



COMMERCE IN THE SUPPLY CHAIN: CONSUMERS COME FIRST

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Executive summary

Commerce - driving the economy forward

The commerce sector generates 11% of GDP with one in three companies active in retail, wholesale or international trade. In retail, it ranges from city centre stores to supermarkets, small corner shops, specialist stores, on-line sellers and multi channel retail. Over 95% of the 6 million companies are small or medium enterprises.

Commerce – a key part of community life

All in all over 31 million EU citizens are employed in commerce – one in seven jobs in Europe. The sector provides many opportunities for part time work, which allows employees to find a balance between work and family life. A high percentage of workers have their first experience of work in retail but the sector also employs many highly skilled managers, food nutritionists and IT experts to drive innovation forward.

Commerce – here to serve consumers

Consumers are at the heart of commerce – without them commerce would have no reason to exist. Retail is the link in the chain between those who produce products and those who want to buy them – and it is the closest link in the chain to the consumer. Customers vote with their feet so retailers are highly competitive in terms of price, in-store experience, range

of goods and innovation (with 8.000 new products hitting the shelves each year) and in what they offer to win and keep customers.

Commerce – a leader in product innovation

Own brands have become a popular, low price addition to the shelves of many retailers. Some are produced by major brands; some by large companies for a number of retailers; and many by smaller enterprises who would otherwise be unable to have such a wide market for their goods. In some cases own brands have become market leaders – for example in innovations such as healthy ready meals, labelling information such as fat and calories, and healthy ingredients such as salt reduction. In that way own brands are a key element in advancing the public policy objectives of governments – for example educating consumers about healthy options and environmental issues. Since commerce is closer to consumers than manufacturers, own brands react quicker to changing consumer demands.

Commerce – the link in the chain

Commerce links 500 million consumers to manufacturers and producers. The precise picture varies from country to country but commerce has the overall role of transmitting the wishes and choices of consumers to manufacturers and producers so they know what people want to buy and what they are prepared to pay. Just as producers, manufac-

turers and farmers rely on retailers to get their products to the consumer, so too do retailers rely on farmers, manufacturers and producers to make the goods that consumers want to buy. In fact, each part of the chain is dependent on the other parts of the chain.

Commerce – bringing fair competitive prices that consumers can afford

Consumers know good value when they see it. To win and keep customers retailers have to be fair and competitive. Retailers go out of business or lose their market share if they charge too much, charge more than their competitors or do not have products at the quality and price consumers want. That is why retailers keep their own margins tight (while needing to make fair profits to reinvest in new products, new technology and attractive stores) and negotiate with suppliers to keep prices down for the consumer. A whole range of factors in the supply chain go into making up the end price – sourcing products, sorting, transport, storage, quality control, packaging, distribution, wages for employees, government taxes, energy costs, rentals for stores, regulatory costs – all these contribute to the final price on the shelf.

Commerce - keeping retail margins tight to help the consumer

Fierce competition for customers means that retailers have to keep their margins tight. Indeed the average profit margin is less than 4% compared say with 8% to 12% in manufacturing. Imagine what it would be like if manufacturers were free to set whatever price they wanted without retailers obliging them to keep prices down for consumers. The reality is that everyone in the chain needs to make a fair profit if companies are to remain in business and pay their employees – and the taxes government needs to provide public services. Strong retail players counterbalance powerful suppliers – and the negotiation between them leads to prices that consumers can afford, a fair profit for retail, and certainty of supplies for food and goods.

Commerce – safe, secure and responsible

Alongside fair prices that the consumer can afford, safe, sustainable and reliable supplies

are the key to success in commerce. Environmentally friendly products from sustainable sources with incentives to suppliers to reach sustainable development goals; huge investment in better logistics to cut down on environmental pollution; a massive reduction in the use of non recyclable bags and packaging – all represent a huge commitment to the environment. To ensure safe products retailers have made a huge investment to meet – and go well beyond – legal safety requirements for food and other products. Often responsible retailers have led the way – with legislation catching up later.

Commerce – creating a single market for consumers

Commerce and the Single Market are allies. The EU Single Market for consumers operates in two ways – it enables consumers to buy goods from other Member States more easily and more cheaply – but just as importantly for consumers it enables businesses such as retail to stock products from other Member States more easily and more cheaply and thus increase the range of products on offer to consumers in their own country. However, the Single Market still needs more work – to remove the final barriers and to ensure that retailers can source their products from anywhere in the EU and shop around for the best prices, instead of being forced by some brand owners to buy them from a particular place.

Commerce – reminding government consumers pay for burdensome regulation

Lawmakers at all levels must remember that ultimately consumers bear the cost of burdensome regulation through higher prices. Today essentially the market works well for consumers – providing an ever growing range of new products, safe and secure food, and high quality options that consumers can afford. A competitive economy means freedom to negotiate fairly among the players in the interests of consumers – and a recognition that there will always be some players who are stronger than others. The key to fairness is not to pick winners and losers, but effective enforcement of the competition rules to ensure a level playing field where all can compete fairly to provide the goods and services consumers want and need.

1. Driving the economy

“The supply chain can only be understood as a single entity comprising a whole set of interrelated commercial relationships. Any efforts to improve the functioning of the supply chain must be based on this business reality and remain firmly focused on the consumer.”

Dr. Rainhardt Freiherr von Leoprechting,
President of EuroCommerce, May 2010

Commerce is so much a part of people's daily lives that we tend to take it for granted. We drop into a food store on our way back from work to pick up something for dinner, go clothes shopping on the high street at weekends, visit a furniture warehouse to get ideas for renovating our home or search for a specific product on the internet.

On the face of it, the commerce sector looks like a fairly simple business – not much more than taking products from suppliers and selling them on to customers. Yet behind the familiar store fronts and web sites, there is a complex, sophisticated and innovative business, competing hard to offer huge variety and value to consumers.

A key part of the European economy, the commerce sector generates 11% of the EU Gross Domestic Product (GDP). One in three companies in Europe is active in the retail, wholesale or international trade sector.

The commerce sector is diverse, with many highly specialised retailers, wholesalers and dispatching companies based on different business models. These range from corner stores to state-of-the-art warehouses and up-market city centre stores, and from niche websites to supermarkets offering more than 40,000 products. Retailers are also moving into other areas, for example offering their customers transport and banking services.

While attention tends to focus on the big retail chains, over 95% of the 6 million companies

in commerce are small and medium-sized enterprises. A customer-friendly and focused approach is the key to success, regardless of size or place in the supply chain.

In the commerce sector, business models and commercial practices are being adapted constantly to meet changing consumer demands. Increasingly, for example, companies are developing online shops for their customers in addition to bricks and mortar outlets.

In a difficult economic environment, commerce remains one of the few sectors in Europe with growth potential.

2. A key part of community life

“The retail sector is vital to the world economy, as it provides large-scale employment to skilled and unskilled labour, casual and part-time workers.”

Monthly labour market monitoring, European Commission, April 2010

Commerce is a dynamic and labour intensive part of the economy. Overall, the retail and wholesale sector provides jobs to **more than 31 million citizens**. That accounts for one in seven jobs in Europe.

The commerce sector has deep roots in local communities and remains one of the few parts of the economy with job creation potential. Unlike many industrial sectors, most jobs in commerce are local by nature and cannot be outsourced to other countries.

For a substantial number of people, their first job and all important first pay packet will come from a retail outlet. Commerce often provides a way into the workforce for people who may otherwise find it difficult to get a foothold in the labour market.

The sector provides flexible work for people who want part-time employment to balance work and home life, as well as employing minority groups and disabled people.

In addition, commerce provides a wide range of highly skilled jobs, from food nutritionists to environmental engineers, and from IT experts to corporate brand managers. Many of the larger companies provide training schemes to allow employees to develop on the job and gain qualifications.

3. Commerce serving consumers

“Consumers weigh up all options and ultimately decide over the entire chain. When purchasing they sometimes vote with their feet, sometimes with their head and sometimes with their heart. And all of this within an average of 7 seconds when standing in front of the shelf.”

Dick Boer, Executive Vice President and Chief Operating Officer Ahold Europe, April 2010

Retail and wholesale source products from local, national and international suppliers, to offer consumers in the EU Single Market an enormous range of safe, healthy, green and attractive goods at competitive prices.

Commerce thrives on fierce competition, with different outlets vying for the attention and loyalty of customers. The consumer is at the heart of the business. Every day, customers vote with their feet for the stores of their choice.

As a result, the sector is characterised by a high degree of competition, wide consumer choice and tight profit margins of, on average, less than 4%.

Retailers depend on preserving the reputation of their company and maintaining the trust of their customers. Companies therefore often go beyond their legal obligations to ensure product quality and safety.

In many cases, firms enforce both public and private (voluntary) standards to provide a high level of consumer protection.

The commerce sector is constantly innovating, often working with suppliers to develop new products or sustainable techniques to meet changing consumer expectations. Some 8,000 new products hit the shelves every year.

A March 2010 Nielsen study, commissioned by the French Federation for Commerce and Distribution (FCD), found that the average number of products in medium-sized and large supermarkets in France increased substantially between 1999 and 2008, with a significant increase also in products from SME suppliers.

The table below also indicates the growing importance of retailers' own brand products (private labels) on the market. Own brand products often provide consumers with a cost-efficient alternative to big-name products. This can be important particularly for those trying to feed a family on a low budget.

Private labels allow retailers to respond more quickly to customer demands, e.g. for organic or fair trade products. In some cases own brands have become market leaders – for example in innovations such as healthy ready meals, labelling information such as fat and calories, and healthy ingredients such as salt reduction.

Graph 1

	Average number of individual products in supermarkets in France, 1999	Average number of individual products in supermarkets in France, 2008
SME suppliers	2,253	3,370
Own Brands	2,099	2,860
Large suppliers/ manufacturers	6,399	5,793
Total	11,051	12,023

Source: The Nielsen Company

Own brand can be an important part of a branded business – many brand suppliers also supply own brand. In other cases, SMEs suppliers produce own brand products. This often necessitates a transfer of know-how to SMEs and helps to provide these small suppliers with national and international openings.

To sum up, own brand provides retailers with an outlet to sell local or regional products, while offering consumers a diversified and innovative range of goods.

4. Pivotal link in the supply chain

“On several dimensions, the chain performs well: it delivers high-quality food products at affordable prices to European consumers, it ensures the safety and traceability of food products and it can pride itself on the ample supply of highly competitive, innovative and traditional products.”

European Commission Communication on “A better functioning food supply chain in Europe”, 28 October 2009.

Commerce acts as the pivotal link between producers and manufacturers on one hand and 500 million EU citizens on the other. In between is a complex supply chain in which suppliers and retailers are both competitors and mutually dependent.

Retailers mainly buy from suppliers (manufacturers, wholesalers, importers), rather than directly from farmers and other primary producers. The commerce sector therefore relies on building long-term, sustainable relationships with suppliers - food processors and manufacturers.

In most Member States, retailers do not have any direct relationship with farmers. However, arrangements can differ from one Member State to another.

In the UK, for example, retailers are increasingly working with groups of farmers in pro-

ducer groups to try and pass more money back to farmers and help them improve efficiency and respond to the market. A number of supermarkets have these arrangements each with hundreds of farmers to supply liquid milk. Industry data shows retailers consistently pay the highest price to farmers for their milk and are working with them to adapt to new challenges such as reducing emissions and improving animal welfare.

Overall, it is in the interests of commerce to have a strong, structured and reactive farming sector in Europe. Only a stable agricultural sector can continue to supply the wide range of fresh, seasonal products retailers need to distribute in their stores.

Retail is not, of course, the only distribution channel for farmers and suppliers who have many other means of distribution, including restaurants and catering, direct sales, online sales and exports. Retailers do, however, offer suppliers the opportunity to reach a large number of consumers at much lower *per capita* costs than if they had to build a distribution network from scratch.

5. Bringing fair and competitive prices

“In general the exercise of buyer power by grocery retailers is likely to have positive implications for consumers. Where competition between grocery retailers is effective, retailers will pass on to consumers a substantial portion of the lower prices that they obtain from suppliers through the exercise of buyer power.”

Extract from UK Competition Commission's Groceries Market Investigation, April 2008.

Commerce is the most visible part of the supply chain and the closest link to consumers. Since customers are very price sensitive, retailers are constantly striving to keep prices low and as a result their margins are tight.

Retailers negotiate with suppliers in order to keep the end price as low as possible for their customers. It should not be forgotten, however, that many different factors have an influence on the final price.

Numerous operations take place in the supply chain between the primary production of goods and the sale of end products on the shelf. Various stages include sourcing products, sorting, transport, storage, quality control, packaging, palletising, preparing orders for clients and selling in retail stores. Each of these stages adds a value and contributes to the overall cost of the product.

Moreover, the end price of products is influenced by many other factors including: fluctuations in the price of commodities (raw

materials) on the world market and possible export restrictions; energy prices that have a crucial impact on farmers, processors, transporters and retailers; taxes at national level; rental rates for store premises; employer costs; inflation; product defects/losses; and administrative burden.

In this complex structure, there is no simple correlation between the price of commodities and the end price of products. In fact, the more processed a product is, the less impact variations on the price of commodities will have on the end price to consumers.

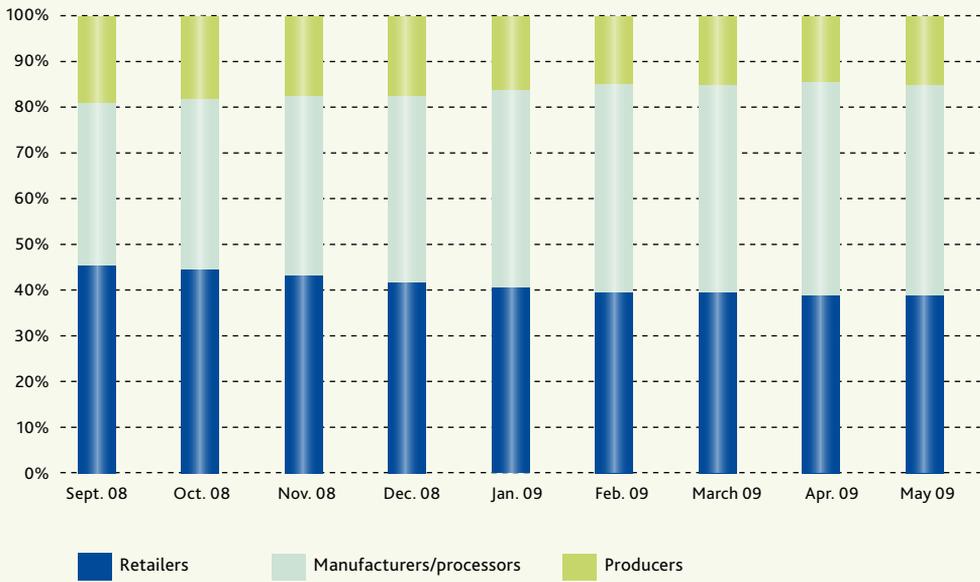
Graph 3 gives one example representing the margin evolution of different factors in the milk supply chain.

Graph 2: The life of fresh fruit & vegetables from farm to shop has many stages – each adds value



Source: EuroCommerce

Graph 3: Price Transmission for milk, Czech Republic. Sept. 08-May 09



The competitiveness of commerce has consistently helped to fight inflation across Europe.

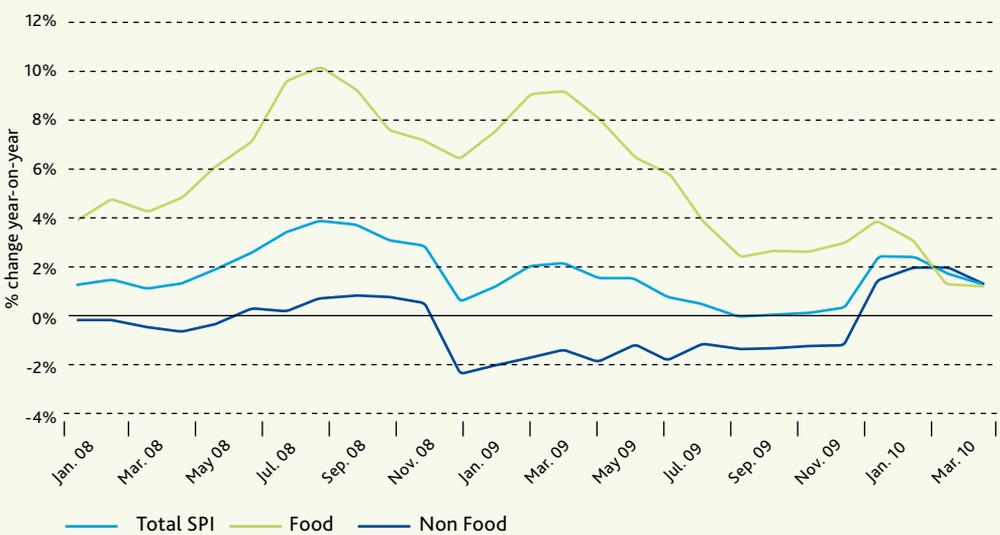
Graph 4

BELGIUM

Average over 15 years

Overall inflation	1.99%
Food inflation	1.55%
Retail price inflation	1.47%

Graph 5: Shop Price Index in the UK, Jan. 2008 to March 2010



6. Keeping retail margins tight

“Competition at retail level is fierce, both between retailers themselves and increasingly between different retail formats. This has also translated into lower net operating margins for retailers and has contributed to cheaper prices for consumers on the long term.”

European Commission staff working document “Competition in the food supply chain”, SEC (2009) 1449.

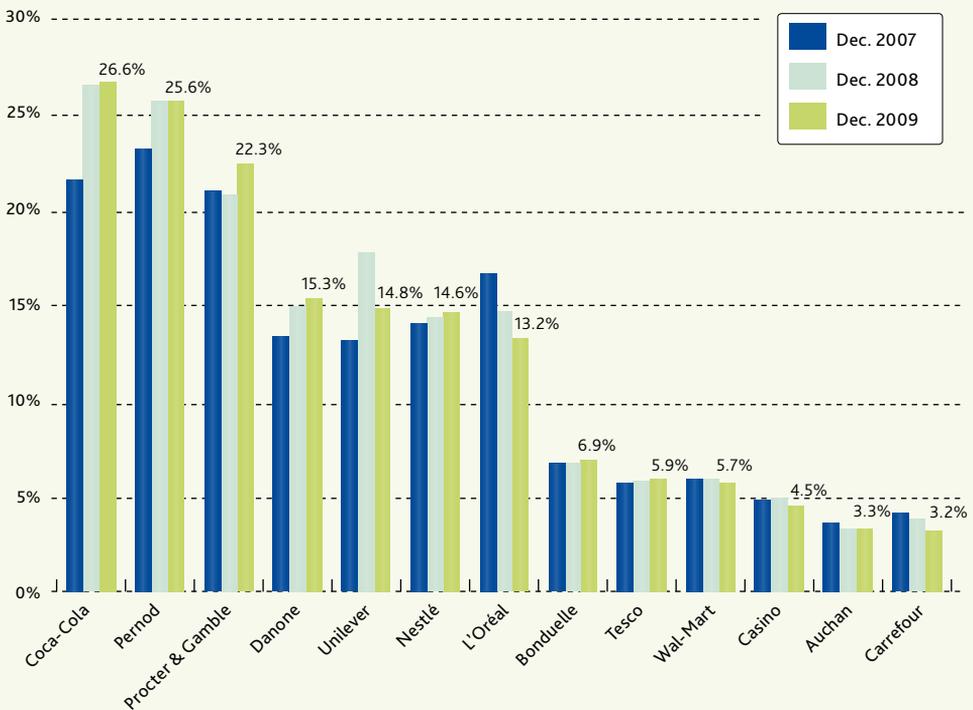
Retailers' margins have, in reality, remained tight due to the fiercely competitive nature of the commerce sector. The average profit margin in the retail sector is less than 4%. The profit margin of manufacturers is on average two to three times higher (see graph 6).

There is also a high degree of concentration among large suppliers.

For example, in 2009, when the two largest dairy cooperatives in the Netherlands merged, the resulting FrieslandCampina company became one of the largest dairy companies in Europe, with an annual turnover of approximately 9.1 billion euros.

The company later hived off some units to satisfy European Commission competition concerns, but these units only account for approximately 4 per cent of the turnover of the new group. Since the cooperative Friesland-Campina is the only Dutch supplier which can provide the entire dairy range, from fresh milk to desserts and cheeses, it exerts huge market power.

Graph 6: Operating margins



Source: EuroCommerce and concerned companies.

Operating margin (marges opérationelles) = ratio between operating profit and turnover; gives the change in business activity excluding the normal running costs.

7. Bargaining benefits consumers

“Suppliers and buyers negotiate on prices and delivery conditions and the outcomes are determined by their negotiating positions... a shift [in power] to the buyers is in principle to be valued positively, because this is ultimately to the advantage of the consumer.”

Extract from conclusions of a 2009 study by EIM Research Agency for Business and Policy, for the Ministry of Economics in the Netherlands.

The European marketplace would not function efficiently without strong retail players that can counterbalance powerful suppliers.

The commerce sector has to remain responsive to customers' expectations. Shoppers expect to find a large number of “must have” branded products which retailers must include in their product ranges, whatever the price.

Suppliers of “must-have” products, whether they are large manufacturers or SME producers, are therefore in a strong bargaining position vis-à-vis commerce businesses. Retailers are obliged to stock this product or else risk losing their customers.

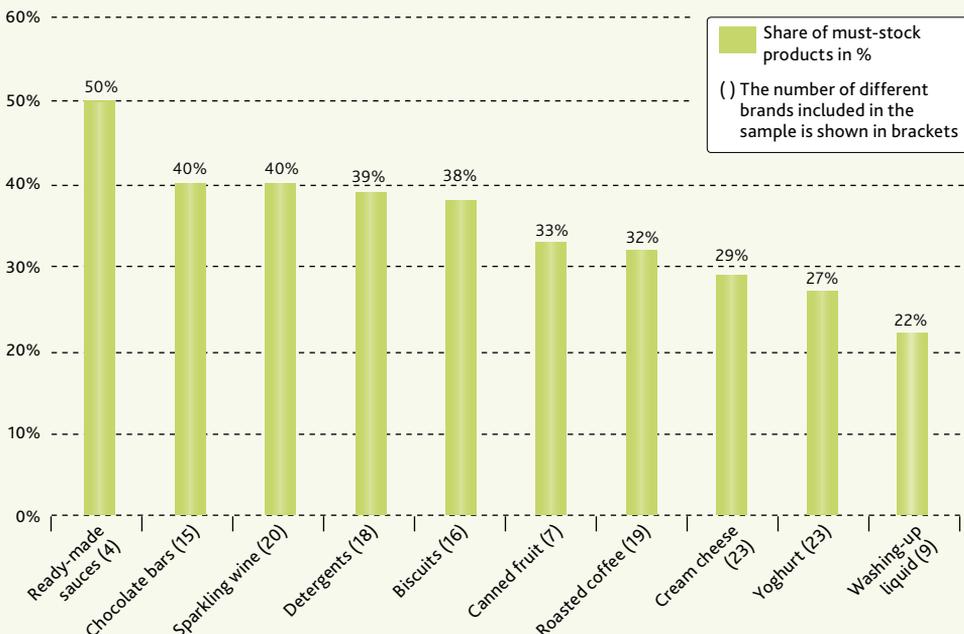
A late 2009 study by the Institute for Retail Research (IfH) at the University of Cologne and the consulting firm BBE Retail Experts, commissioned by the German Retail Federation (HDE), examined the bargaining power of suppliers and retailers in Germany (see graph 7).

The study looked at the domestic turnover of the top five manufacturers in Germany compared to the net-buying-volume of the top five retailers according to product-group. The results indicated that there is generally a balanced market relationship concerning the 22 product-groups examined.

As a result, consumers are able to benefit from relatively low food prices and high price stability.

While consumers will go looking for established, “must-have” items, other products require targeted promotion. Retailers and

Graph 7: Operating margins



Source: IfH/BBE Study

suppliers have therefore cooperated to develop new forms of marketing and promotion.

In many, but not all, EU countries the price of such marketing services may be covered by various fees, including so-called "listing fees". Since retailers may run a financial risk, especially for the stocking of new products which often fail, they may ask suppliers for a financial participation in the promotion of their products.

8. Safe, secure and responsible

"Corporate social responsibility is about acting voluntarily to create a better world for today and for future generations – we are committed to it."

Senator Feargal Quinn, non-executive President of Superquinn, an independent Irish supermarket company, May 2010.

In the supply chain, there is more at stake than simply price. Other aspects such as safety, quality, sustainability and reliability of supply are equally important and retailers are acting on all these areas.

The commerce sector has developed a wide range of voluntary initiatives which respond to the challenges of sustainable development both in the way traders operate and how they work within their supply chains. These initia-

tives are commonly set out in Corporate Social Responsibility (CSR) strategies.

One of the strongest consumer movements in recent years has been the growing demand for more environmentally friendly products. Commerce is responding to this demand by increasing organic and eco labelled product ranges e.g energy efficient light bulbs or detergents that wash at low temperatures.

Retailers have massively reduced the use of non recyclable bags and packaging. Stores are also buying in products from environmentally friendlier sources e.g. sourcing wood from sustainable forests.

In some cases, retailers give incentives to suppliers to reach certain sustainable development goals or provide advice on how to reach higher environmental standards.

Retailers have invested in better logistics and intelligent transport systems, to cut down on environmental pollution. Moreover, many outlets have made substantial investments to improve the use of energy efficient in-store equipment and improve the overall environmental performance of their business.

To give just one example, the British company Tesco opened in 2009 the world's first "zero-carbon store" in Cambridgeshire and has low-carbon stores in some EU Member States.

RE-USING FOOD SURPLUSES TO RELIEVE POVERTY

While European retailers try to minimise food surpluses, they are also developing donation projects — in cooperation with local authorities and charities — to re-distribute surplus food to people in need. To give just one example, "Protocollo di Parma", launched in 2009 in Italy, is an innovative partnership between Federdistribuzione (Italian Retailers Federation), the Parma municipality and the state-wide food bank.

Project partners made a commitment to collect unsold yet nutritious and fresh food products and redistribute them to local charities. Such initiatives contribute not only to food surpluses re-use, but above all to food poverty relief and waste reduction.

Retail companies involved in "Protocollo di Parma" can also benefit from economic incentives and waste management tax rebates. If such incentives were more widely available, it would help to promote similar food surplus initiatives in other regions and Member States.

Retailers must not only increasingly meet high statutory requirements with regard to safety and traceability of products, but commerce has also put considerable resources in to meeting consumer demands for healthier lifestyles. This has included providing low fat and healthier options in food stores, as well as ensuring easy to understand nutritional information that allows customers to make informed choices.

Such information of course needs to be relevant, targeted and supported by educational programmes by public authorities.

9. Creating a Single Market for Consumers

“Commerce can really make the most of the EU Single Market by satisfying the needs of confident, empowered and well informed consumers with a wide choice of high quality, innovative products and services.”

Malcolm Harbour MEP, Chair of the Internal Market and Consumer Protection Committee, European Parliament, May 2010.

The commerce sector has always been a strong supporter and beneficiary of the EU Single Market. Not only is the Single Market good for business, but consumers benefit from an increased choice of products at better prices.

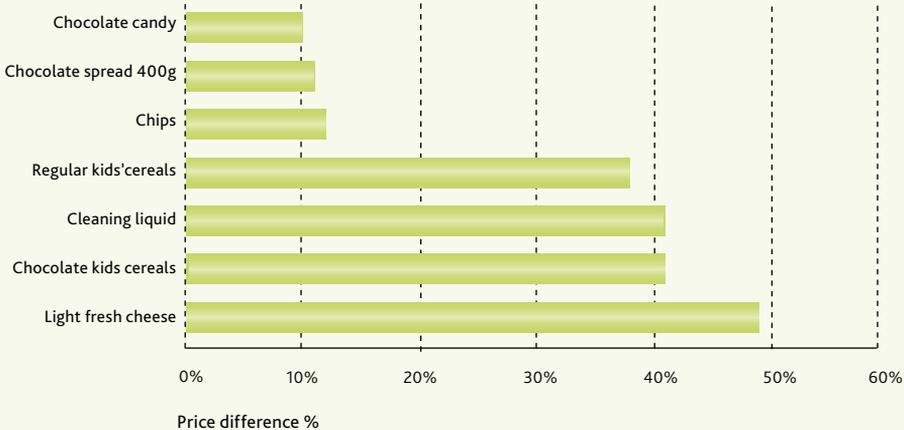
Fair and effective competition is ultimately the best way of empowering consumers and protecting consumer interests. For this reason, commerce has been supportive of EU initiatives designed to strengthen competition by boosting cross-border sales within the Single Market and promote greater consumer confidence when purchasing across borders.

For the commerce sector, creating the conditions for companies and consumers to trade across borders in a clearer legal environment is indispensable to allow both to benefit from the opportunities the Single Market offers.

If commerce is to strengthen its competitiveness and fulfil its growth potential, it must be able to rely on a consistent and reliable EU policy framework that allows healthy competition to flourish.

Despite the progress that has been made to date, Europe still needs to complete the Single Market in goods and services, if it is to maximise competition to the ultimate benefit of consumers.

Graph 8: Pricing policy of some big manufacturers leading to the fragmentation of the internal market: price difference between the cheapest and the most expensive sourcing country



Source: FCD, study realised in summer 2008 by one main European retailer on 1000 products

In practical terms, commerce today still faces some obstacles to doing business within the Single Market. Suppliers of branded goods have largely managed to prevent the creation of an EU-wide Single Market for their products, by forcing retailers to purchase from their national distribution organisations.

Retailers are unable to negotiate on identical products on a cross-border basis (rather than on a national basis). As a result, purchase prices invoiced to retailers for the same products differ substantially from country to country, and suppliers manage to push through higher purchase prices.

Allowing traders to fully benefit from a functioning Single Market for the supply of goods in branded products, would have a positive impact on prices to the benefit of consumers (see graph 8).

10. What commerce needs from government

“Even when we are talking about regulation which seeks to achieve other public policy objectives, it is important to bear in mind that regulation which creates distortions of competition is never in the interests of consumers.”

Joaquín Almunia, Vice-President of the European Commission responsible for Competition Policy, speech 23 March 2010.

Healthy competition is central to an efficiently functioning supply chain in a market economy that delivers value to European consumers. Commerce currently functions efficiently and provides an enormous range of products at competitive prices within the EU Single Market.

Legislators at EU and national level have to be aware that when they introduce new regulation, there is a cost to be borne by the commerce sector and ultimately by the consumer.

- It is of crucial importance for commerce – and consumers – that neither European nor national legislative and supervisory bodies impose far-reaching restrictions on the functioning of the market.
- It should be recognised that achieving and exercising market power is a normal and necessary practice in any business sector and essential to a functioning market economy.
- There is no evidence that cases of imbalance in bargaining power between retailers and suppliers are common. However, any potential abuse of market power in the supply chain needs to be investigated by the existing competition authorities and, if proven, ended and sanctioned.
- As long as the free market is providing for choice, competition and innovation, there is no justification for imposing unnecessary restrictions on the freedom of contract of parties in the supply chain.
- The Single Market should work to offer shoppers greater opportunity for cross border buying through the trade in goods and services.
- A better regulation approach is urgently needed at European, national and local levels to reduce the administrative burden faced by businesses, especially SMEs, and to ensure legal certainty and predictability.
- In a globalised economy, trade policy plays a pivotal role in furthering the competitiveness of the supply chain. It is imperative that the EU helps to dismantle market access barriers for the import and export of goods and services, as well as enhancing predictability, legal certainty and transparency.
- EU and national governments should recognise that all players in the supply chain have a unique role. Any initiative to understand the supply chain should therefore take a holistic approach which looks at the chain in its entirety.

In conclusion, with the right legislative and business environment, the commerce sector can continue to drive Europe towards a smarter, greener and more prosperous future, to the benefit of all consumers.

EuroCommerce and the commerce sector

EuroCommerce represents the retail, wholesale and international trade sectors in Europe. Its membership includes commerce federations and companies in 31 European countries.

Commerce plays a unique role in the European economy, acting as the link between manufacturers and the nearly 500 million consumers across Europe over a billion times a day. It is a dynamic and labour-intensive sector, generating 11% of the EU's GDP. One company out of three in Europe is active in the commerce sector.

Over 95% of the 6 million companies in commerce are small and medium-sized enterprises. It also includes some of Europe's most successful companies. The sector is a major source of employment creation: 31 million Europeans work in commerce, which is one of the few remaining job-creating activities in Europe. It also supports millions of dependent jobs throughout the supply chain from small local suppliers to international businesses.



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