Handelsverband Deutschland

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Study of the EU Commission on the Development of Product Choice and Innovation of the Food Retail Sector in Europe

HDE Position
January 2015

Introduction

The German Retail Federation (Handelsverband Deutschland – HDE) is the umbrella organisation for the German retail sector with approximately 400,000 companies with a total of 3 million employees who generate a combined annual turnover of 450 billion euros. Today, the retail sector is Germany's third largest branch of economy after the industry and crafts sectors. HDE has 100,000 member companies of all sectors, locations and sizes and especially represents the interests of the food retail sector.

Published in October 2014, the starting point of the European Commission's investigation on the development of product choice and innovation in the food retail sector in Europe was the question whether allegedly unfair business practices of retailers, the increasing concentration in the food retail sector as well as own-brands had a negative effect on consumer welfare by reducing product choice and innovation. This extensive study encompasses 23 product groups in 9 member states and over 100 representative geographical markets and examines the developments between 2004 and 2012. In addition to an econometric analysis, it also contains six different case studies on certain product groups in different countries.

HDE welcomes the European Commission's goals to make the debate on allegedly unfair business practices of the retail sector and a supposedly existing buying power of the food retail sector more objective and to gain new data-based insights into this question. Moreover, the simultaneous analysis of procurement and sales markets is positive. Even though the focus of the investigation lies on the effects on consumer welfare and therefore on the B2C relationship, the findings of the study are also relevant to the debate on the relationships within the B2C supply chain in which HDE plays an active role at the European level.

Evaluation of the investigation findings of the study

1. **From the viewpoint of the retail sector, in general the findings regarding core topics of the study should be assessed positively.**

The study proves that the assumption of a market-domination position by the retail sector over the industry cannot generally be made. The high concentration values which have partly been detected during the investigation period do not demonstrate a link to increased negotiation power and a market-dominating position.

According to the study, modern retail was able to increase its market share during the investigation period. The number of outlets has increased as well as the total sales area. The increased concentration, however, cannot be generalized according to the study. National markets are constantly in motion, the concentration has decreased in 16 of the 26 examined markets. The German market which has not been included in the study has been classified as "moderately concentrated".

In contrast, the concentration on the producer side has increased but this is dependent of the situation in each member state and product category. A general, pan-European trend could not be discovered. Depending on member state and product category, in over 50 per cent of cases of imbalance between retailer and producer, a dominant position was found of the side of the industry.

The findings of the study support the HDE position that the actors on the retail as well as the on industry side operate in a fiercely competitive and overall functioning market. As a result of intensively conducted negotiations, consumers benefit from the resulting product variety and quality.

Furthermore, it is confirmed that the consumer goods industry creates pressure to offer certain products by heavily investing in advertisements which retailers can only withstand with difficulty. As a result, there is a high percentage of so-called 'must stock' products, especially for branded products. Here, the industry sector tends to have a good negotiating position.

2. The development of product choice

The findings of the study show that in most examined member states the choice for consumer products has generally increased.

The increase concerns the number of outlets as well as retail formats, product range (number of EAN codes within a product category), package sized and number of branded products. In all areas larger gains were recorded before the financial crisis. The range of prices, however, has increased in all product categories.

The study has not found any prove that an increasing concentration of retail at the national level has a significant impact on consumer choice. The opening of new stores at the local level strengthens competition and has a positive impact on product ranges on offer in the existing shops. A dwindling of competitive intensity as a result of concentration increase was not discovered.

According to the study, own-brands have a positive impact on product choice – even if only to a slight degree. If their share of the product range surpasses a certain threshold, they are being equated with less product choice.

In this context it has to be noted that the consumers want own-brands to be part of the product range and that for retailers with their tight margins own-brands are a sensible complement to their product portfolios also regarding economic aspects.

These benefits of own-brands are obvious. By consistently implementing consumer wishes, retailers can offer their customers a customized and diverse product range. This is possible because, due to their closer proximity to the market, retailers possess excellent knowledge of consumer desires. Own-brands often complement product ranges that are strongly formed by producer brands. Thereby, own-brands facilitate the consistent advancement of the general quality policy. Improved product quality and product safety contribute to the consumer welfare. Own-brands are trail-blazers for sustainably quality and therefore a key success factor.

The ability to place an own-brand onto the market is, however, not evidence of market power. Rather, own-brands increase the competitive intensity and exert additional innovative incentives.

At the same time, own-brands enable small and medium-sized producers to establish themselves on the market and grow their market share. Thus, on the one hand they improve market access as well as capacity utilization of producing companies on the other hand. Especially small and medium-sized companies benefit from this. As a result the efficiency of the distribution systems increases which contributes to the reduction of transactions costs and brings macroeconomic benefits. It should also be pointed out that own-brands perform a welfare function for certain groups of customers.

3. The development of innovations

Regarding innovations, the study shows a more differentiated picture which was significantly influenced by overriding factors (macroeconomic development). Moreover, questions regarding definitions play a key role.

In its investigation of the development of innovations, the study solely included the field of product innovations. These are measured in terms of innovations which have found their way onto the shelves of retailers (new EAN codes). It is noted that the area of innovations has experiences an overall slowing down during the investigation period which can be traced back to the drop in product innovations after the financial crisis.

The findings of the study demonstrated that the type of shops as well as their size has a positive impact on innovations. In any format, larger outlets offer a larger amount of innovative products. This can also be observed in the development of supermarkets in Germany which today offer 11,500 products on average. In comparison, the number of products in the mid-1990ies was circa 7,500. Customers perceive this intuitively as the opening of new stores is being associated with more innovation at the local level.

Regarding the effects of own-brands on innovations, only little data is available (little economic relevance). If their share of the product range surpasses a certain threshold, they are being equated with less innovation.

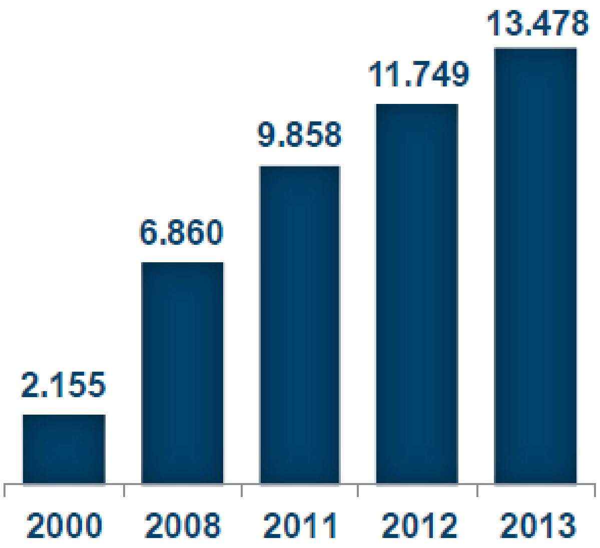
The example of Germany shows that also product groups with a strong presence of own-brands are characterized by innovations and are increasingly influencing tend markets such as organic and convenience segments. Therefore, it cannot be stated that a high own-brand market share slows down innovation.

Also the own-brand study[1] commissioned by the EU Commission - which among others addressed the question whether own-brands have a negative impact on the added value and innovation in the consumer goods sector – proves that the innovative strength of the consumer goods industry is not under threat. Rather, the number of product innovations continues to grow.

The fierce competition in the retail sector also results in consumers benefiting from reasonably-priced high-quality and added value food products (organic, convenience, fair trade products), a broader choice of shopping opportunities and types of outlets, a larger coverage, nutritional advice, delivery service and many more goods and services[2]. Over 80 per cent of customers of the food retail sector are content or very content with the product choice and performance standard of the types of outlets and their product ranges. Over 90 per cent of customers assess the price attractiveness of the food retail sector as high[3].

The companies of the retail sector have the ability to react to changing customer expectations in a quick, flexible and adequate manner. Through their negotiating positions and steered by consumer demands and behaviours, retailers initiate increased efficiency and quality and generate many types of formats and retail outlets[4]. Retailers are trail-blazers in the fields of innovation, quality, service, health, ethics, social responsibility, environment and technologies[5]. An inhibiting effect of own-brands on product choice was not found. Own-brands tend to rather dampen a large spread in prices which means that own-brands are influencing the pricing level in favour of customers.

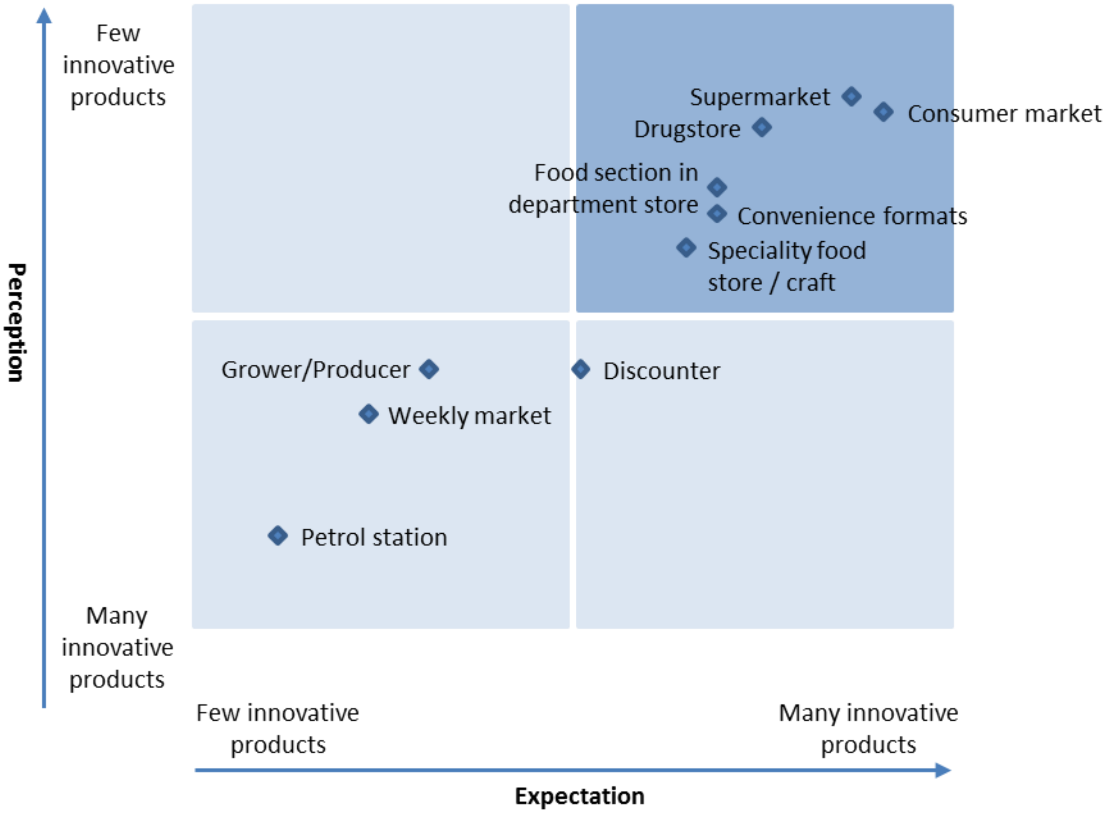
In Germany, the number of innovations within the product group food has increased significantly over the past few years. The ranking is headed by the product groups confectionary and dairy products. In these segments, innovations are expected by most consumers.



Development of Innovations in Food Product Groups between 2000 and 2013
Source: IFH Cologne, Survey Innovations 2014

[1] http://ec.europa.eu/enterprise/sectors/food/files/study_privlab04042011_en.pdf
[2] Through the prominent competitive intensity in the food retail sector characterised by a technology-driven rationalisation and innovation of all processes, consumers save approx. 30 to 15 billion euros annually. (see Greipl, Retail Brand Politik, 2012)
[3] Valid Research Januar 2011.
[4] See Ahlert/Kenning/Olbrich/Schröder, Vertikale Preis- und Markenpflege im Kreuzfeuer des Kartellrechts, 2012, S. 174.
[5] This is supported by the findings of the EU own-brand study:
http://ec.europa.eu/enterprise/sectors/food/files/study_privlab04042011_en.pdf

The retail sector fulfils the innovation expectations of consumers. In formats where many innovative products are expected, customers also perceive many innovative products. This is demonstrated by the current survey by the Institute for Retail Research (Institut für Handelsforschung - IFH).



Source: IFH Cologne, Survey Innovations 2014

4. The development and effects of concentration

The study draws the conclusion that the concentration on the producer side has increased. Overall, the study provides crucial evidence for concluding that a market balance between retailers and producers exists.

Overall, the concentration on the retailer side is not seen as proof of negative competitive effects with regards to product choice and innovation. This confirms the assessment by HDE that there is no evidence for a critical competitive situation in Germany. In any case, looking at the turnover concentration of the largest market players in isolation does not offer sufficient evidence of market power. Rather, the individual and complex negotiating situation is key.

When examining the ratios, the total consumer spending for food and luxury food products should be used as a reference value and should be compared to the food product turnovers of food retailers. In using this method, the share of total spending of private households in the five largest food retailers equals 40 per cent.

As an independent advisory body on competition policy and regulation to the German Federal Government, in 2010 the Monopolies Commission found that - despite of the concentration - the competitive intensity at the retail level of the food retail sector is not decreasing noticeably[6]. Moreover, the extent of the concentration in the German food retail sector is being overestimated as the turnovers of the specialist food retailers and the food crafts have not been considered. With regards to the extent of the concentration in the food retail sector, Germany does not hold a leading position.

[6] http://www.monopolkommission.de/images/PDF/HG/HG19/5_Kapitel_HG_19.pdf