

Supplier-Buyer Relationship Regulation in Food Retail in the Czech Republic

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Abstract

An amendment to the Act No. 395/2009, on the Significant Market Power in the Sale of Agricultural and Food Products and Abuse thereof, was approved beginning 2016. This Act which came into force in 2010, regulates supplier-retailer relationship in the food chain, respectively restrains particular behaviour of retailers in this relationship. The European Union recently pays also big attention to this topic, see for instance the European Commission report published this year. The aim of this article is to assess the efficiency of this Act on the Czech market in the past five-year period.

Supplier-retailer relationship and the EU

There are several important documents concerning the issue of supplier-retailer relationships in the European Union. The most important are: Communication from the Commission - A better functioning food supply chain in Europe (Commission of the European Communities, 2009), Report from the Commission - Retail market monitoring report "Towards more efficient and fairer retail services in the internal market for 2020" (European Commission, 2010), A more efficient and fairer retail market European Parliament resolution (European Parliament, 2010), Green paper on unfair trading practices in the business-to-business food and non-food supply chain in Europe (European Commission, 2013), Communication from the Commission Tackling unfair trading practices in the business-to-business food supply chain (European Commission, 2014) and Report from the Commission on unfair business-to-business trading practices in the food supply chain (European Commission, 2016).

The first one from 2009 was de facto the starting point of further discussions about this issue in the EU. Significant fluctuation, respectively increase in consumer prices with all corresponding consequences, has been the impulse to investigate retailer-supplier relationships more into detail during the second half of the first decade. The document says that "pervasive inequalities in the bargaining power between contracting parties contribute towards reducing both the speed and magnitude of price transmission along the chain and offer an explanation for its asymmetry" (Commission of the European Communities, 2009) (note: asymmetry in the price development).

The text then also mentions the unfair practices that can be found at all levels of retailer-supplier relationship. Three priorities were set for further development of this issue:

1. promote sustainable and market-based relationships between stakeholders in the food supply chain
2. increase transparency along the chain to encourage competition and improve its resilience to price volatility
3. foster the integration and competitiveness of the European food supply chain across Member States.“ (Commission of the European Communities, 2009)

The aim of the reports from 2010 is to identify the key changes and challenges in the industry, including their impact on the whole economy and outline further steps supporting the strategy Europe 2020 (European Commission, 2010b). The paper states in the part tackling this issue that „concentration across the borders of the internal market and vertical integration have jointly given certain retailers considerable negotiating power, allowing them to negotiate low prices.“ (European Commission, 2010a), which was the incentive for similar cooperation and integration processes with suppliers. Thanks to this development, the competitiveness of retailer-supplier chains grew, however, this caused that several externalities emerged, which has impact e.g. on small enterprises, consumers or environment etc. Moreover, retail still lies under its potential from the point of view of the economic efficiency.

The document describes a specific tension accompanying the retailer-supplier relationship. For example, retailers cannot choose their suppliers voluntarily in some cases (some food producers prefer geographical distribution of B2B relationships, and hence e.g. Czech retail chain cannot buy the goods in the Dutch affiliate, but must cooperate with the Czech affiliate). On the other hand, the problem is that “certain contractual requirements applied directly by retailers or their central purchasing groups on their suppliers or by suppliers on primary producers could, in some circumstances, be considered unfair and likely to curb the growth and even the viability of certain competitive companies.“ (European Commission, 2010a). In conclusion, one of the most serious problems of the food chains, is that there is “a lack of rules governing unfair commercial practices and contractual relations between the various parties in the supply chain, and/or poor application of the rules where they do exist“. (European Commission, 2010a). In the 2011 resolution, usage of the current legal means and implementation of the EU measures are stressed. What is more, the self-regulation principle is preferred to the legislative regulation. (European Parliament, 2010)

The purpose of the Green paper on unfair practices from 2013 was to initiate a discussion about these practices and to gain relevant information from particular countries. The paper states the change in the supply chain, especially in its structure. The organisational concentration has enhanced, that enables some players get stronger negotiation power. Unfair practices are defined and described quite into detail, whereas the paper recalls that usage of unfair practices, refers to all members of the supply chain and all phases of supplier-buyer relationship.

The results of the Green paper investigation then mirror, apart from others, in the Communication of the Commission from 2014. In this paper, the unfair trading practices (UTPs) are defined as follows: „UTPs can broadly be defined as practices that grossly deviate from good commercial conduct, are contrary to good faith and fair dealing and are unilaterally imposed by one trading partner on another“ (European Commission, 2014). The document describes the approaches of individual member states towards retailer-supplier relationship regulation with the aim to eliminate the UTPs. The final recommendation of the Commission supports the combination of volunteer initiatives and enforceable measures, which must be

comparable within the EU. Member states were called to re-evaluate their regulatory frameworks in this area, also with respect to cases of good practice.

A very recent report from January 2016, follows many other partial measures and initiatives within the EU concerning this issue. This report foremost evaluates the efficiency of first, regulatory measures in particular countries, and second, the EU Supply Chain Initiative based on voluntary self-regulation. The report states that 20 member states have some legislative measures regulating unfair practices, whereas the most of them have been introduced during the last five years. Some countries define the UTPs only in those relationships, where retailer is one of the contractual parties. However, this is not considered to be enough: the regulatory measures should relate to all actors of the supplier-buyer relationships. The UTPs are divided into four groups: (European Commission, 2016)

- unfair shift of own costs or risks to other party
- asking the other party for benefits without performing some service that would be related to the benefit asked
- unilateral or retroactive changes in conditions agreed
- unfair contract termination or unjustified threat to terminate the contract

In relation to possible solutions, a so called “fear factor” is considered, when the complaining party may be concerned about some measures from the partner, who was accused of using unfair practices.

As far as the voluntary Supply Chain Initiative is concerned, although it is positively perceived as an element cultivating retailer-buyer relationship, it does not have such an importance for solving the disputes, respectively unfair practices so far. Lower awareness about the initiative, and certain distrust of impartiality of the decision-making structures of the initiative and distrust of the ability to efficiently enforce the final decision, may be the most important reasons of this state. At the same time, the above mentioned fear factor plays a role here, as the party making the complaint is not guaranteed anonymity.

In general, the recommendation of the Commission is not to harmonise the legislative measures in this area within the whole EU so far, and to further develop the platform of voluntary initiative as a tool of self-regulation. There is a need to investigate the efficiency of both accesses to the solution of unfair practices in supplier-buyer relationships after some time, with the aim to assess, whether some measure at the EU level would bring some benefits.

Retailer-supplier relationship in the Czech Republic

The Czech Republic regulates this relationship by a so called hard regulation, this means, legislative measures have been adopted. Apart from that, also volunteer initiatives have evolved, however, without any special impact so far. The Act No. 395/2009 on Significant Market Power in the Sale of Agricultural and Food Products and Abuse thereof, which came into force beginning February 2010, is the key legislative regulation of this issue. The preparation and the process of approval of this act lasted for almost ten years, and the final text was mostly influenced by agricultural-food industry lobby. The Act has been criticised not only in the time of the approval process, but also after coming into force. Both subjects involved and specialists on legislation and economy pointed to its weaknesses. Apart from factual reservations, they also claimed that the Act is of a very low juristic quality and that it

is not clearly formulated. This was also one of the reasons why many interested parties aimed to either cancel or amend it.

From the factual point of view, the Act states that only retailers can have the so called significant market power. This is, apart from other factors, defined by the frontier of CZK 5 billion turnover. Further, the Act defines practices banned in the retailer-supplier relationship. Other issues set by this Act, as sanctions and supervision of the Act, are more or less standard. Low quality of the text of the Act made its application uneasy from the beginning. However, the Office for the Protection of Competition then started to apply the “presumption of fault” principle. Any retailer with turnover exceeding the frontier defined by the Act was automatically considered to be a company with significant market power, without any deeper analysis of further factors set in the Act. Such a company had to behave according to this Act to all of its partners, even to big international companies, which are not normally considered to be weak in their B2B relationships. The paradox of the one-sidedness of the Act is thanks to this practice even more visible. Enumeration of the banned practices turned this Act into one of the rigid regulations, which are often criticised by the EU because of its low flexibility.

During the five years, when the Act was applied in its first version, 106 complaints were sent to the supervising authority – Office for the Protection of Competition. The final decision was issued in the cases of two companies. In the first one, there was no sanction, as the firm promised to improve the situation. In the second one, the fine was cancelled by the court and the case was given back to the supervising authority to investigate it once again.

The number of investigations and decisions can be seen in two different sights:

1. the Act is efficient and prevents the misuse of negotiation power and usage of unfair practices
2. the Act is inefficient, as it cannot prove, respectively punish the misuse of the negotiation power and usage of unfair practices

In order to verify one of the two above mentioned positions, the team conducted primary research, in which 500 suppliers to retailers with significant market power were anonymously questioned into detail. As 17 per cent of the questionnaires responded, 85 relevant answers were obtained, to which 16 questionnaires from the farmers directly supplying retailers were added. In this group of 101 respondents, small, medium, and also big companies were represented, with both domestic and foreign capital and various food assortment. Especially the first two questions, asking about the change in the quality of the retailer-supplier relationship respectively change in the negotiation position are important to assess the efficiency of the Act.

Table 1: Change in the quality of the retailer-supplier relationship after the Act came into force

The relationship	Number of the companies according to their size				
	Micro	Small	Medium	Big	Not answered
Improved	-	3	9	2	-
Did not change	4	22	36	15	2
Deteriorated	1	3	2	2	-

Source: Own research

Table 2: Change in the negotiation position after the Act came into force

The negotiation position	Number of the companies according to their size				
	Micro	Small	Medium	Big	Not answered
Improved	-	1	6	2	-
Did not change	4	24	38	15	1
Deteriorated	1	3	3	-	1

Source: Own research

The survey shows that with 78 per cent of the respondents, there was no change in the quality of the relationship, and that with 83 per cent of them, their negotiation position hadn't changed. It may be therefore claimed, that the Act has not been effective. The answers concerning the particular banned practices were even more alarming. Thanks to their precise enumeration, the team was able to ask about the practices unequivocally defined in the Act. Depending of the type of the practice, 24 – 47 per cent of the respondents have met particular practice even after the Act came into force. However, if the Act was obeyed, there should be no respondent confirming usage of the banned practice now. Moreover, many respondents in many cases described strategies of retailers, where strictly defined enumeration of banned practices helped to find a way, how to compensate the particular practice. For example, politicians mention the elimination of two practices as a success of the Act: shortening the payment period for less than 30 days and returning non sold food back to the supplier. The first ban was compensated by the pressure on lowering the prices explained by time value of money. The second ban caused, apart from others, more frequent supplies, which enhances the suppliers' costs. In a similar way, most of the forbidden payments were replaced by others that were not enumerated in the law.

As a result, the authors of this paper incline to the second opinion about the Act inefficiency. All these factors then led to amendment to the Act, which came into force in March 2016. Key changes are to be found especially in the following: (Neruda et al., 2016)

- defining the scope of the Act
- definitions of some terms
- definitions of the banned practices
- contract requirements

From the point of view of the scope of the Act, it was also extended to the suppliers of the services that are linked to food supplies. It is also not important any more, where the significant market power was misused, the decisive factor is that the misuse has an impact in the Czech Republic. Among definitions, the term buyer has been extended also to purchasing alliances, respectively to a certain type of agents. The practical implementation of the former Act, inspired the law makers to define that the significant market power relates to the buyer, and is not related only to certain suppliers (e.g. only to the small ones). Further, only one violation of the Act is enough to punish the buyer according to the law, there is no more need of systematic violation.

It can be positively seen that the definition of the term “food” has been precise. As far as the definitions of the individual banned practices are concerned, these were embodied directly to the Act, formerly they had been added in attachments. However, generalisation of their definition represents a very important change in the Act. Whether this will support the enforceability of this law or whether this will only cause even higher legal uncertainty, will be

seen in practice. Concerning the contract requirements, apart from some uncertain definitions, opponents of the Act mainly criticise that all the payments from suppliers to retailers, must not cross the border of 3 per cent from the supplier's turnover of food, towards the certain retailer from the last year. To sum it up, taking into account many ambiguities and uncertainties in the Act, it is not sure that the amendment to the Act on significant market power will improve retailer-supplier relationships.

Conclusion

Supplier-buyer relationships are considered to be an important topic in the EU. The European bodies pay a big and systematic attention to this issue. This interest mirrored also in quite serious documents, whereas it is expected that the investigation of the supplier chains will continue. Especially, the food supply chain stands in the spotlight. Although there are many problems identified, the EU does not want to harmonise the legislation in the whole EU, and prefers regulatory frameworks in particular countries and voluntary initiatives of self-regulation.

The Czech Republic belongs to the countries, where the supplier-buyer relationships are regulated by law, especially by the Act No. 395/2009 on significant market power, respectively by its current amendment. The former practice proved its relative inefficiency that mirrored not only into the number of cases with final decisions, but also into the evaluation of the Act from the point of view of suppliers. Whether the current amendment will help to efficiently solve the issue, will be seen during the coming years.

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