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Food Retailing and Prices in Slovenia

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Abstract. This paper focuses on agro-food chains and agro-food consumer prices in Slovenia considering its European Union (EU) membership. As the Slovenian agro-food markets were distorted prior to the EU accession with some agro-food prices that were greater than comparable EU prices, the empirical results confirm that with the EU membership Slovenian real agro-food consumer prices have largely downward adjusted. Besides policy changes, internalization of retailing and distribution chains by entries of supermarkets and hypermarkets have had impacts on market structures and rationalization of marketing activities. Supermarkets and hypermarkets are taking over a substantial proportion of retail trade in agro-food products with implications on increasing food chains efficiency by squeezing structures in consumer prices, including for farmers, processors and marketing margins for main agro-food staples. After the greater price adjustment changes that occurred by the EU membership, some stabilizations in agro-food markets are occurring, but at different levels of real consumer and producer prices and marketing margins. This implies that agro-food markets in the new EU member states are becoming much more integrated into internationally competitive markets, where pricing and sales promotion issues and branding are taking important role in market segmentation of agro-food products.

Keywords: Marketing, Segmentation, Price Adjustments, Slovenia.

1. Introduction

Competition plays a central role in increasingly global markets. Its impact goes to the very heart of the way industries are structured and how they operate. With the EU membership the competition and competitive pressures have increased and the regulatory environment created by the liberalization of markets is reinforcing their importance. Different efficiency strategies, market leader strategies, market segmentation and brand name development strategies are increasing in their importance. This food retailing development patterns hold for developed as well as for new emerging market economies.

Agro-food suppliers aim to increase alliances with potential buying retailers in the EU markets, which are mostly retail chains, supermarkets or hypermarkets to strengthen efficiency in supply chain management. At the same times retailers rely to capitalize on the prevalence of own labels that require more effort to product design and development. The intensifying competition has resulted in higher concentration in all major European retail markets. Germany, France and the United Kingdom (UK) are among the largest markets and have the most concentrated retail industry. The concentration has been taking place in two major directions: firstly, through ownership alliances on one hand, and secondly, through an increase of shop-size by a reduction in the number of outlets on the other. The increasing global competition creates pressures for restructuring and requires investments to streamline, rationalize and optimize the operations to improve quality and reduce costs. There are of course farmers and food processors within the agro-food chains, which are becoming more entrepreneurial and market oriented either within large-scale agro-food marketing chains, which is largely based on quality and cost efficiency or with searching for own market niches, which are largely based on bio production and supplementary own marketing and selling activities such as farm tourism.

The EU membership has increased competitive pressures in the agro-food markets. Under such circumstances the increasing competitive markets are creating pressures for downward price adjustments, but this also depends on the initial market conditions. The initial market conditions and the increased competition in domestic markets whether or not domestic markets have been flooded by low-cost suppliers might explain adjustments in market prices and marketing margins. Therefore, we expect that the EU membership might have different impacts on agro-food price adjustments by various agro-food markets. Agro-food domestic producers and traders might be squeezed under the pressures to reduce their prices and trade margins, but real consumer price reductions lead to the consumers' gains from these price reductions. However, the crisis might encourage farmers and food processor to start and develop own entrepreneurial activities outside the mainstream agro-food retailing that is based on efficiency and utilization of economies of scale.

We focus on consumer price adjustments in Slovenian agro-food markets. We apply partial market analysis by main agro-food products in Slovenia. We first review market structures and market segmentation and then present methods of analysis and data used. After then we present main empirical results by individual agro-food chains, whereas the final section concludes with policy implications.

2. Market structures and market segmentation

The market structures and market segmentation in most new EU-10 member states have been shaped by few factors. Firstly, besides general agricultural policies (e.g. ^[1]), this were changes in food market chains due transition process from previous centrally planned system to a market economy, liberalization, privatization and restructuring of enterprises (e.g. ^[2]). Secondly, product and market differentiation and market segmentation have been caused by both supply side investment activities in new technologies, products and brand name developments on one side and demands toward new product qualities and product varieties by consumers on the other. Market liberalization and deregulation has provided new incentives to suppliers, but also new requirements and demands by consumers. Liberalization and deregulation of agricultural and food markets have led to quality improvements as a result of food importation, restructuring in agriculture and the food sector, and restructuring in trade and retailing sector with the increasing role of supermarkets and hypermarkets (e.g. ^[3]). Thirdly, the adjustment process to the EU membership has stipulated changes in legal, quality and competition policy among others that cause changes in business environment at micro- and at macro-economic level. This lead to the changes in market structures, different market segmentation, business and market efficiency. Finally, besides mainstream agro-food marketing and retailing, there are new diversification development patterns in marketing of bio agro-food products and in providing farms by supplementary activities at farms, including brand name development, marketing via special shops and selling agro-food products at the farm such as for example through farm tourism.

The economic literature argues that there are static and dynamic benefits from competition (e.g. ^[4], ^[5], ^[6]). Among static benefits, this is greater output at market for consumers at lower costs and lower prices with reduction or elimination deadweight loss. Among dynamic benefits, there are at least three efficiency gains such as making firms more cost efficient, allowing more efficient firms to expand and inefficient firms to exit through market selection process, and providing incentives for innovation. Besides static and dynamic efficiency improvements, there is also equity consideration in a case that small competitors such as small farmers, suppliers of inputs and consumers are protected from abuse of monopoly power. Whereas in the initial phase of transition, there was typical entry of small-scale private shops to fulfill market niches in retail market structures, later there are more intensive processes of mergers, takeovers and concentration of retail sales outlets by entry of supermarkets and hypermarkets to

increase economies of scale, rationalize costs and reduce marketing margins. Besides efficiency, cost-leadership strategy to reduce costs, there is also market-leader strategy with retailing consolidation and supermarkets/hypermarkets brand name increasing market structures. This has affected differently food consumer pricing and indirectly processors and farms, as it will be shown by individual agro-food chains in Slovenia.

With the Slovenian negotiation and adjustments to the EU membership, Slovenian retailing markets have been gradually liberalized allowing easier entries into the Slovenian retailing markets. To investigate these developments, the starting point of this analysis is ^[3]. The focus of this paper is on the most recent developments in agro-food markets in Slovenia that have occurred since the start of negotiation for the EU membership. We consider the year 1999 as the base year since after then market structures, market segmentation, price, and marketing margins developments in agro-food chains have been considerably caused by this process. The focus is less on the Slovenian retailing market structures, but particularly on real consumer price developments for main agricultural and food marketing chains. We assume that levels and patterns in real consumer price developments reflect both real price consumer size and the size of marketing margin as response to increasing competitive pressures in the markets due to overall liberalization, integration processes, and increased competitive pressures in the markets. As recorded by ^[3] there are some real consumer price reductions in some food chains such as for milk and dairy chains. The increased competitive pressures on reductions of producers and/or processors margins and retailing prices within the marketing chains therefore create pressures on efficiency improvements and cost reductions. The increased competitive pressures in the agro-food chains create pressures on rationalization and efficiency improvements introducing measures for greater competitiveness such as differentiation of supply and new product developments toward more advanced food quality regulations, food standards, packaging, marketing approaches and new ways of purchase of products to rationalize or reduce trade margin employing economies of scale. So we can expect that with possible consumer price reductions there are also reductions of some operational and marketing costs.

3. Method and data

There are few opportunities to analyze adjustments in the agro-food and retailing sectors to consumers' behavior, their preferences, economic and demographic changes. One way of adjustments there are changes in corporate values, images and marketing campaigns that are followings as well as creating consumers values regarding agro-food products in terms of new regulations, requirements and standards towards food safety, brand development and for long-term sustainable development. However, we limit our analysis to food retailing and more specifically to patterns in development of food real consumer prices, their patterns in developments and adjustments.

3.1. Method

To study the patterns in real consumer price developments we use real consumer prices for main food staples. Real consumer agro-food prices are analyzed by food chains. The average consumer price is price achieved for a certain product in retail trade. To exclude the impact of inflation and to get a real consumer price, prices at retail levels are deflated by the consumer price index with 1999 as the base year. The increasing, decreasing or more stable development patterns in real consumer prices will indicate relative position for suppliers and consumers at a certain food chain. We are aware that real consumer price development can be biased to changing quality of products as well as to changing quality in marketing services, particularly by more significant introduction of packaging and a greater degree of half-prepared food products that is now possible to buy in different retail shops, supermarkets and hypermarkets. Demand for food quality of products and their more sophisticated marketing has increased substantially due to higher incomes by

consumers, availability and accessibility of better and more information about product quality. So there might be two market forces shaping agro-food markets at the same time. First, the increase in degree of competition is likely to create downward pressures on consumer prices and marketing margins. On the other hand, consumer demands for higher quality and healthier food products are likely to create pressures for upward price developments. However, this market segmentation provides opportunities for different kind of marketing and retailing for tailored made bio and similar specific targeted agro-food markets. It is more likely that innovative production and marketing approaches are focused in directions to meet consumer needs, and thus it is interesting to study how all these different processes are causing real consumer price changes. However, in this paper we do not study segmentation of agro-food products. There might be some changes in quality of produce reflecting pressures for higher prices at the same time. However, in future, it would be worth to consider market segmentation for the similar produce, which might cause some market shifts. This is particularly related for demands of those consumer groups with a higher income that might demand for higher quality produce with higher prices. Such segmentation, for example, can be conducted for organic products vis-à-vis traditional produced produce. Brand name development, such as for wines, can also be linked to a specific micro-climatic and geographic territory, that is developed by specific supply to satisfy specific target demands by customers also through special marketing and retailing channels such as special boutique shops and special brand wine sales through wine tourism.

3.2. Data

Data on consumer prices for food staples are obtained from the Statistical Office of the Republic of Slovenia (SORS), which collects data on consumer prices each month in exactly defined period of time by price collectors in about 1100 selected outlets (e.g. shops, marketplaces, at craftsmen and other organizations) in four Slovenian towns: Ljubljana, Maribor, Koper and Novo mesto. With the rapid developments of advanced information and communication technologies, some of consumer prices are also collected by SORS, particularly through the Internet. There are also available some producer prices of certain processed food products that are collected by SORS monthly via questionnaires that are sent to selected food-processing enterprises, which are selected according to their role and significance in total production. The consumer price is the final selling price in retail shops, supermarkets, hypermarkets, and similar market outlets that customers pay to purchase a certain product. It includes the prescribed value-added tax as well as all other duties.

4. Empirical results

The empirical results of real consumer price developments are presented by main food staples chains. Before this analysis, we present general pattern in development of producer price indices for manufactured goods and separately for producer price index for agriculture, hunting and forestry on one hand and producer price index for manufactured products of food, beverages, animal feeds and tobacco products on the other.

4.1. Real producer prices for agriculture and food

As can be seen from Figure 1 there are analyzed real producer price indices of manufactured goods by activity. They explore some differences in their patterns of development. The real producer price decreases is the greatest for producers in agriculture, forestry and hunting. It is interesting to note that on the other hand real producer prices for food, beverages, animal feeds and tobacco products remain rather stable as producer price index for food, beverages, animal feeds and tobacco products roughly follows the similar pattern of development as consumer price index, but at a bit higher level. This clearly indicates an improvement in real producer prices for food,

beverages, animal feeds and tobacco products vis-à-vis agriculture during the period 1999- 2004. Therefore, agriculture faced the greatest down-ward price pressures during the adjustment and harmonization period to the EU membership. This is much more severe than this holds for the food sector. In some extent real agricultural price decreases were compensated by the increase in direct budgetary payments to farmers. These direct budgetary payments had been introduced during the pre- accession period. With the Slovenian entry into the EU, they become a constituent part of the agreed Common Agricultural Policy (CAP) for Slovenia, which are partly paid from the EU budget and partly from the Slovenian national budget.

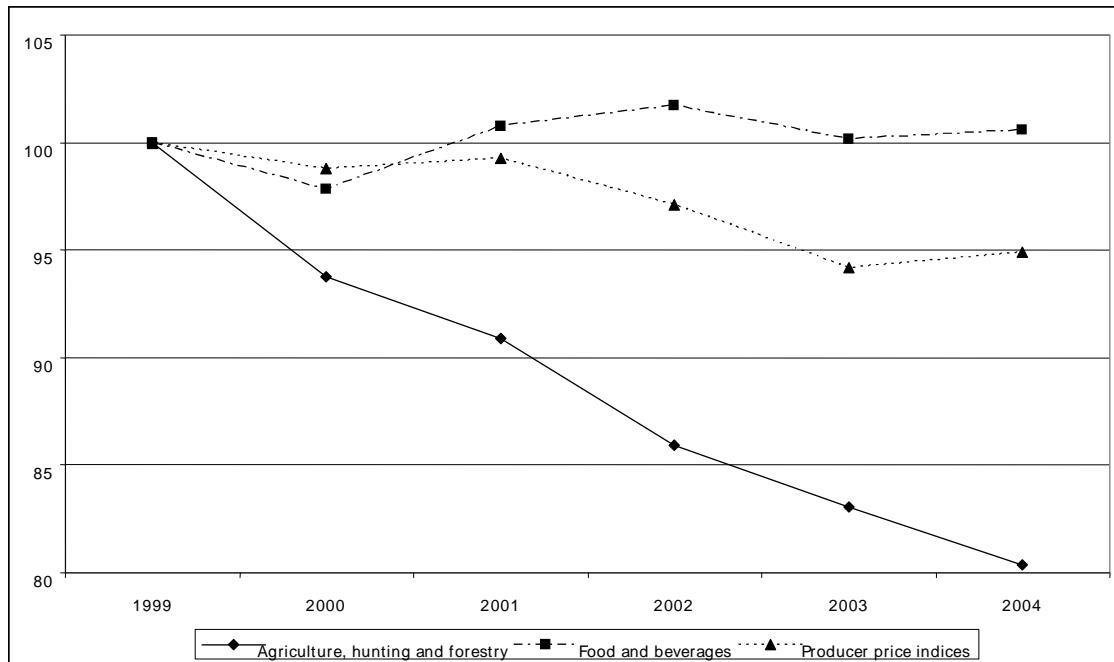


Figure 1. Real producer prices for agriculture and food (1999=100, deflator is consumer price index)

4.2. Real consumer prices for food, beverages and tobacco

Figure 2 clearly illustrates declines in real consumer prices for food, non- alcoholic and alcoholic beverages, but the increase in real consumer prices for tobacco products. The decline for the former is particularly in 2004 when Slovenia entered into the enlarged EU-25. This indicates that the increasing competitive pressures in the consumer markets that occurred from the entry of new competitors, particularly western supermarkets and hypermarkets, have reduced real consumer prices for main food staples, which are more visible for beverages, but also for food prices. On the other hand the increase in real consumer prices of tobacco products is also biased to taxation policies as well as regulations that are important in the market of tobacco products.

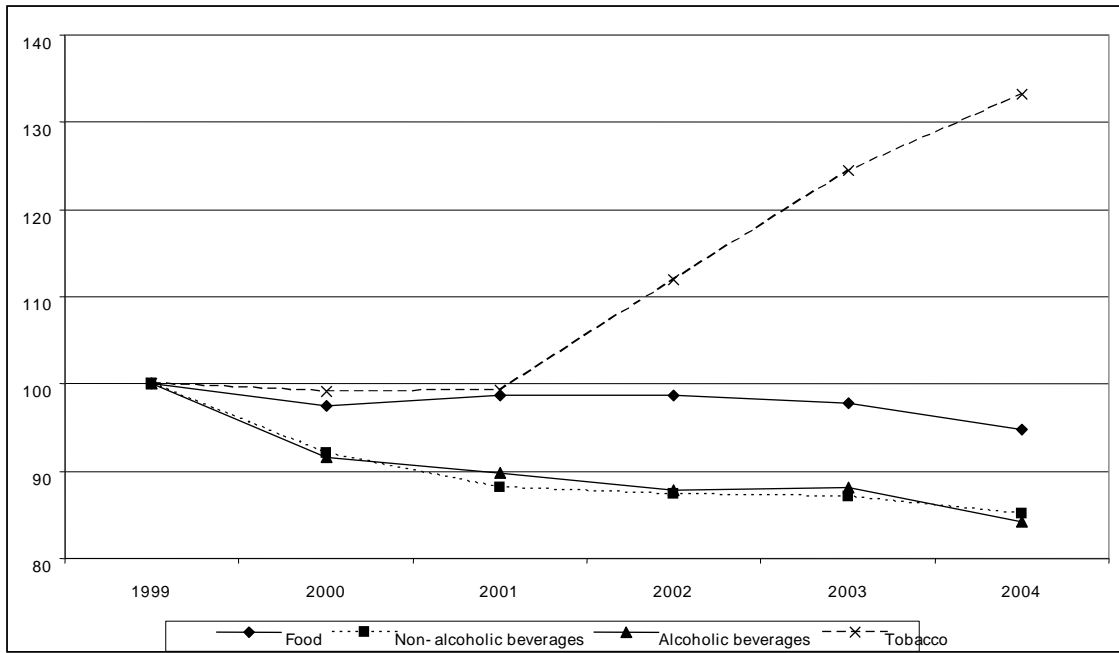


Figure 2. Real consumer prices for food, beverages and tobacco (1999=100, deflator is total consumer price index)

4.3. Real consumer prices for food

Within the structures of real consumer prices for food, except for bread and cereals, there are downward real consumer food price adjustments (Figure 3). The first wave of real consumer price declines for food occurred in the year 2000, but in 2001, there were some real consumer price recoveries for some food staples such as for meat, fruit and for fish (for the latter some real consumer price recoveries have been observed later as well). In 2002 real consumer price increases are observed for oils and fats, but for most other food produce, there is a steady decline in real consumer prices. The entry of Slovenia into the enlarge EU-25 in 2004 was also associated with real consumer price decreases for most food produce. Among an exception is sugar, jam chocolate and confectionary products where an increase in real consumer price occurred in 2004 as a reflection in sugar policy change.

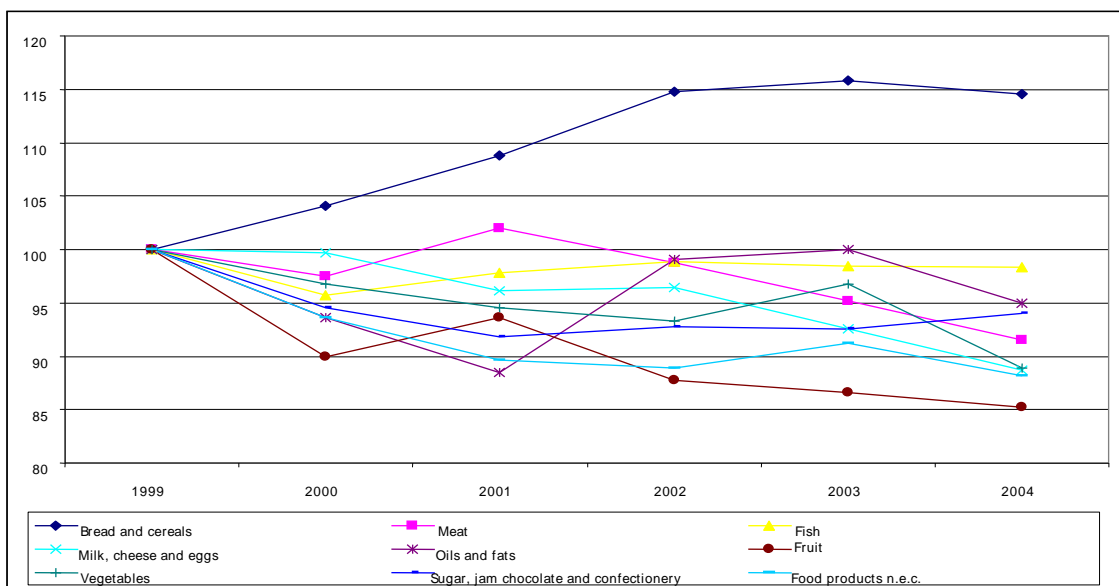


Figure 3. Real consumer prices for food (1999=100, deflator is total consumer price index)

These findings are largely consistent with our previous analysis ^[3]. For example, for bread, the real consumer price increases have occurred when the real farm-gate wheat price (without direct subsidy payments for wheat producers) has declined, while the real retail white flour prices has remained rather stable. Since 2003 there has been a greater stability in developments in real prices in the wheat- flour- bread chain suggesting that competitive pressures have been squeezing further increases particularly in the real consumer bread prices. Moreover, the real farm-gate milk price achieved its pick in 1998. The real consumer milk prices have started to decline since the end of the 1990's. With trade liberalization and particularly adjustments to the EU markets, under the pressures of the increased import competition and the most recent increased competition created by rival chains of supermarkets and hypermarkets the Slovenian real milk and dairy prices have started to decline. In the pork chain, the real farm-gate pig prices and to a lesser extent real consumer prices have cyclically declined (see ^[7], whereas for comparison with Hungary see ^[8]). In the beef chain real farm-gate cattle price has declined since mid 1990's, but this is less so far for the consumer beef price.

4.4. Real consumer prices for non- alcoholic beverages

Among non- alcoholic beverages, the most severe decline in real consumer prices was found for coffee, tea and cocoa beverages (Figure 4). Between 1999 and 2001 there is also decline in real consumer prices for mineral waters, soft drinks and juices, which latter stabilized, but again decreased in the accession year 2004. This decline in the year 2004 is even more considerable in the case of coffee, tea and cocoa drinks.

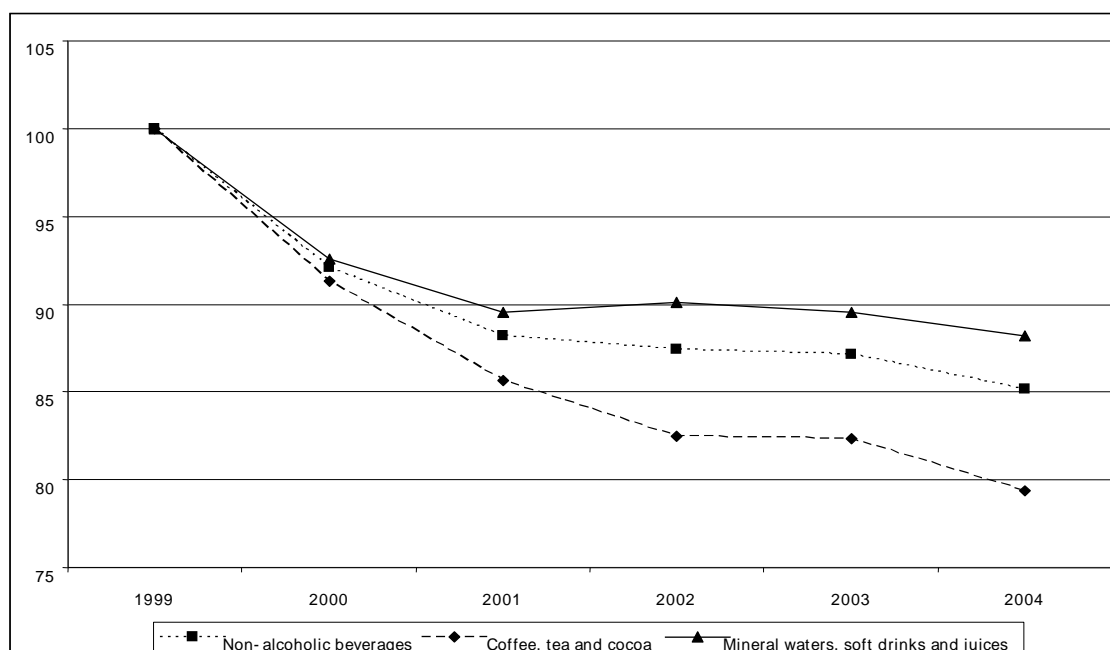


Figure 4. Real consumer prices for non- alcoholic beverages (1999=100, deflator is total consumer price index)

4.5. Real consumer prices for alcoholic beverages

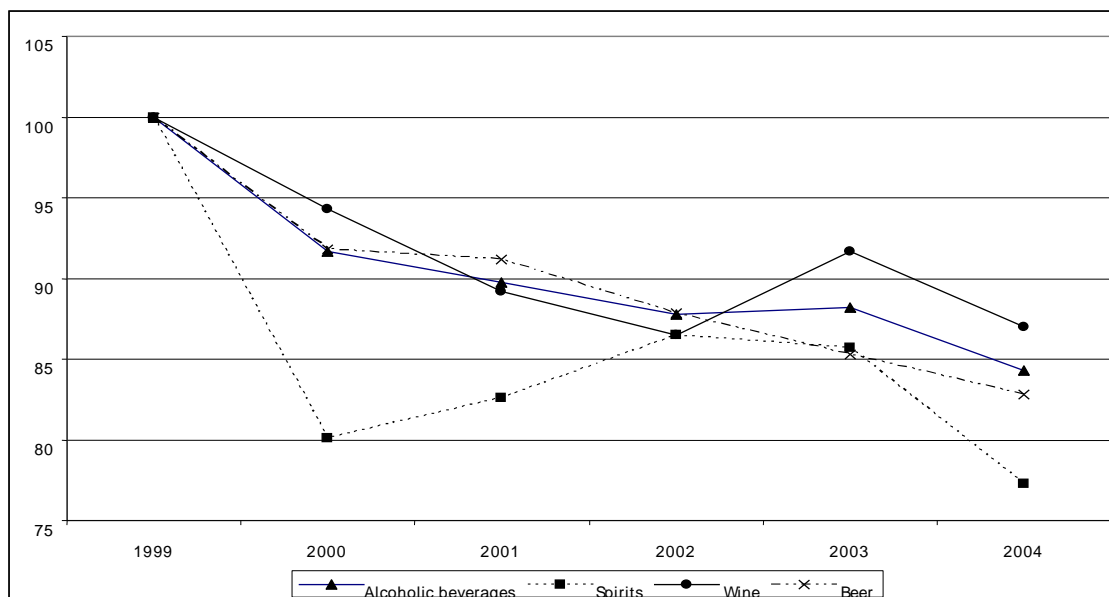


Figure 5. Real consumer prices for alcoholic beverages (1999=100, deflator is total consumer price index)

Figure 5 clearly illustrates that there are declines in real consumer prices for different alcoholic beverages, which have in general occurred since 1999. The most rapid variations and real consumer price declines for spirits are recorded. Some temporary recoveries in real consumer price declines for wines are observed as well, whereas real consumer prices for beer tends to declines steadily. Real consumer price volatility for wines is associated with volatilities in real farm-gate price for wine grapes ^[3]. This has encouraged some wineries that have entered efficiently in wine tourism, particularly in the region bordering with Italy. With the EU membership in 2004, there is decline in all real consumer prices for alcoholic beverages.

5. Conclusions

The transition process and the entry of Slovenia into the enlarged EU-25 have brought considerable changes in agro-food retailing and pricing. Different efficiency and market leader strategies have been implemented to response to the increasing competitive pressures in agro-food retailing and pricing. Whereas in an initial stage of transition several small shops were set up, the later developments were reversed by less new entries and more exits particularly by merging and taking over of the previous retailing structures. This merging and concentration process of the Slovenian retailing sector was under the umbrella of the biggest Slovenian retailers Mercator, which has become one of the largest retailing chains in Slovenia up to recently and even after the entry of foreign chains of supermarkets. Marketing of several agro-food products have now been channeled through chains of supermarkets and recently hypermarkets. These are new developments, which explore some similarities with some other developed EU countries, particularly in the neighboring Austria.

The process of restructuring of the retailing sector was conducted in a way of closing and exits of small shops on one side, and the expansion and setting up of supermarkets. Besides this, after the end of the war in the former Yugoslavia, Mercator as the leading retailing chain in Slovenia entered into the markets in the states of the former Yugoslavia as one of the largest food-product chain in Croatia, with a strong market position in Bosnia and Herzegovina, and has also entered into the retailing chain in Serbia and Montenegro. Both efficiency strategies to reduce costs and market leadership

strategies to develop retail brand name products have been used to response to competition at domestic and regional markets.

However, at the same time in Slovenia has been set up an independent chain of Tuš's retail stores, which is targeted towards the biggest customers' concentrated areas of the biggest Slovenian towns. With the liberalization and opening of the retailing sector to foreign competition, in the Slovenian retailing market have entered foreign retailing, supermarket and hypermarkets chains. Among them are Spar/Interspar, E.Leclerc, Hofer and some others that compete particularly with Mercator for market shares in the Slovenian food and other retailing chains. In several cases this competition has resulted in real consumer price reductions for most of food staples.

We have analyzed particularly food-chain real consumer prices in Slovenia focusing on their response to the EU membership. With the EU enlargement food retailing and food consumer prices in Slovenia have adjusted in different directions to the new market situations depending on policy changes and related distortions that existed in individual markets prior the enlargement. These new market situations are characterized by the increased competitive pressures in more internationalized EU agro-food markets.

Agro-food chains and agro-food prices in Slovenia experienced different distortions prior the EU enlargement. Considering Slovenian entry into the enlarge EU, the EU membership has had impacts on retailing, marketing margin distribution, and prices, which vary depending on the pre-membership distortions and later policy changes induced by the EU membership. These imply that with the EU membership agro-food prices and marketing margins have adjusted in different directions, but consumer's price reduction tendency has been found to prevail.

Besides policy changes, there haven been also induced greater internalization of retailing and distribution chains by entries of supermarkets and hypermarkets with impacts on market structures and rationalization of marketing activities. Supermarkets and hypermarkets are taking over a substantial proportion of retail trade in agro-food products with implications on marketing margins for main agro-food products. After the greater price adjustment changes that occurred by the EU membership, some stabilizations in agro-food markets are already recorded, but at different levels of real prices and marketing margins. This imply that agro-food markets in the new EU member states are becoming much more integrated into internationally competitive markets, where pricing and sales promotion issues and branding are taking important role in market segmentation of agro-food products. Among such segmentation strategies and brand name development strategies, there are also examples of good practices by farmers who aims to avoid general agro-food marketing patterns for bulk of commodities by developing own entrepreneurial activities such as agro-food bio production and farm tourism development.

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