

ERRT comments on the DG Competition study “The impact of modern retail on innovation and choice”

The European Retail Round Table (ERRT) welcomes the study on ‘The impact of modern retail on innovation and choice’. It is a broadly robust study that is based on detailed data and objective econometric analysis. This lends its findings significant authority and sets a gold standard for analytical quality that studies commissioned by the European public sector should adhere to.

We notably welcome the fact that the results of the study show that the “received wisdom” about the retail sector often is not based on factual evidence; it confirms that the retail sector is both extremely competitive and innovative. We therefore view this study as an important contribution that should help to raise the quality of the EU public policy debate on food supply chain issues. It is therefore a major contribution to the Better Regulation agenda.

We regret, however, that the initial study has been revised since its first publication, and that the section on private labels appears to be the only section that has now been subjected to a different analytical approach (non-linear analysis) than all other sections. We fail to understand this selective approach.

The following remarks are aimed at providing further elements that should help to foster an objective understanding of the functioning of the food supply chain.

1. The study proves that retailers play an important role for innovation and choice

We particularly welcome the fact that the study provides empirical evidence that:

- Retail concentration has no significant impact on choice
- Retail concentration has a positive impact on innovation (except packaging innovation)
- Supplier concentration, conversely, has a negative impact in innovation
- Larger retail spaces are associated with increased choice and innovation

2. The study is likely to underestimate the impact retailers have on innovation and choice

The study correctly measures innovation and choice as seen from the consumer perspective. We strongly support this approach as retailers’ daily business consists in aiming to respond to consumer demand in terms of choice, innovation and price (the latter not being covered by the study, see below).

However, the study’s focus on product innovation and the associated methodology are likely to significantly underestimate the contribution of retailers to innovation activity in the EU, as well as innovation as it benefits final consumers:

- Retailers engage in different types of innovation, including product, process, technology and concept innovation¹. In all these areas, retailers innovate to bring inventions successfully to the market, often in close collaboration with the supply chain. A comprehensive analysis of the role of retail in the overall

¹ These are further detailed in the ERRT contribution to the 2nd European Commission Workshop on the Retail Action Plan, 21 February 2012. See also: Final Report of the Expert Group on Retail Sector Innovation, http://ec.europa.eu/research/innovation-union/pdf/Report_from_EG_on_Retail_Sector_Innovation_A4_FINAL_2.pdf

innovation system would therefore have to take into account these different types of innovation. **The study focuses on only one of these four types of innovation in retail.**

- The choice of data source, based on changes in bar codes, is due to a limitation in data availability across the sample countries. Against this background, we congratulate the researchers for identifying a data source that does provide good quality information. However, it should be recognised that the data only allows the detection of innovation when this leads to a change in the bar code associated with a product. While this will capture a certain proportion of product innovations, notably packaging innovation, it will not capture all changes to product formulation. **Thus, the study is likely to understate product formulation innovation both for retailer own brands as well as for manufacturer brands.**
- Retailer's own brands play an important role in innovation. Firstly, they add to consumer choice by providing additional alternatives to consumers – in terms of increased product variety, or in terms of price variety (or a combination of both). Secondly, they are a driver of product innovation as they allow retailers to work with suppliers to develop new products or product variants. We assume that both these would have been captured by the study. However, own brand products also have an important effect by nudging brand manufacturers to engage in speedier and/or more active innovation than would otherwise be the case. Thus, an increase in own brand product penetration will give an incentive to brand manufacturers to engage in more innovation activity. **The study does not examine such intertemporal effects and thus is likely to understate the role retailer own brands play in product innovation.**
- Modern retail is only one of several channels by which consumer products reach final consumers. Depending on the country, other distribution channels can have very substantial market shares. Consumers can choose to shop with small retailers, at traditional markets, or (increasingly) online. (In addition, food products also reach final consumers through restaurants and catering.) **By excluding all these channels from the analysis, the study is certain to underestimate the degree of competition that modern retailers face, and consequently to underestimate the degree of consumer choice. The study also fails to acknowledge the degree to which new retail channels, particularly online, offer retailers the opportunity to launch new innovative products (branded and own-brand products) given the ability to increase ranging online.**

All these factors explain why the study can only paint a partial picture of the positive role retailers play in innovation and choice. In addition, it is likely to underestimate future developments in the regard because the trend towards online shopping is likely to accentuate consumer demand for a wide choice of innovative products.

3. Interpretation of the study should be objective and consistent with the consumer perspective

The study is an important empirical contribution to the debate about the functioning of the food supply chain. For the ensuing debate, it will be critical to be rigorous in representing the findings of the study objectively.

We regret that the accompanying documentation (press release, executive summary and introductory speech at the launch event on 2 October 2014) all put forward certain messages that, upon close examination of the report, appear unduly critical of the retail sector when the results do not bear this out.

The greatest concern in this regard relates to the revision of the analysis on own brands. The initial version of the study found that own brands have a positive effect on innovation and choice until a certain threshold is reached. This threshold was expected to differ depending on the product category and not specified in the study. We regret that the subsequent revision of the study fails to analyse this finding more in-depth but instead gives poorly

motivated special methodological treatment to the analysis on private labels, with an unduly negative representation of the study's actual findings².

It is important that the debate recognises that a statistical correlation does not allow any statements about the causality between the correlated variables. Two particularly important examples are present in the section on retailer own brands:

- Every single product category displays its unique characteristics. As the study indicates, there are product categories where the share of own brand products is higher than in other product categories³. In many cases, the higher own brand market shares as well as the higher market share growth rates can be observed in categories where brand presence tends to be relatively low and thus the overall number of products available in a given national market and in a given product category is relatively low to start with. The analysis in the study (notably the phrasing “but for the small number of cases... where the share is high, there is a clear indication that choice is much reduced”⁴) suggests that the presence of private labels leads to an active reduction in choice. In fact, **the data merely shows that choice between different products is comparatively low in certain product categories. In our experience, it is the introduction of own brand products in these categories that leads to greater choice.** Thus, the dynamic in each product category needs to be considered before a causality should even be inferred.
- The study's findings on the relationship between private labels and innovation should be equally qualified. Own brand products play an important intertemporal role in spurring product innovation, and the analysis should have taken an intertemporal approach to analyse the real effects of private labels on innovation. Again, the dynamic in each product category needs to be considered before a causality should even be inferred. A visual inspection of the regression results (p 441-462) appears to support this view: while the study would suggest that many visual depictions of the effects of private label products on innovation should show a clear negative trend line (i.e. as dots are further to the right on the x axis, they are situated less high on the y axis). In fact, practically no result appears to show this kind of relationship. Instead, numerous categories display simply that beyond a certain market share, there are no own brand products available, but the figure suggests no negative relationship between innovation and private label market share whatsoever⁵.

Care should also be taken that the debate retains the study's focus on the consumer perspective. It is important to recognise that retailers structure their offer according to consumer preferences and corporate strategies. Elaborate processes are used to determine the best offer in the eyes of consumers (measured by sales success). In addition, the own brand share is a key distinguishing factor which retailers may decide to use to differing

² We regret that the study has since been revised, and that the section on private labels appears to be the only section that has now been subjected to a different analytical approach (non-linear analysis) than all other sections. We fail to understand this selective analytical approach and the revision of the Executive Summary, which only refers to the revised outcome, while the analytical section of the study is more nuanced in its findings: “When the same specification as for all other drivers was used, evidence was found of small positive impacts of private labels on most measures of choice except product price variety where the impact depended on the choice of measure of private labels” (p 222). Equally, there is only evidence that in a “small number of cases... where the share is high, there is a clear indication that choice is much reduced” (p 223). In addition, the alleged negative impact on innovation is qualified twice, where the authors of the study indicate that the statistical significance of their findings was at the 1% interval level only “for a few cases” (p 224) and that the impact was negative only “when a non-linear specification was used” (p 224).

³ Refer to The Economic Impact of modern retail on innovation and choice, Figure 113, page 167

⁴ Ibid, p 223

⁵ Refer particularly, but not exclusively, to the results for coffee, chocolate, milk, ham and delicatessen, savoury snacks, soft drinks and yogurt for hypermarkets on pages 441-462

degrees in order to add value to consumers and respond to specific consumer demands, including niche demands that are often not served by brand manufacturers.

Finally, it is important that the findings of the study get filtered into EU policy making more broadly. Notably, **growth and economic prosperity** have been identified by the study as important drivers of choice and innovation. This strongly supports the European Commission's long-standing policy focus on growth and jobs. However, this has not necessarily translated into better regulation. In fact, the retail sector continues to face numerous obstacles that prevent it from reaping the full benefits of the Single Market and passing these on to consumers. In addition, we continue to face the threat of legislation on issues where the evidence base shows a startling lack of empirical evidence. The present study underlines the need for a rigorous approach to testing all policy proposals for the solidity of the underlying motivations, as well as the real impact on growth and economic prosperity and therefore on choice and innovation for consumers.

4. Retail competition and prices

Prices play a key role in consumer perspectives in retailing. Competition in the retail sector is fierce, and price plays a central role in this competition.

We welcome the fact that the study recognises the impact of European citizens' "stunted purchasing power" (page 56) and the challenge this creates for the food supply chain, including retailers. In this context, it is very important to realise that a significant proportion of European consumers are very price sensitive and consistently look for the lowest prices. Retailers, competing fiercely with each other for every single customer shopping trip, have to take this into consideration, even in markets where the number of different retailers is lower than in others. The fact that consumers make a decision about where to shop frequently – usually on a weekly basis or increasingly more regularly than that – means that a retailer risks losing a customer to a competitor every week. Equally, there is an opportunity to regain a customer every week. We estimate that collectively, European consumers make around 30 billion such decisions every year – probably one of the highest frequencies of choosing between competitors of all markets. In addition, data shows that EU customers on average visit 3.3 different retailers per month – in other words, customers shop around for the best offer.

Against this background, it is unsurprising that the study finds 'little evidence' of a relationship between 'retail concentration' and consumer choice, as each retailer strives to attract as many consumers as possible away from its competitors.

5. Further research

Overall, we welcome this study and the fact that its results show that the "received wisdom" about the retail sector often is not based on factual evidence, notably the findings that:

- Retail concentration has no significant impact on choice
- Retail concentration has a positive impact on innovation (except packaging innovation)
- Supplier concentration, conversely, has a negative impact in innovation
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In principle, these results should close a policy debate that has for far too long focused on emotional and anecdotal evidence which has now been disproved.

There are certain areas in which further focus could help to foster further understanding of the food supply chain:

- The study's case studies give anecdotal evidence of the importance of supply-chain wide collaboration and its importance for innovation in the food supply chain. This is strongly in line with retailers' business

experience, which reflects an ever-increasing focus on competition-driven collaboration in order to deliver innovation to consumers. This reality, which presupposes a cooperative approach and good trading relationships, tends to be underestimated. An improved understanding of this reality is essential to ensure appropriate policy making.

- As highlighted above, the nature of competition in retail generally remains poorly understood. Retailers compete fiercely with each other for consumers, who in turn decide – collectively – around 30 billion times per year where to shop, making the retail sector one of the most competitive industries in the world. This dynamic must be considered in any further consideration of the retail market.