Retailer-Manufacturer Relationships
in the Food Sector -- Some Observations
From the U.S.A.

By

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This paper illustrates some of the structural and performance implications for the U.S. food system of the procurement relationships between U.S. food distributors and food manufacturers. The elements of buyer-seller bargaining power in industrial sectors are enumerated to help in identifying key bargaining elements present in the U.S. food sector. General descriptions of how retailers and manufacturers interact when exchanging brand products and retailers-own-label products are presented. Through these descriptions, several significant implications for the U.S. food system are enumerated. These descriptions also allow for an examination of the U.S. price discrimination law's effects on food retailer-manufacturer interactions. Some significant factors which might alter the bargaining power balance between U.S. food industries are identified as an aid to helping project future U.S. food retailer-manufacturer interaction and the resulting public policy implications.

Elements of Buyer-Seller Bargaining Power

The ubiquity of buyer-seller bargaining in exchange economies is of interest to a great many analysts. Understanding the determinants of bargained exchange is of particular interest to individuals planning competitive strategies. A recent enumeration of basic elements defining the power relationships between buyers and sellers was made by Michael Porter (Porter, pp. 24-29). His lists incorporated in the basic industrial organization framework from economics are presented in Figure 1 below. Referring to this general framework for buyer-seller power assists in understanding a) how buyer-seller interaction dynamically interacts with sector structure and performance, and b) what specific power elements are the most critical to food retailer-food manufacturer bargaining.
Figure 1. Elements of Buyer-Seller Bargaining Power within a General Industrial Sector Framework.

Determinants of Bargaining Power of Buyers*

A buyer group or buying industry is powerful when:

- It is concentrated or purchases large volumes relative to seller sales.
- The products purchased from the selling industry are a significant fraction of the buyers costs or purchases.
- The products purchased are standard or undifferentiated (i.e., commodities).
- The buyer incurs few costs when changing to alternate suppliers.
- It earns low profits.
- Buyers pose a credible threat of backward integration.
- The supplying industry's product is unimportant to the quality of the buyer's products or services.
- The buyer has more complete information.
- The buying industry can influence consumers' purchasing decisions.

Determinants of Bargaining Power of Suppliers*

A supplier group or supplying industry is powerful when:

- It is dominated by a few companies and is more concentrated than the buying industry.
- It sells products with few substitute products for sale to buyers.
- The buying industry is not an important customer of the supplying industry.
- The suppliers' product is an important input to the buyer's business.
- The supplier group's products are differentiated.
- The supplier has built up the switching costs for the buyer.
- The supplier group poses a credible threat of forward integration.

Basic Conditions of the Buying Industry

Structure of the Buying Industry

Structure of the Selling Industry

Basic Conditions of the Selling Industry

Sector Conduct

Efforts to shift risk
Sector coordination
Terms of trade determination, etc.

Sector Performance

Allocative accuracy
Equity of returns for risk and investment
Sector adaptability
Accuracy and equity of information distribution
Employment characteristics, etc.

For any given industry (either retailing or manufacturing) the basic technical and economic conditions largely determine the industry's structure.\footnote{Enumeration and explanation of basic conditions and structure dimensions were excluded from Figure 1 for the sake of clarity. For more detail, refer to Scherer, pp. 1-9.} Principal structural characteristics, including things like the number and size of firms, degree of product differentiation, cost structures, etc., form the basis for an industry's bargaining position with its suppliers and buyers. A brief review of the determinants of bargaining power suggests that power in the exchange process is primarily a function of: the degree of competition (or lack thereof) in the industry; the relative importance of the other industry to the sales or purchases of the industry in question (who needs who the most); and the potential for one industry to integrate some or all of the functions of the other industry.

The outcomes of buyer-seller bargaining processes result in sector conduct. In relatively nonindustrialized sectors, the bargaining process results in a price which represents the value of the transferred product. However in more highly industrialized (organized) sectors the bargaining process determines many conditions, some of which are not readily convertible into a common price denominator. These negotiated elements often shift to other industries in the subsector and thereby can influence performance in the entire vertical sector. For example, suppose a chemical spray is required to grow a certain agricultural product. However, when bargaining with food processors suppose the buyers for grocery stores insist that the processors be liable for any damages caused by chemical residues in the finished product. The processor may then in turn require agricultural producers to accept the financial consequences of chemical use. In this case, the bargaining process between retailer and manufacturer directly
influences the entire sector performance.

The other critical aspect of bargaining between buyers and sellers is that the outcomes (conduct and performance) feed back onto the basic economic and structural conditions in the buying and selling industries. Consequently, today's bargained outcome can influence the power distribution between buyers and sellers tomorrow. Thus many of the evolving structural trends in industries logically flow from the interactive relationships of retailers and manufacturers.

Noticeably absent from Figure 1 is government and public policy. Since government policy, rules, and influence are omnipresent in all dynamic industrial interaction, it would be misleading to isolate and assign its influences at one particular stage in the bargaining process. Of particular concern to this paper, are government policies which directly impact on buyer-seller bargaining relationships. The United States has one particular law, the Robinson-Patman Act, which directly addresses buyer-seller relationships. The operation of the Robinson-Patman Act in the U.S. food system is discussed below.

Although food retailer-food manufacturer bargaining relationships have many of the elements enumerated in Figure 1, one bargaining element is a particularly important source for food retailer buying power. Generally, the way consumers buy food products gives food retail buyers much influence over their decisions. This is because while food as a category is a large part of a consumer's budget and therefore merits time investment by the consumer, this is not usually the case for individual food items. Since individual food items are relatively small purchases, consumers often find it uneconomic to invest in search time in order to make the optimal purchases.
As a result, consumers often are not very price sensitive for individual food items. This consumer behavior therefore grants some discretionary power over many individual food items to food retailers. The retailer's discretion to price and position individual products can dramatically alter a manufacturer's product(s) sales performance. (See Appendix Table 1 for empirical evidence).

While this particular element is critical to food retailer buyer power, other elements are also important to food retailer-food manufacturer relationships. The profit level of retail firms clearly influences how hard they bargain with suppliers. Also crucial is the degree to which buyers allow themselves to be bound to suppliers so that switching becomes expensive. For example, retailers are usually better off not developing unique product specifications for their own label products or allowing brand manufacturers to sell large arrays of products. Both of these strategies increase suppliers' bargaining power. The examples presented below will illustrate that the bargaining process in the USA does not consistently favor retailers or manufacturers. Rather it is dependent on the nature of the individual food products and which industry controls the brand identification of the product.

The Heterogeneous Nature of the U.S. Food Sector

Products sold in the U.S. grocery stores have different physical and marketing characteristics which influence their procurement patterns. Perishable products (fresh meats, produce, dairy products) have different supply channels and procurement procedures than manufactured or processed grocery products. Grocery products delivered directly to retail stores have different

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2 In the U.S. there are about 400-500 items in a 10,000-12,000 item supermarket for which consumers display some general price level familiarity. For a theoretical economic explanation of this process, see Hamm (1981, pp. 391-406.)
advertising and promotion characteristics from those delivered and sold through food retailer warehouses. However, perhaps the most significant differences between food products sold through food retail outlets are whether they are the retailer's own label (private label) products or whether they carry the brand identification of the manufacturer.

Any manufactured food product must inter alia go through a design stage, production stage, distribution stage and marketing stage. The basic difference between brand and private label food products is with the monitoring and responsibility for the product in the vertical food sector. Brand food products are conceived, usually manufactured, distributed and marketed under the manufacturer's control. These products maintain the manufacturer's identity through the food system. Of particular importance is that manufacturers are responsible for the market identification process. Retailers merely provide the product access to the consumer.

Private (distributor, controlled, retailer, etc.) label products are items whose identity is largely determined by the food retailer. Often retailers do not design or manufacture the product. Rather they purchase the product from a manufacturer who chooses not to or is unable to develop distribution and marketing functions for the product. Therefore retailers assume responsibility for the wellbeing of the product through the distribution system. Retailer buyers are thus responsible for quality specifications, label design, transportation, warehousing, promotion and advertising of private label products. Since retail food buyers have different degrees of responsibilities for brand versus private label food items, one would expect that the bargaining relationships of food retailers with brand food manufacturers and private label processors to be different.

In 1971, C.R. Handy and D.I. Padberg's article entitled "A Model of
Competitive Behavior in Food Industries," postulated a vertical, behavioral interaction between four food industry subgroups identified as 1) a food manufacturing oligopoly core, 2) a large fringe of small and medium sized food manufacturers, 3) a food distribution oligopoly core (large food chains), and 4) a large fringe of small and medium sized food retailing firms (Handy and Padberg, pp. 183-190).

Large manufacturers were said to concentrate on selling to new and existing brand products to marketing oriented small/medium sized food retailing firms. The cost control, efficiency oriented, large food distributors link with the limited line, efficiency oriented small and medium sized processors which specialize in making private label products. Handy and Padberg then postulate that these two vertical units compete against one another for the consumers' attention. The large distributor/small processors sector tends toward price competition with limited differentiated private label products. The large manufacturer/small retailer sector tends toward various nonprice, new product competitive strategies. In this way, according to the authors, the two oligopolistic elements (large manufacturers and large distributors) in the food industries avoid direct confrontation.

There is some question today whether the large fringe of small and medium sized food retailing firms exist as a separate entity in the U.S. food system. Most of these firms are now affiliated with large wholesale distributors who, for the most part, procure manufactured food products with methods very similar to those used by large chain distributors (Hamm 1981, pp. 564-567; Grinnell). However there is little question that two procurement systems, one for brand products and one for distributor label food products, operate simultaneously within the U.S. food sector.3

3In a recent working paper, Connor (1981a) attempts to separate the proportion of food manufacturer production going to various segments of the U.S. food economy. This is the first attempt to quantify these channels for all food manufacturing.
For many products there are different suppliers selling to these market segments. Logic dictates that retail buyers would not want to deal with dual brand manufacturers, and manufacturer sellers would not want to be a dual brand (manufacturing both brand and private labels of the same items) processor. Because the retailers control consumer access (shelf space) for all items, dual branding would place the manufacturer in a vulnerable position, whereby the retailer could put pressure on one area of the business in order to get concessions in the other area. Retailers also realize that should a dual-brand manufacturer suffer raw product interruptions or supply problems, the manufacturer would logically protect its brand franchise first. Thus, dual branding leaves retailer private label supply lines vulnerable.

A recent U.S. study on the procurement practices of food distributors documents how food buyers interact with food manufacturer sellers (Hamm, 1981). The study provides a good basis for examining the relationships of brand grocery buyers to brand manufacturers and private label buyers to smaller private label commodity processors. The two case descriptions which follow are taken from that work. Because processed fruit and vegetables are one crop a year commodity type items, the general level of sector risk is high and inventory costs significant. Consequently, the implications of the outcomes of retailer-manufacturer bargaining are more dramatic for subsector performance and structure. They demonstrate the importance of various elements

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4 Dual brand manufacturers are firms who process both advertised brands and private labels in the same product category. Manufacturers often package private label products in product categories where they do not have brand labels.

5 Extensive dual branding raise several policy issues including issues about the direct comparability of brand and private label products and dynamic competitive consequences to specialized private label manufacturers. A study of dual branding is now underway at the Univ. of Wisconsin.
in bargaining power for explaining structural evolution in food sectors. They will also show that it is necessary to analyze these power elements within various segments in the food sectors. Where there is heterogeneity among firms in food industries, the structural consequences of retailer-manufacturer interactions can differ markedly.

The Interaction of Brand Manufacturers and Food Retailers

Success for any brand manufacturer is dependent on gaining entry into grocery stores. The criteria retail buyers use to judge the probable success of a new item thus are critical to manufacturers. Retailers will need to displace or reduce the shelf space for existing items irrespective of what kind of new product manufacturers are introducing. From a retailer's perspective the decision is one of net profit gain. If the new item, all things considered, will likely contribute more net revenue to the retail organization than the existing product it is displacing, retailers will approve the new item for distribution to their stores.

Ultimate new product success depends on consumer acceptance. Since precise prediction is impossible, retail buyers have developed criteria for the probable success of a new product, based upon past experience (Hutt; Hamm, 1981, pp. 139-148). These include:

- Advertising support
- Test market results
- Quality and appearance of the package
- Product "newness"
- Introductory advertising allowances
- Introductory deals
- Reputation of the manufacturer
The first four criteria relate directly to how consumers will learn about and react to the product. The last three are criteria which relate to retailers. Introductory allowances and deals affect the retailer profit margin. These are direct payments made by manufacturers to retailers to help defer the costs retailers incur by allowing the new product into the stores. The reputation of the manufacturer is a proxy for the size, past performance and sophistication of the firm: in other words, whether this manufacturer's recent product introductions have lived up to their claimed consumer sales and retailer profit potentials. These criteria will be assigned different weights depending on the type of "new" product being introduced. Advertising support (consumer advertising and couponing activity) is the most significant criterion. Even if buyers have reservations about other new product selection criteria, they will nevertheless accept the item for distribution if they deem that the manufacturers advertising will create consumer buying interest (WSJ, August 2, 1980). Consumer advertising is thus a necessary condition for entry into brand grocery distribution.

New product campaigns are given in written form to all grocery buyers in the geographic market where the manufacturer is trying to establish the new item. These formal announcements assure all grocery buyers that they are receiving the same financial considerations as are their competitors. Simultaneously, the manufacturer's competitors find what competitive tactics it is using to gain greater consumer sales.

After the product introduction stage, the formal specification of dealings between retailers and manufacturers continues through the life of the product in the grocery trade. List prices issued by manufacturers govern the wholesale pricing structure on a daily basis. This process assures everyone in the
market region that prices are the same.⁶ The dynamics of manufactured food 
pricing change however when manufacturers decide to lower their product's price.⁷

Manufacturers normally lower prices either to increase their product's 
market share over rival products or to balance an inventory problem caused 
by changes in basic supply or demand factors elsewhere in the sector. How-
ever, to increase sales via a wholesale price decrease requires that the 
distributor pass on the wholesale reduction to consumers and that consumers 
recognize the price decrease and respond to it. Because of the power retailers 
have over individual products (recall Appendix Table 1), manufacturers 
attempt to have their price reductions tied to specific marketing actions by 
retail distributors.

To accomplish this, manufacturers develop elaborate programs (called 
"deals") which contractually link a wholesale price reduction with retailer 
marketing actions for the manufacturer's product. Table 1 enumerates the pro-
visions and gives an example of fairly standard promotion programs offered 
by manufacturers. The basic provisions outline the length of the price 
decrease (usually four weeks); the extent of the price reduction; the 
performance requirements for the retailer; and other standard payment conditions. 
A key factor is that all retail distributors in a market area get this same 
promotion. Provision 6d of Table 1 demonstrates how critically manufacturers 
view this responsibility. They contractually require wholesalers to inform 
their independently owned retail store customers about the price reduction 
and required marketing actions.

The essence of retail distributor-food manufacturer bargaining in the

⁶List prices usually include provisions for discounts for large quantity 
purchases. Thus, list pricing assures that all buyers buy by the same rules 
even though they might have different net prices.

⁷Price increases are handled by issuing a new schedule of list prices.
U.S. focuses on the composition of these formal promotion programs. The retailers would like to have the price reductions with the minimum amount of marketing concessions on their part. In fact, they would like to have the price concessions (retailers allowances) with no conditions. Conversely, the manufacturers attempt to maximize retailer marketing activity directed toward their products for a given price reduction.

In the U.S., a typical grocery buyer will have between 400-600 of these manufacturer promotions to choose from on any given week. As with shelf space, retailer merchandising opportunities are limited. Off-the-shelf display space is generally fixed. Because of budget constraints and commitments to private label, produce and meat advertising, retail newspaper advertisement and promotional activities are limited for brand grocery products. Retailer power comes from being the consumers' purchasing agent and controlling access to limited sales space and marketing activities.

A key to a manufacturer's success is assuring that its promotions are chosen and implemented by retailers. Comparing activities (like Provision 6a in Table 1) informing consumers about the price concession available at local grocery stores put pressure on retail buyers to select this manufacturer's promotion over those offered by competitors. When promotions are coordinated with extensive television advertising (Provision 10 in Table 1) buyers and merchandisers generally lose their discretionary power over which of the hundreds of promotions to choose. Not to choose a manufacturer's promotion with well planned and executable direct consumer price promotion and advertising strategies would cause consumer resentment toward the retail firm. This essence of food manufacturer power in the U.S. is the ability to fund and execute consumer promotion programs which diminish retailers' discretionary powers.

When consumer advertising is combined with well-coordinated manufacturer
Table 1. Grocery Manufacturer Promotion Programs

<table>
<thead>
<tr>
<th>Standard Deal Provisions</th>
<th>Example of a Specific Promotion</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Local Market Area Covered</td>
<td>To all our customers in the Greater Detroit market area</td>
</tr>
<tr>
<td>2. Product Identification</td>
<td>NB Peanut Butter - 12/18 ounce</td>
</tr>
<tr>
<td></td>
<td>Smooth Dumpy</td>
</tr>
<tr>
<td></td>
<td>UPC-72046 UPC-72006</td>
</tr>
<tr>
<td>3. Promotion Period - Time period during which price reduction is offered</td>
<td>March 31, 1980 - April 25, 1980</td>
</tr>
<tr>
<td>a. First Shipping Date - First day when priced product can be shipped to distributor warehouse</td>
<td>a. March 31, 1980</td>
</tr>
<tr>
<td>b. Last Order Date - Last day for accepting buyers orders for deal merchandise</td>
<td>b. April 18, 1980</td>
</tr>
<tr>
<td>c. Last Shipping Date - last day for distributors' orders to be shipped from manufacturer's warehouse</td>
<td>c. April 25, 1980</td>
</tr>
<tr>
<td>4. Performance dates - Time period during which retailers must execute the stipulated requirements set down by the manufacturer.</td>
<td>March 31, 1980 - May 10, 1980</td>
</tr>
<tr>
<td>5. Terms of the Promotion - Stated Reduction off of list price; method by which this price reduction is passed on to the distributor; and statement of retailers responsibility.</td>
<td>$1.44 Special Advertising Merchandise Allowance on 18 ounce NB Peanut Butter will be deducted from the invoice or paid by NB Foods, Inc. at the end of the performance period on all shipments during the above period providing the retailer qualifies as listed below.</td>
</tr>
<tr>
<td>6. Performance Conditions - Standard legally binding performance contracts are written by manufacturers and signed by retailers. Provisions vary according to manufacturers marketing strategies. Some specific classes of provisions include:</td>
<td>Standard form of performance contract utilized with all accounts.</td>
</tr>
<tr>
<td>a. Require a retailer controlled coupon for a specific price reduction be placed in retailer's advertisements.</td>
<td>a. Include in regular principle newspaper ads or handbills a 12c (minimum value) &quot;throw-away&quot; store coupon. NB Foods is not responsible for any redemption or handling costs. Coupon will be good on 18 oz. NB Peanut Butter (Smooth or Dumpy) at stores noted in advertisement in which a coupon appears.</td>
</tr>
<tr>
<td>b. Require the retailer allocate space and/or time in retailer paid advertising to the promoted product at the promotion price.</td>
<td>b. Place a two column inch ad in regular principle newspapers for 18 oz. NB Peanut Butter showing 12c (minimum) price reduction below regular price during the performance period.</td>
</tr>
<tr>
<td>c. Require that the promoted product be given, for a specific time period, different shelf location and/or in-store advertising support than that normally given to the product.</td>
<td>c. Display separate and apart from regular shelf space featuring 18 Oz. NB Peanut Butter at a 12c (minimum) price reduction below regular price for at least one week during the performance period.</td>
</tr>
<tr>
<td>d. Require that cooperative, affiliated, and unaffiliated wholesale dealers provide their store accounts with the option to participate in this promotion.</td>
<td>d. Wholesale dealers must publish to all accounts (in bulletins or manner usually used) informing accounts that they will pay allowance for a minimum period of three consecutive weeks. Bulletin should state that allowance is payable to retail customers for performing according to terms of the NB Foods, Inc. contract.</td>
</tr>
<tr>
<td>7. Stock Protection Clauses - Statements that are designed to eliminate the possibility that retail buyers will suffer inventory losses as a result of the manufacturer's price reduction.</td>
<td>For all merchandisers accepting this contract, unsold stocks in buyers' warehouses, except Fodservice and Industrial users, shipped between March 3, 1980, and March 31, 1980, and not to exceed prior 30 days shipments will be protected to the full amount of promotional allowance, regardless of price at which billed. This applies to off-invoice allowance or to performance promotions when customer signs contract.</td>
</tr>
<tr>
<td>8. Terms - Standard Payment Terms</td>
<td>2% for cash in 10 days will be allowed on the gross amount of the invoice before deduction of this allowance, providing remittance is mailed to address designated on invoice.</td>
</tr>
<tr>
<td>9. Advertising - statement of manufacturer provided advertising support</td>
<td>Heavy prime time network and spot TV on ABC, CBS, and NBC during promotion period.</td>
</tr>
<tr>
<td>10. Miscellaneous Provisions - statements added which attempt to prevent retailer attempts to subvert the performance contract.</td>
<td>a. NB Foods, Inc. reserves the right to limit quantities purchased by merchandiser.</td>
</tr>
<tr>
<td></td>
<td>b. Merchandise sold under the terms of this allowance is offered for resale only in the above market area.</td>
</tr>
</tbody>
</table>
representative (salesperson or brokers) actions in the local stores, the sales impact is even greater. Large manufacturers who have sales personnel visit buyers and stores can assure that their promotion program is given a fair hearing. These personnel also help to construct displays, post signs, etc. in grocery stores. Therefore, manufacturer personnel help assure that retailer agreed-to contractual provisions in the manufacturer's promotion are implemented and coordinated with consumer advertising.\(^8\)

Within the framework developed in Figure 1, the bargaining power relationship between retailers and brand manufacturers is largely a balance between the degree of retailer control of consumer access and manufacturer's ability to create product differentiation: The interplay of these two forces tends to feed back to the market structure in the basic industries. Manufacturers with successful product differentiation have higher profits and therefore prosper. Since the process of selling brand food products and managing their flow through the distribution system tends to be transferable across product types, conglomerate food marketing tends to be a natural by-product of successful brand marketing.

The structural feedback on food retailing industries is less apparent. So long as all retailers have equal access to manufacturer price concessions, there would be no direct structural impact. However, as manufacturers become increasingly large with more differentiated products, retailers must adopt strategies to keep the relative balance of power stable. The most obvious strategy is to grow larger and therefore control more consumer access. A more direct approach is to develop their own products.

\(^8\)In the U.S., retail trade directed activity is called "push promotion" whereas consumer directed activity is called "pull promotion." For a more complete enumeration of techniques, see Gallo and Hamm.
The Interaction of Private Label Manufacturers and Food Retailers

Food retailers' interactions with private label suppliers are a marked contrast to those with brand manufacturers. While brand manufacturers are responsible for their products beyond the manufacturing process, private label processors abdicate those functions to retail distributors. This is critical in bargaining power with retailers especially if retailers have several private label suppliers. An individual private label manufacturer has no incentive to advertise, promote or hire retail salespersons. To do so would mean that his resources would be promoting the sales of other private label manufacturers producing the same products. Consequently price is more critical in the bargaining between private label suppliers and retail buyers.

An example of the procurement of private label processed vegetable products is presented to illustrate how private label manufacturer-retail buyer interaction operates in the U.S. This example is applicable to most private label products which have large agricultural raw product components. Otherwise it is difficult to generalize about the U.S. private label system. Elements of retailer backward vertical integration exist. Procurement of non-agriculturally based private label products have some unique characteristics. Also, U.S. retail distributors often sell several private label lines in the same store, each with different characteristics. These types of differences affect the distribution of power between manufacturers and retailers. Therefore, some caution must be used when generalizing from the example given here.

The first step in developing a private label product is the formulation of product specifications. Appendix Table 2 is an example of the type of

9 For a more exhaustive study of the U.S. private label procurement system, see Hamm, 1981.
product specification developed by food retail buyers. It is quite specific and usually is the retailer's attempt to copy the leading selling national brand item in that product category. This product specification is then sent to many manufacturers. From the samples prepared by the processors, the retail buyer selects a set of suppliers who are authorized to pack or process this product. Most major U.S. private label procurement organizations maintain quality control and monitoring laboratories to develop, test, and monitor manufacturer compliance with product specifications.

Retailers also develop labels for these products. The authorized suppliers are issued label inventories from which they can draw when they receive a shipping order from the buyer. The labels are the property of the buyers. When a manufacturer packages a product in a retailer's label, that product has little salvage value. Retail private label specifications differ across firms so that the packaged product might not meet another buyer's specifications. More prohibitive, however, is the cost of removing the label and relabeling and repackaging the product.

For these products, the U.S. private label buyers use a verbal contracting system known as "booking." Some time before a manufacturer initiates processing the product but often after the manufacturer has to commit to growers for the raw product supplies, the retail buyer comes to the manufacturer and makes a verbal contract similar to the following. The retailer agrees to take a given number of units (100,000 cases of green beans, for example) during the upcoming market year subject to the buyer's approval of price and sample at the time of shipment. Under this system, the buyer reserves product from the manufacturer's production run but does not commit to purchasing that product unless the manufacturer's product meets the buyer's specifications and buyer's price at the time that the buyer wants the product. Should any particular
supplier disagree with the buyer's price, they can refuse to ship product. In that case, the buyer usually requests shipment from another supplier. The buyer also has some protection should market price fall between the time of shipment and receipt of the product at the retailer's warehouse. Should the manufacturer not agree to lower the invoice price, the manufacturer may find that this product shipment does not meet the buyer's specification. At this point, the manufacturer has his product in the buyer's labels and in the buyer's warehouse. To minimize losses, the manufacturer usually agrees to the new price quote of the buyer.

Private label manufacturers are in a dramatically different situation than are brand manufacturers. A key difference is the general knowledge of all buyers and sellers of the market price. An equilibrium market price for unlabeled processed green beans does exist. However, in the absence of a central market which would generate a price that both sides could use, buyers and sellers are relegated to discovering the price through their own business dealings. Buyers always have superior information. Buyers can poll all suppliers, but suppliers, because of U.S. antitrust laws, must be cautious in discussing prices with competing suppliers. In general, suppliers only receive price information from buyers when buyers are willing to share that information.

Under this private label pricing mechanism, the buyers are not assured that other retailers in their market area are paying the same price for their private label product. Unlike the formal price promotion schemes used by brand manufacturers which inform all market participants about the wholesale price, the private label system in the U.S. runs with unwritten and informal pricing mechanisms.

Another difference is that private label manufacturers have less ability to balance their inventories during the marketing year. The formal brand
promotion plans and consumer advertising help get wholesale price reductions through to the consumer. Therefore, lower wholesale prices usually lead to increases in quantities demanded. Private label manufacturers, however, have no control over retail prices. Retail buyers must use their discretionary marketing power to increase consumer sales. Should retailers pass on none or only part of a wholesale price decrease, private label manufacturers would have to lower wholesale prices even more in an attempt to balance supplies with demands. For this reason, processed food products with large agricultural commodity components and with large private label sales tend to have highly volatile price cycles (Hamm, 1981 pp. 478-500).

The private label buyer behavior also impacts on the agricultural producer. Since private label suppliers are responsible for nearly all the price risk associated with balancing the inventory of processed products in the system and exercise little influence over retail buyers, inventories may not balance. If they do not, processors will cut back orders for raw product from growers. Grower incomes then become more cyclical than otherwise would be necessary with different retail buyer behavior. The performance implications are particularly pronounced for producers of perennial crops.

Retail buyer-private label manufacturer interactions also feed back dynamically onto industry structure. Without differentiated products, private label manufacturers are at the mercy of large private label buyers. These buyers, if they take a short term view, could force small and medium size manufacturers to sell below cost. In the long term, however, the buyers would create a more concentrated manufacturing industry. This result would be the same irrespective of whether retailers used their monopsony power to generate monopoly returns or used the extracted revenues to offset losses they are suffering on other products.
When reviewing the elements of bargaining power for suppliers (Figure 1), there appears, in the absence of product differentiation, little that private label suppliers can do to overcome retail buying power aside from becoming more efficient. Often the quest for efficiency leads to firms becoming larger. As concentration occurs however, private label suppliers often diversify into other markets. Private label manufacturers tend to shift their customer lists away from the grocery trade and become important suppliers of the restaurant and public sector markets. In this way, they attempt to reduce the importance of food retail buyers as a percent of their output.

In the U.S. food sector, the actions of food retail buyers in their dealings with food manufacturers seem to be dynamically altering the structure of food manufacturing industries. In the brand segment of the U.S. industry, this seems to be a consequence of the success of the largest firms in overcoming retail buying power. Large brand manufacturers' product differentiation strategies generate profits sufficiently large so that they can continue to grow and prosper. In the private label segment of the U.S. industry, retailer procurement power forces suppliers to be the lowest cost producers and encourages expansion into other food market segments. Over the long run, retailer bargaining power could diminish as brand and private label suppliers decrease in numbers and increase in relative size. Some retailers recognize the longer term consequences of increasing concentration and have adopted policies to develop and maintain viable competition (Hamm, 1981, pp. 528-50).

The likely structural implications of food retailer-food manufacturer interactions enumerated above logically follow when the parties involved respond to the economic conditions that they face. The qualitative analytical evidence to date (Hamm, 1981) generally supports these trends. Quantitative empirical verification has yet to be done. Currently, there is little empirical doubt
about the role of advertising in the structural evolution of U.S. manufacturing industries (Mueller and Rogers). The empirical work isolating the impacts of advertising and other product differentiation strategies on food manufacturing are not emerging (Rogers; Connor, 1981b). Unfortunately, the data bases needed to document the structural evolution of private label manufacturers are just now being developed (Connor, 1981). As they become available and as more attention is directed toward the food retailer-manufacturer interface, the structural and performance implications of retailer-manufacturer relationships will become better understood.

**Government and Food Retailer-Manufacturer Relationships**

As mentioned earlier, government influence is omnipresent in the dynamic operation of the U.S. food sector. For example, government grades and product standards of identity are important for the operation of private label procurement system (see Appendix Table 2). Direct restructuring of food industries via mergers and acquisitions is regulated to some extent by U.S. antitrust laws. One U.S. law, the Robinson-Patman Act, however, has particular implications for the relationships between food retailers and manufacturers.

Although a prohibition against price discrimination was included in one of the first U.S. antitrust statutes (Clayton Act of 1914), it was not until a fundamental change in U.S. food retailing structure that a comprehensive price discrimination law was passed. The development of retail grocery chains (particularly A & P) and self-service supermarkets put significant financial pressure on small independent food and drug retailers. The aggressive buying practices of these new actors in food retailing led to the enactment of the Robinson-Patman Act in 1936. Since then the Act has been a fixture in the U.S. food sector. It has also been one of the more
controversial components of U.S. food sector policy. Economists generally disapprove of the Act which they maintain is designed to protect competitors rather than competition (Scherer, pp. 571-82). Enforcement via case law through the U.S. judicial system has been inconsistent. Irrespective of these factors however, the Robinson-Patman Act does influence retailer-manufacturer relationships.

There are a number of basic components of the Act. Manufacturers are prohibited from charging different prices to different buyers of "goods of like grade and quality" where the effect "may be substantially to lessen competition or tend to create a monopoly in any line of commerce, or to injure, destroy, or prevent competition with any person who either grants or knowingly receives the benefit of such discrimination, or with customers of either of them." Price differences can be justified by differences in the costs of doing business with different buyers. Two other exceptions are also made. Prices can be different if the goods sold are distressed (perishable, obsolescent, or bankrupt merchandise) or the prices charged are a "good faith effort to meet an equally low price of a manufacturer competitor." The Robinson-Patman Act also outlaws certain types of brokerage (most notably "buyer brokers") arrangements.\textsuperscript{10} The Act also prevents sellers from making payments or providing services to buyers unless the payments and/or services are available to all buyers on proportionally equal terms. Things included under

\textsuperscript{10} Brokerage fees paid by the supplier to brokers are for services that brokers perform. These include developing new buying accounts as well as inducing current buyers to purchase more product. A buyer's broker serves only one retail account and therefore does little for the supplier other than providing the retailer with discounted merchandise.
these provisions are promotional allowances; merchandising allowances; display racks; inventory credit terms; etc. A final provision makes it illegal for a buyer to knowingly induce or receive a discriminatory price from a supplier.

While these provisions appear to be straightforward enforcement has been hampered by the cost of documenting the existence and impacts of price discrimination. The costs of the burden of proof have run in both directions. Suppliers find it extremely difficult to prove that their price differences are in fact cost justified. Public prosecutors and buying firms have found it expensive to prove that discriminatory actions will substantially lessen competition by creating undue harm to competitors.

Given these difficulties and the fact that the judicial interpretation of the statute has been inconsistent, there have been no systematic economic assessments of the value to the food sector of having this price discrimination law. The current publicly available data on the structural evolution of the food sector are not sufficiently refined to allow a general evaluation of the dynamic structural implications of the Act. The evaluations that follow are therefore based on the observations of industry participants and observers (Hamm, 1981, pp. 298-301, pp. 555-556). As such, they may prove useful only for discussing the impacts of public policy toward price discrimination.

A key factor in the Robinson-Patman Act is that the manufacturer is legally responsible for making sure that all competing retailers have access to equally priced products. If manufacturers do change different prices, they are responsible for proving that these price differences can be justified under one of the exceptions made in the Act. The Act also covers
all types of allowances and concessions granted to retailers by manufacturers. To protect themselves, manufacturers have developed the formal and published promotional plans which form the basis of Table 1 above. These written pricing documents allow brand manufacturers to resist distributors' attempts to use their procurement power to wrestle "special" corporate or personal financial concessions. As such, the Robinson-Patman Act serves as the basic law governing retailer-brand manufacturer relationships and has probably directly prevented large scale retailers from growing relative to small retailers via discriminatory price concessions. However, indirectly, the operation of the Act may foster increased retailer concentration.

Brand manufacturers assert that they must structure their promotion packages so that even the smallest retailer in a geographic market can take part in the promotion. Some brand manufacturers claim that the result of this requirement is that the largest retail buyers are able to comply with stipulated performance relatively easily and therefore receive more net benefit from the promotion. They claim that over time the largest retailers will continue to grow at the expense of smaller competitors. Brand manufacturers use this argument as a call to policy makers to allow them to be more discriminatory with their nonprice marketing tools. So while the Robinson-Patman Act has prevented large retailers from directly gaining procurement advantages, the operation of the Act has probably not kept the food retailing industry from evolving toward fewer and larger firms. Without it, however, retail concentration might have increased further.

The Robinson-Patman Act may be partially responsible for increasing brand manufacturing concentration. Since the operation of the Act makes
prices public to all retailers and manufacturer competitors, it may have
induced manufacturers to move toward nonprice methods of competition. If
the successful application of nonprice competitive methods is skewed toward
the largest brand manufacturers via product differentiation, product pro-
iferation, etc., then the Robinson-Patman Act may be partially responsible
for increasing concentration in brand manufacturing.

Generally, it is much more difficult to enforce the Robinson-Patman
Act in the private label segment of the U.S. food system. For unlike
brand products where every buyer is assured that he is buying the same
product, the development of product specifications by retail chains means
that a manufacturer could be selling different products to different retail
competitors. For example, Retailer A's green beans may have a different
formula from Retailer B's green beans. Therefore a retailer or government
official would have to prove that the difference in price was not the result
of differences in account servicing costs (billing, quantity discounts, etc.)
and manufacturing costs due to different quality and package specifications.
As a result, the litigation costs of a private label Robinson-Patman case
are very high. Few Robinson-Patman cases have been brought in the private
label business. Consequently, private label buyer and seller actions
are not as constrained or influenced by the Act as are brand transactions.

There appears to be some structural implications of the different way
that Robinson-Patman operates for private label products. Smaller retailers
could be at a competitive disadvantage if they could not get access to
private label supplies as cheaply as their larger competitors. Smaller
retailers in the U.S. seem to have overcome the fact that the Robinson-
Patman Act does not assure them of a comparable price on private label
products as their larger competitors by banding together with other retailers and developing joint private label procurement facilities. Specialized private label procurement organizations have developed to the extent that private label procurement in the U.S. tends to be more concentrated than is brand procurement (Hamm, 1981, pp. 64-70, pp. 321-335). Thus the lack of an enforceable price discrimination law in the private label segment of the U.S. food economy is probably partially responsible for balance of power held by private label retail buyers.

The relative concentration of procurement power in the retail sector and the inability of private label suppliers to get protection from the operation of the Robinson-Patman Act results in significant financial pressures on private label suppliers. In the short run, some retail buyers could force processors to sell below costs. Most vulnerable are processors of commodity products which experience a series of large crop years in succession. However in short supply years, suppliers could use the lack of the Robinson-Patman Act enforcement to discriminate against selected buyers to recoup the losses they suffer in large supply years. Generally the pattern has been that there are more large crop years than short crop years. Private label commodity processors have not been able to recoup all of their losses and consequently many of these suppliers are leaving the business. Growers of many of these products are seeing their traditional market outlets disappearing. Whether active enforcement of the Robinson-Patman Act is sufficient to help assure growers long term market access is not clear.

In retrospect, a price discrimination law probably has some benefits for any food system. Because these laws deal with price systems, they tend to be costly and difficult to administer consistently over time. Whether
the benefits outweigh the costs is always debatable. Benefits are most likely to occur when one sector having significant procurement power because of horizontal industrial concentration interfaces with another sector characterized by small firms with little or no ability to differentiate their products. The operation of the Robinson-Patman Act has made it largely ineffective in protecting small specialized private label suppliers. However, the U.S. price discrimination law was written to protect buyers from other buyers and therefore was not originally intended to protect sellers.

**Evolution of U.S. Retailer-Manufacturer Relations**

As retailers and manufacturers interact they set in motion forces which dynamically feed through sector conduct and performance back to basic structural conditions in their industries. Concurrently, new technologies and realigning world economic forces alter the basic demand and supply conditions in the food sector. These simultaneous flows of influence will reshape the basic bargaining positions of food retailers and food manufacturers. What these future relationships will be is, of course, speculation.

There are, however, several developments in the U.S. industry which might be significant. One is the emergence of a functional Universal Product Code (UPC) computerized laser scanning technology. As more retailers adopt cash register systems with this capability, they will generate information previously unavailable. For example, retailers can routinely monitor consumers' actual expenditures and match that with specific demographic information. Systems now exist in the U.S. where this technology is linked with cable television systems that can target specific commercial messages to specific households. The actual purchases of the households are then
monitored to measure the effects of promotional messages. In the past, manufacturers (brand) tended to know more about specific grocery product categories than did retailers. UPC technology will shift the information power element (see Figure 1) toward retailers. Retailers will, among other things, develop more accurate inventory records, be able to test the sales and profit impacts of brand promotion and coupon strategies, and know precisely how individual products perform in various stores. When this information is juxtaposed with the retailers' ability to influence consumers' choices, the balance of power adjustments, let alone social policy implications, are indeed substantial.

Another force impacting retailer-manufacturer relationships is the increased foreign ownership of U.S. food retailers (Siegle and Handy). The new owners have brought new ideas, personnel and operating procedures. The most significant of these has been the development of new retail store types (limited assortment). Many of these foreign firms were accustomed to dealing with manufacturing industries different from the U.S. system. Consequently, new types of purchase agreements developed. These are now putting stress on the system of procurement relationships discussed above (WSJ, August 25, 1981, SMN).

A final factor affecting retailer-manufacturer relationships is the development of more sophisticated and extensive retailer label strategies. As retailers have gotten larger, they have recognized the value of product differentiation. The advent of generic or plain label products awakened retailers to the potential for developing consumer market segments and establishing differentiated retailer brands.11 After being stable for

11The generic product concept came to the U.S. from France. However, U.S. generics are different (usually lower quality) from their French counterparts.
years, the market shares of retailer label products have begun to rise slowly. As retailer brands gain in strength, manufacturers' power obtained through product differentiation might begin to wane. As retailer owned label programs expand, so do retailers' opportunities for vertical integration back into food manufacturing.

There are, no doubt, other forces at work in the U.S. food sector which could help food manufacturers maintain or gain bargaining power. However, many observers are predicting that food retailers will continue to increase their power relative to U.S. food manufacturers (WSJ, August 21, 1981, FTC). Concurrent with that power increase will be a general level of increase in food retailing concentration.

Conclusion

Measuring and assessing food sector performance is never easy. It is even more difficult to empirically link dynamic behavior analyses to food sector structure and performance. Nevertheless, behavioral case studies can provide useful insights. Perhaps a first step toward assessing the significance of retailer-manufacturer interactions on performance is to link several case studies from different industrialized food sectors with a common analytical framework. These types of studies can be very useful for highlighting differences in private industry and public agency actions which influence the economic evolution of food industries. Likewise, similarities discovered across various food systems can lead toward a more comprehensive framework for assessing food sector performance. The OECD is in a unique position through conferences such as this to stimulate this type of research. As the studies progress, some general relationships will be discovered which can assist societies in shaping the performance of their food systems.
Appendix Table 1. Effects of Merchandising Techniques on Product Movement.

The results reported below are from a special study conducted by Progressive Grocer during 1970. The study consisted of testing various merchandising techniques in sets of one company's stores matched for volume, design, size, and demographics. These figures represent averages of several products over several time periods.

<table>
<thead>
<tr>
<th>Technique</th>
<th>Description</th>
<th>Impact On Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Change in shelf location with no price or facing change</td>
<td>Movement from top shelf to bottom shelf</td>
<td>-80%</td>
</tr>
<tr>
<td></td>
<td>Movement from next to top (eye level) shelf to bottom shelf</td>
<td>-45%</td>
</tr>
<tr>
<td></td>
<td>Movement from bottom shelf to middle (waist level) shelf</td>
<td>+43%</td>
</tr>
<tr>
<td></td>
<td>Movement from next to bottom shelf to middle shelf</td>
<td>+10%</td>
</tr>
<tr>
<td>2. Change in number of product facings with no price or shelf location change</td>
<td>Reduce facings from 4 to 2 units</td>
<td>-48%</td>
</tr>
<tr>
<td></td>
<td>Reduce facings from 3 to 1</td>
<td>-58%</td>
</tr>
<tr>
<td>3. Use of off-shelf (special) displays</td>
<td>End-aisle display with special price compared to shelf location with same special price, no advertising.</td>
<td>+420%</td>
</tr>
<tr>
<td></td>
<td>Same as (a) above but with the addition of more elaborate, colorful signs.</td>
<td>+542%</td>
</tr>
<tr>
<td></td>
<td>Display of two related items together versus display of each item separately. Total sales increase:</td>
<td>+170%</td>
</tr>
<tr>
<td>4. Use of shelf-signs</td>
<td>Use of a simple “as advertised” sign to point out advertised product on shelf compared to same product without a sign. No special price.</td>
<td>+124%</td>
</tr>
<tr>
<td></td>
<td>Use of simple sign with no advertising, no price reduction, and no product name identification</td>
<td>+5%</td>
</tr>
<tr>
<td></td>
<td>Same as (b) above but with a product name identification on the sign (i.e., Budget Saver Joe’s Salad Dressing)</td>
<td>-18%</td>
</tr>
<tr>
<td></td>
<td>Same as (c) above but with the addition of a price on the sign. This price is the normal price (i.e., Joe’s Salad Dressing - 39¢)</td>
<td>+39%</td>
</tr>
<tr>
<td>5. Combinations of various techniques</td>
<td>Product advertised in newspaper with special price combined with a simple shelf sign “as advertised at $x.xx”</td>
<td>+196%</td>
</tr>
<tr>
<td></td>
<td>Same as (a) above with the addition of an end-aisle display.</td>
<td>+62%</td>
</tr>
<tr>
<td></td>
<td>Same as (b) above but with manufacturer’s theme sale making use of store-wide banners, P-O-P, etc.</td>
<td>+782%</td>
</tr>
</tbody>
</table>
Appendix Table 2. Actual Product Specifications in Use for Snapbeans.

**PRODUCT SPECIFICATION**

**PRODUCT:** BEANS, GREEN & WAX, CANNED

**QUALITY:** FIRST LABEL

First Label Canned Green Beans and Wax Beans shall conform to U.S. Standards for Grades of Canned Green Beans and Canned Wax Beans and shall be U.S. Grade A or U.S. Fancy with the following additions and modifications.

<table>
<thead>
<tr>
<th>SCORED FACTORS</th>
<th>MINIMUM POINTS ACCEPTED</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liquor</td>
<td>9</td>
</tr>
<tr>
<td>Color</td>
<td>14</td>
</tr>
<tr>
<td>Absence of Defects</td>
<td>32</td>
</tr>
<tr>
<td>Maturity</td>
<td>37</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>92</strong></td>
</tr>
</tbody>
</table>

**VARIETY:** Green beans having white or light colored seeds such as Tendergreen, Slendergreen or Blue Lake. Wax Beans - Kinghorn or similar variety.

**TYPE:** Round

**STYLE:** Cut, French cut, or whole as specified on contract/purchase order.

**SIEVE SIZE:**
- **Cut Green:** Straight 3 or 4 sieve as specified on contract/P.O.
- **French:** Straight 5 sieve or a blend of 4 and 5 sieve.
- **Whole:** Straight 3 sieve or a blend of 2 and 3 sieve.
- **Cut Wax:** Straight 4 sieve or a blend of 3 and 4 sieve.

**LENGTH OF CUT:** 1-1/2 inch cut.

**FLAVOR:** Typical of canned beans, free from any trace of foreign or objectionable flavors.

**COLOR:** Shall possess a color bright and typical of very young and tender beans with not more than 3% by count of units which vary.

**LIQUOR:** Shall possess a practically clear liquor with a slight tint of yellow-green to green and not more than a trace of suspended matter and sediment.

**DEFECTS:** For each 8.5 ounces drained weight there may be present not more than:
- (a) two unstemmed units, or two detached stems,
- (b) a total of 10% by count under one inch in length as long as there are not more than five units less than 1/2 inch in length.

**MATURITY:** Seeds shall be in the early stage of maturity and the beans shall be full fleshed for the variety; tender and not fibrous and show no signs of sloughing.
REFERENCES


