to provide a product range with great depth and a wide choice. This situation may – and often does – negatively influence the bargaining position of the retail sector vis-à-vis businesses in the food industry.

**Consumers expect to find certain products in the product range (must-stock products). Furthermore, they expect a very considerable depth of product range. There is a tendency for these consumer expectations to lead to a weakening of the position of the retail sector vis-à-vis industry.**

### Own-brand policies in the commerce sector

Own-brands are also important competitive instruments. In some cases the commerce sector is "predestined" to implement an own-brand policy because it knows what customers require, it can readily assess the acceptance of own-brands by customers, and is in a good position to close gaps in supply as well as to break monopoly positions in the industry by awarding production contracts. Own-brand products are often considerably cheaper than branded products and offer end consumers an advantageous and low-cost alternative to other products in the product range of retail businesses. Frequently, the commerce sector awards the contracts for the production of own-brands to medium-sized businesses. This allows medium-sized industries to intervene in the production process and to benefit from it.

## **Own-brands have a positive effect on the social welfare of consumers.**

### **Conclusions**

A generalised imbalance of (bargaining) power in favour of the retail sector in the area of Fast Moving Consumer Goods (FMCG) does not exist. The results of the market structure analysis as well as the insights of the consumer survey show a varied situation. Thus, sweeping notions such as “strong commerce versus weak producers” must be flatly rejected. The discussions should follow a more differentiated approach – for instance, by taking into account bilateral producer-commerce relations or examining the situation in regard to individual product types.

In summary, the results of the study lead to the following conclusions:

- “Bargaining power” should be clearly defined as a term which refers to the bilateral relationship between an individual retailer and an individual supplier. There is no “blanket bargaining power” of the commerce sector.
- Apart from the food retail sector, producers have at their disposal a large variety of alternative distribution channels (e.g. food services, the export sector, etc.) which are becoming increasingly important in quantitative terms.
- Producers are specialised in individual segments, whereas the food retail sector bundles many product groups. This means that the latter plays a crucial role as an intermediary between industry and consumers. Therefore, producers and retailers cannot be compared as such.
- In none of the product/goods’ groups under investigation does a situation that could be described as “weak industry versus strong commerce” exist.
- Therefore, there is no further need for regulation. The existing competition law is sufficient.
- Moreover, as a result of the generally balanced relationship between producers and retailers, consumers are able to benefit from relatively low food prices and high price stability.
- The commerce sector is the conveyor of costumers’ expectations. Customers expect to find a large number of so-called must-stock products, which retailers must include in their product ranges. These are exclusively branded products.
- The producers of must-stock products are mainly large, international companies with several brands. But also small and medium-sized businesses produce must-stock products.
- Accordingly, suppliers of must-stock products are in a favourable bargaining position vis-à-vis commerce businesses.
- As a general rule, consumers expect to find a significant depth of product range, regardless of the type of retail outlet and/or retail format concerned.
- The own-brands of retail businesses – as distinct from branded products – constitute an effective additional means of meeting customer expectations as regards the availability of a varied, regionally differentiated and attractively-priced range of products. Medium-sized businesses benefit from the contracts awarded by retailers for the production of own-brand products. Price alignment between branded and own-brand products leads to further benefits in terms of social welfare.