HDE
German Retail
Federation

Some facts about
the bargaining power of commerce and industry



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Contents

Some facts about

the bargaining power of commerce and industry

A current scientific study has confirmed that:

- The markets are functioning effectively;
- The retail sector has no one-sided bargaining power;
- Consumers benefit from the existing market situation.

The retail sector brings together the various players in industry and is therefore part of a complex value-added chain of producers, food industry and suppliers, all of which aim to meet consumers' needs. The retail sector's core competencies lie in the procurement of goods, the bundling of ranges of goods, and distribution. The retail sector acts in an extremely competitive environment at the local, national and international levels.

Comprising some 3.8 million retail companies, the European commerce sector has a yearly turnover of 2,700 billion euros. 500 million consumers in the EU rely on the services of retail outlets. In Germany alone, the retail sector with its 2.6 million employees generates a yearly turnover of 400 billion euros. 50 million customer contacts testify to the outstanding importance of the sector as a link between producers and consumers.

As a key player in an area which is of central day-to-day importance to consumers, the retail sector is a focus for political decision-makers. This results in policy debates on the evaluation of market structures and market development in the retail sector from the point of view of competition policy and competition law, as well as in political initiatives at European and national level. The discussions focus particularly on the question of what measures, if any (e.g. code of conduct, price monitoring), might be necessary in the context of a supposed bargaining power of the commerce sector.

Against this background, the HDE has secured the services of the renowned Institut für Handelsforschung (Institute for Retail Research – IfH), based at the University of Cologne, as well as of the consulting firm BBE Retail Experts, to investigate the relationship between industry and commerce. It is hoped that the results of this analysis of key aspects of competition policy will contribute to promoting a more objective debate.

The most important finding of the study is that a general bargaining power of the commerce sector does not exist. The players in the retail sector and manufacturers act in an intensely competitive and generally well-functioning market. As a result of an intense negotiation process between these players, consumers benefit from a large variety of quality products. This fact is confirmed by the results of a market structure analysis conducted specifically for this purpose as well as by the findings of the consumer survey which forms an integral part of the study. Both tools show extremely differentiated market situations which arise from competition.

The commerce sector reduces transaction costs for producers and consumers alike

The retail sector contributes significantly to the reduction of transaction costs for producers as well as for consumers. The benefits result mainly from the bundling of product ranges to the advantage of the consumer and the provision of distribution services to the advantage of the manufacturer. Thus, the retail sector contributes to enhancing efficiency and fostering social and economic prosperity.

The examination – in the framework of the study – of a number of key factors relevant to consumers, such as choice, quality, price, variety and accessibility of products, highlights the outstanding performance of the commerce sector.

The German food retail sector largely ensures steady prices. In recent years, food prices have mostly evolved at a slower rate than the general consumer price index.

Because of the high density of retail outlets, the commerce sector is able to offer comprehensive access to its products. With some 6,200 consumer markets, 15,500 discount stores and 13,000 supermarkets, including 10,000 independent retailers, the German food retail sector is a comprehensive and varied distribution network.

The number of products on offer has increased since 2000 in all product groups and all types of businesses. The average number of articles on offer is approximately 50,000 in hypermarkets, 10,000 in supermarkets and 2,000 in discount stores. Product variety has significantly increased. In the personal care/cosmetics segment alone, some 2,000 new articles have been added since 2003. The „dairy products" and „confectionery/chocolate products" ranges have each been increased by approximately 1,000 new articles.

The commerce sector is in a permanent state of flux, which is driven not least by the changing consumer requirements. This process of development has been and still is associated with concentration processes both in the commerce sector and among producers.

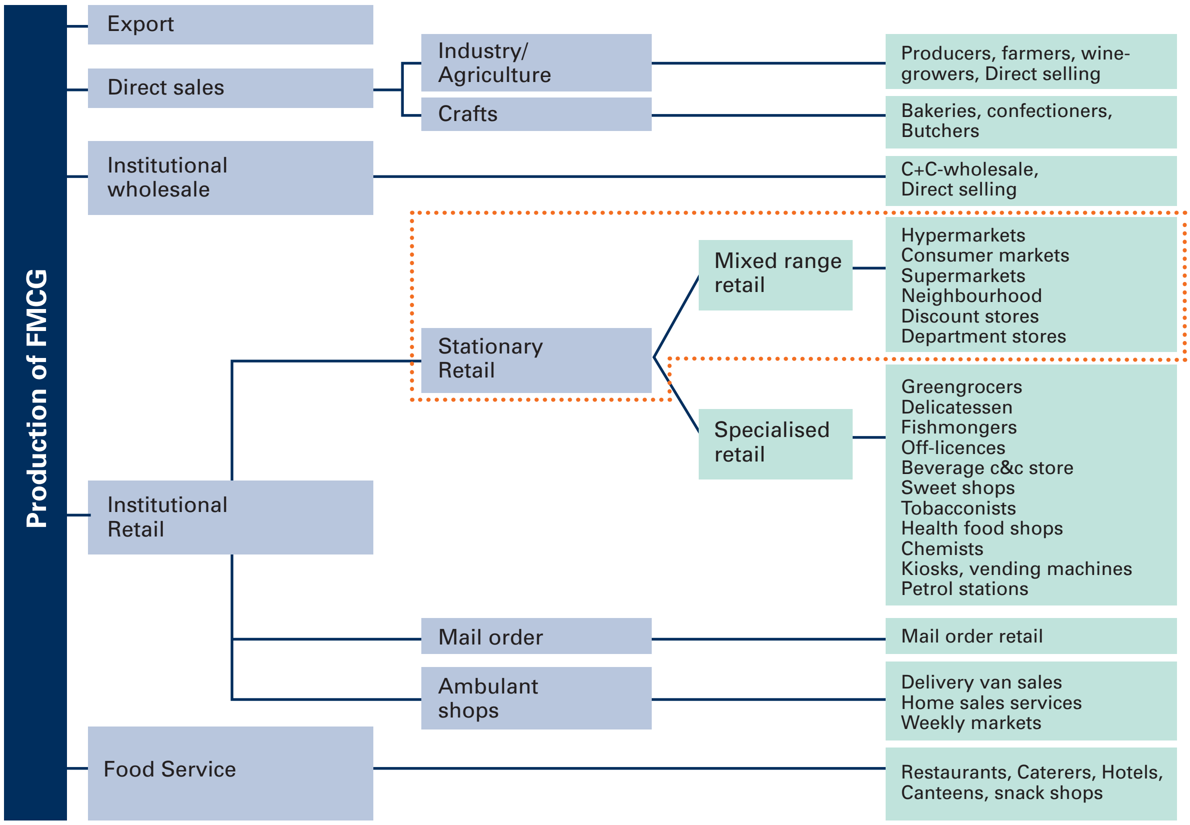
Fact:

In many market segments, transaction costs are considerable. They may represent as much as 50 per cent of total costs. The retail sector enables cost savings by realising the potential for rationalisation. By bundling ranges of products, it reduces distribution costs for the producer. For their part, consumers benefit from this process by being able to procure many products in one place and shop at advantageous prices.

Diverse distribution channels are available to producers

The consumer product industry has many alternative outlets for its products in addition to food retail outlets and chemists. The relative importance of the various distribution channels has changed significantly over the years. Among other trends, an increase in the export of food products and in consumption outside the home (for instance, in restaurants) is apparent at present.

Distribution channels in the food industry



Source: IfH/BBE Study

Fact:

Looking at the industry's sales outlets, the food retail sector holds an important but not a pre-eminent place. Thus, for instance, only 22 per cent of the total production of meat products is sold through food retailers. Restaurants and caterers, direct sales, wholesale, online sales and exports are other sales markets which are of growing importance to the industry.

Consumers use a wide range of retail outlets

Just as the consumer product industry relies on a variety of distribution channels, so consumers have a broad choice of shopping alternatives available, particularly for everyday-use products. Consumers choose their retail outlet depending on the type of purchase concerned, i.e. the „shopping situation" and individual preferences. Different distribution formats in the food retail sector compete with each other. In addition, consumers have the choice to buy their products directly from the producer, in weekly markets or shopping on line. All of these distribution channels compete with the classical food retail outlets.

Typology of different shopping situations for food purchasing

Type of purchase	Use category	Source of supply
Planned or routine purchase	To meet daily requirements To buy food of customary quality, in customary quantities	Discount stores Full-range supermarkets Food craft Delivery services
Quick and impulse shopping	Buying a few but necessary products quickly and unproblematically Spontaneous satisfaction of needs	Convenience Shopping/Shopping on the move: e. g. snack shops, kiosks, petrol stations, etc. Home Meal Replacement
Price shopping	Buying products at low price	Discount stores Consumer markets Hyper-markets
Direct and prestige shopping	Combining shopping with cultivating social contacts Achieving social distinction through shopping	Food craft Delicatessens Weekly market Buying directly from producer Delivery services
Guidance/advice shopping	Buying specialties that require guidance/explanations Looking for particular qualities	Specialised retail Food craft Weekly market Buying directly from producer Mail order
Adventure shopping	Combining shopping with authenticity of food production	All types of direct marketing Catering

Source: IfH/BBE Study

Fakt:

Consumers avail themselves of a variety of shopping facilities. In addition to shopping in food retail outlets, 36 percent of consumers occasionally make use of specialist food retailers, while 28 per cent occasionally buy food in weekly markets and 14 per cent buy food from smaller local shops.

Different realities require a differentiated approach and close scrutiny of the markets

The study shows that the criteria generally taken to assess an increased and „critical" bargaining power of the food retail sector do not stand up to closer scrutiny.
To merely compare retail sales volumes with producer sales volumes in order to determine bargaining power must be considered inadequate. In order to assess the power relations, a differentiated examination is necessary.

For this purpose, an analysis at the level of the product and/or the product group is necessary. Such an analysis clearly shows that the „power question" poses itself differently for each product category. Negotiation situations differ significantly and therefore the balance of forces between the market partners also varies considerably from segment to segment.

An in-depth evaluation of bargaining power is only possible if the balance of forces between commerce and the producer is evaluated independently for each product group. Moreover, the concrete relationship between retail and producer must be taken into account. The current study is based on this differentiated approach.

Fact:

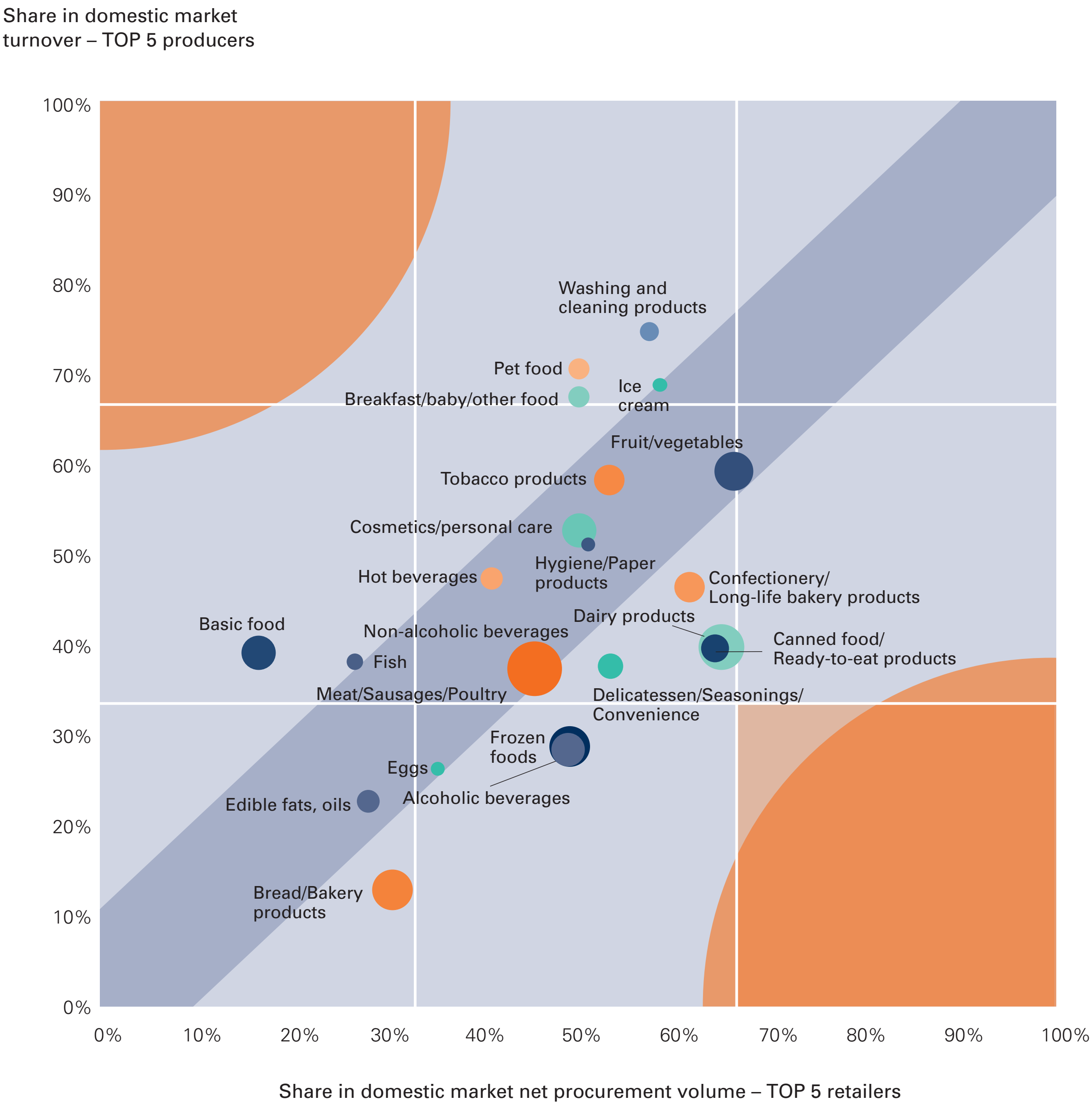
The study commissioned by the HDE is the first of its kind to consistently implement this innovative, negotiation-based approach and thereby arrives at new, differentiated results which are relevant to the question.

Structural analysis shows no one-sided power relationship

The market structure analysis carried out on the 22 most important groups of daily-use products shows that the retail sector has no overall bargaining power. In none of the product groups under examination was any evidence found of a critical imbalance of power neither to the benefit of commerce nor to the benefit of the producer.

If we compare, for example, the product volume of the Top 5 producers for each of the 22 product groups examined with the net procurement volume of the Top 5 retailers for each product group, it appears that the market relationships are different for different product groups.

The chart below represents the production volume of the Top 5 enterprises of the food industry and the net procurement volume of the Top 5 retail companies for each product group.



Source: IfH/BBE Study

Looking at the graph, we find the results clustered in the middle area and a diagonal band, suggesting balanced market relationships. Clustering in the bottom-right and top-left areas would indicate a significant, possibly critical power imbalance to the advantage of the retail sector or the producers respectively for the product groups concerned.

Comparing, for example, the results of the Top 5 retailers and Top 5 producers for the product group „Confectionery/Long-life bakery products", we find a slight imbalance in favour of the commerce sector. However, if we look at the sub-level – e.g. the product group „Chocolate" – we see a shift towards the manufacturers, since powerful brands are active in this segment and a high degree of brand loyalty is apparent among consumers. For the commerce sector, such a trend results frequently in a „must-stock" situation: due to customer expectations, retailers are obliged to include certain products in their product range.

Fact:

In many product groups, the top retailers are confronted with producers that supply commerce with high production volumes comparable to the high procurement volumes of commerce. Comparing the product volumes of the Top 5 producers with the net procurement volumes of the Top 5 retailers, we find that none of the 22 product groups lies in a „critical" area. The fact that half of the product groups are found within a variation range of 10% is evidence of relatively balanced structures.

Consumers with specific demands regarding product range

By positioning their own brands, producers manage in many areas to create consumer expectations with regard to product ranges in the retail sector. This is clearly apparent from the representative survey carried out – as part of the current study – to determine customer behaviour in relation to brand products. Customers have specific expectations about the product range in retail outlets, including both the depth and the breadth of the range. Furthermore, there is a high level of brand loyalty for certain product groups.

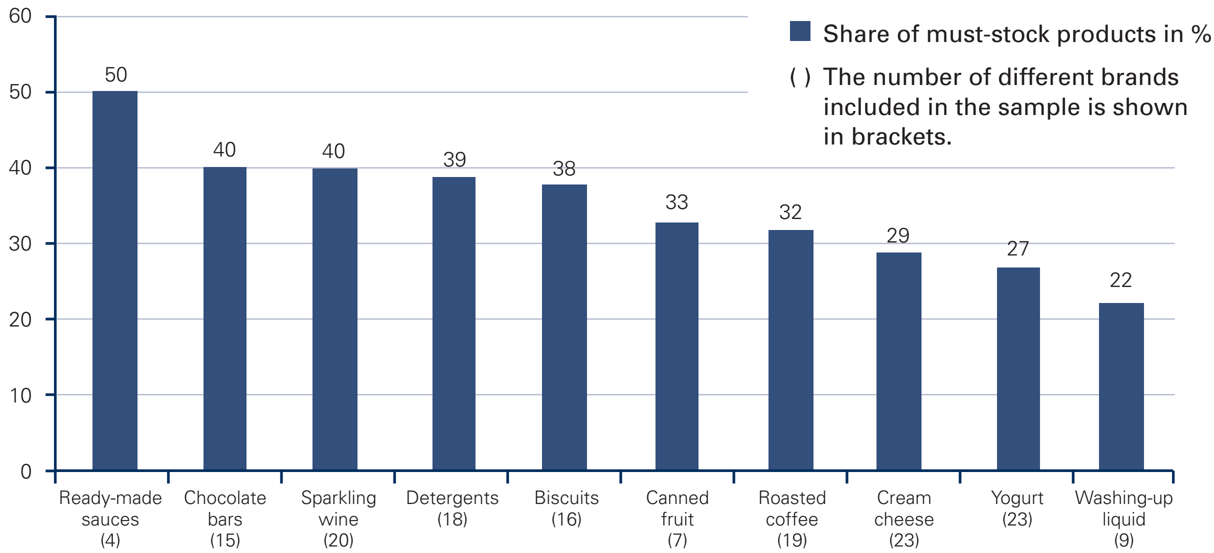
Thus, by expressing their individual requirements, customers contribute to making decisions about the product range. This strengthens the starting position of producers, including small and medium-sized manufacturers of brand products.

Customers also expect to find the products of relatively small companies as part of the available product range (e.g. „Ritter Sport" in the range of chocolate bars). As a reaction to the unavailability of a specific brand, approximately one-third of customers switch to a different retailer. This occurs particularly frequently in the case of sparkling wine (44 per cent), roasted coffee (42 percent) and detergents (37 per cent).

Fact:

Through their requirements concerning product range, customers place strong pressure on the retail sector to design their product ranges accordingly. This also applies to the presence of producers' own brands. Depending on the product group concerned, up to 50 percent of the product range offered by retailers results from must-stock situations. Owing to customer requirements, the producers/manufacturers are in a good starting position to negotiate parts of the product range.

Shares of must-stock products in different product groups



Source: IfH/BBE Study

Own-brand products constitute an important part of the product range

Today, house brands or own-brands represent an established segment which is not limited to starter price ranges. The overwhelming majority of own-brands are not manufactured by the retailers themselves, but rather, as licensed products, often produced by medium-sized manufacturers. By producing own-brands these companies have the opportunity to produce on a large scale under the label required by the retailer and can thereby secure their future without having to bear the market risks in full. Moreover, these medium sized manufacturers may be able to establish products for other distribution channels and thus finance the development of a „second foothold".

There are big differences in the division of labour between industry and retail as regards brand management. The terms „producer-brand" and „own-brand" reflect the diverse possibilities for the division of labour between industry and commerce only to a very limited extent. Again, a differentiated approach is necessary.

Alternative own-brand policies (according to functions fulfilled)

	Activities					
Case	Market Analysis	Development of products	Market tests	Production	Communication (Image-building)	Sale
1					●	●
2				●	●	●
3	●	●	●	●	●	●

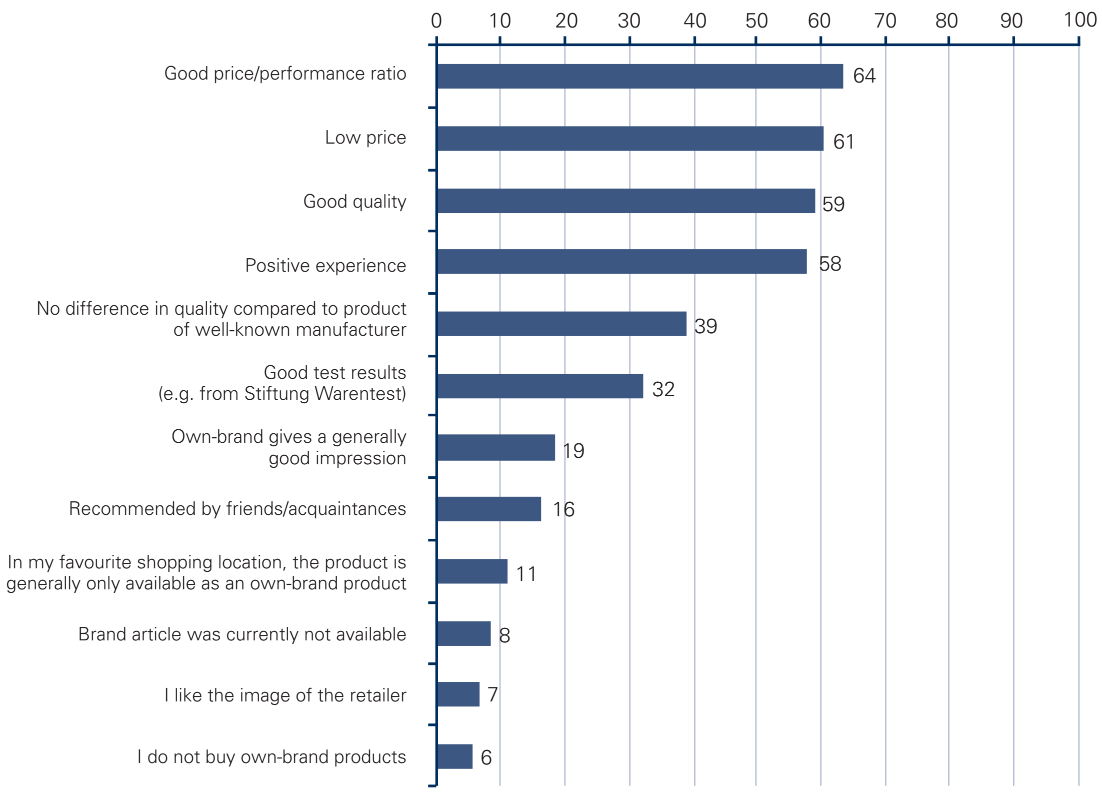
Source: IfH/BBE Study

The ability to market an own-brand product is no indication of market strength. Own-brand policy is an important element of holistic retail branding, whereby retail companies strive to position their own brand optimally in a competitive environment.

Fact:

Own-brand products are, on the whole, highly accepted by consumers. Over 60 per cent of respondents gave „good value for money“ as the main reason for purchasing own-brand products. Just under 60 per cent said they bought own-brand products because of their good quality.

Reasons for the purchase of own-brand products in %



Source: IfH/BBE Study

Conclusion

The study provides scientifically grounded information about the structure, functioning and achievements of the commerce sector and its relationship to industry.

The findings of the study show that the retail sector does not have a generalised bargaining power. The market situation for the 22 product groups considered in the study is significantly differentiated. Through their requirements concerning the product range, consumers exert considerable pressure on commerce to design their offer accordingly. On the whole, consumers benefit from the market situation in terms of greater diversity of offer and attractive price levels.

Handelsverband Deutschland (HDE)
German Retail Federation

The leading organisation of the German retail sector

The HDE is the employers' and trade association for the entire retail sector, in addition to functioning as an interest representation and service provider:

- 400,000 businesses
- 2.6 million employees
- 160,000 trainees
- Approximately € 390 billion in annual turnover

The retail sector is one of the three largest economic sectors in Germany.
The HDE comprises 100,000 member businesses of all sizes and in all sectors and geographical areas, with a combined annual turnover of approximately € 300 billion.
The HDE represents the interests of the German retail sector at EU level.

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