

# Large-Scale Retailers and Strategies in Retailer-Supplier Relationships\*

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## Abstract

*The role of large-scale retailers has evolved over time through a multi-stage processes that has profoundly influenced the retail sector. Large-scale retailers are no longer considered "handing over boxes" intermediaries, but they have become decision makers in retailer-supplier relationships. Consequently, manufacturers can no longer impose, but they are in fact forced to adopt a collaborative scheme in order to create greater efficiency in the supply chain.*

**Keywords:** Large-Scale Retailers; Retailer-Supplier Relationship; Supply Chain; Private Label; Global Markets

## 1. The Role of Large-Scale Retailers in Retailer-Supplier Relationship

The role of large-scale retailers has evolved over time through a multi-stage processes that has profoundly influenced the retail sector. Today's retailers are completely different from what they used to be back in the '60s due to a transformation process that can be divided into four well-defined stages: 1) the collusive marketing of the '70s; 2) the balanced marketing of the 80s; 3) the retail marketing of the 90s; and 4) today's systemic marketing.

In the early '60s, the phenomenon of large-scale retailing, which had just begun in Italy, could be defined as a process consisting merely in 'handing over boxes'. That is to say that manufacturers had the final say on which products to place on store shelves, relying on the fundamental role wholesalers played back then. Basically, manufacturers built direct connections with consumers without engaging any intermediary. It was a direct-to-consumer model where the producer made also the final decision on product selling prices.

Over the years, things have changed dramatically. As the role of large-scale retailers in the global market has become increasingly important, the concepts of store loyalty (i.e. consumers' brand commitment) and enterprise autonomy (i.e. self-directed stores) have gradually gathered momentum. As a result, that straight line that used to connect manufacturers with consumers has progressively turned into a triangle where large-scale retailers represents the third 'pole', which, despite being cumbersome and unwanted by many, has gradually become crucial to creating value for consumers.

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\* Invited Article

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Today, large-scale retailing has evolved into a worldwide phenomenon of ‘branding through signage’, a transformation process that has taken place also in Italy. A recent survey shows that 70% of consumers decide first ‘who’ to buy from, and then ‘what’ to buy. It has taken us more than fifty years to reach this mainstay, but now the situation is the opposite of what it used to be back in the 60s.

As a result, large-scale retailers are no longer considered ‘handing over boxes’ intermediaries, but they have become the main decision makers when it comes to buying products, choosing assortments, and implementing pricing and promotional policies. In other words, large-scale retailers have succeeded in establishing a direct connection with their target market (i.e. consumers). Consequently, manufacturers can no longer impose, but they are in fact forced to negotiate. This turn of events basically ended the phase of ‘collusive marketing’ and marked the birth of the so-called ‘balanced marketing’, which was largely based on the ‘trade marketing’ discipline.

In the 80s and more precisely in 1983, multinational corporations played a crucial role in determining the trajectories of retail business development. Starting from first experiences gained in the US, and rightly predicting that large-scale retail business development would have also occurred in Italy, these corporate enterprises tried to shape such trajectories according to their models. Thus, as retailers, we witnessed a reverse ‘stagecoach attack’. Large manufacturers were, all of the sudden, offering large sums of money to gain more promotion and visibility in our stores. Technically speaking, this gave rise to trade marketing or balanced marketing as we know it, a new model of retail business, which forced large-scale retailers to quickly restructure their merchandising and marketing functions.

It is important to highlight that this phase of transition marked one of the milestones of modern retailing because it brought not only novel expertise (i.e. know-how), but also new resources important for maintaining a balanced budget over the years. Nevertheless, today’s manufacturers tend to complain about it, failing to remember that it was them in the first place who contributed significantly to the birth and development of this new business model. Hence, trade marketing is now generally regarded by the manufacturing industry as a negative fallout of the contract stipulated in the past with the retailing industry. In order to mitigate the negative consequences of this unilateral “change of mind”, the Monti government introduced, according to Article 62, a number of legislative reforms concerning payment deadlines and commercial terms between manufacturers and retailers.

From the mid-70s to the early 80s, Italy experienced raging inflation that rose from 15% to 21.1% in 1980. Clearly, a 20% inflation rate represented a serious economic problem with even worse social repercussions. Throughout this difficult phase, Italian large-scale retailers played an important role in preserving the purchasing power of consumers. In particular, Coop, besides implementing price freeze policies, set itself the target of always maintaining prices two points below the average of the Italian consumer price index according to ISTAT.

In those years, Italy became a land of mergers and acquisitions. On the one hand, many Italian industries were acquired by large multinationals (e.g. Nestlé, Unilever, and Procter & Gamble); on the other hand, a number of historical Italian brands (e.g. Buitoni, San Pellegrino, Algida, and so on) became foreign-owned. Moreover, a series of acquisition of Italian retail chains by international corporations brought to a staggering 30% the market share controlled either directly or indirectly by

foreigners. Basically, in just 10 years the Italian market had been completely revolutionized, with the large-scale retail share rising from 26 to 54%. We were in the midst of the so-called ‘commercial revolution’. Italy closed the gap with Europe at an unprecedented fast-moving, albeit delayed, pace following a one directional process of internationalization.

In the 90s, another relevant transformation phase took place in Italy: the opening of the first discount stores. In just a few months, in the two-year period 1992-1993, about 2,000 discount stores were launched. They were very basic first-generation discount stores selling low-quality products. Nonetheless, they represented a novelty with respect to the supermarket model Italians were accustomed to. The emphasis these stores put on prices, which in some cases could go as low as 50% of regular prices, felt like a ‘slap in the face’ for all, including us at Coop. Nevertheless, we decided to react to this turn of events by seeking alliances with these new actors instead of competing against them. Thus, in those years, a new phase of collaborative planning took shape allowing us to find common solutions that could meet not only consumers’ needs, but also those of the retail industry at large.

An important outcome of the collaborative effort between major manufacturers and large-scale retailers was the creation of the joint trade and industry body called Efficient Consumer Response (ECR) Italy. This body was meant to bring together the most important groups of the food distribution industry in Italy – Barilla, Ferrero, Nestlé, Unilever, Procter & Gamble were sitting at the same table together with Coop, Conad, Carrefour, Esselunga, and Auchan – in order to devise new strategies aiming to gain competitive strength. The combined turnover of the ECR members was more than 100 billion in revenues, with a total workforce of over 200,000 people. Despite being direct competitors on the Italian market, we felt the urgency of coming together to devise and implement new common development policies that would ultimately foster system efficiency.

Our efforts were mainly aimed at creating greater efficiency in the supply chain – at that time, there could be counted as many as 20 intermediaries along the supply chain. In this regard, the cost-benefit analysis entrusted to Boston Consulting, which I still regard as one of the ECR’s best proposals, showed how the supply chain costs accounted for 30% of the selling price of large-scale retailers, while for discount stores it only accounted for 10%. This important piece of information allowed us to develop a new model of supply chain that would have later on reduced waste and inefficiencies leading to larger profits. In other words, we felt the need to implement a business model based on many-to-many relationships, that is to say that all the structural investments required by this new approach could have only been effective as long as they were made and implemented by the largest possible number of enterprises. Basically, we came to the realization that just one actor alone would not have been able to create and implement a lean supply chain.

This collaborative effort continued throughout the 2000s with excellent results. However, in those years a new retail business model, strictly dependent on the demand side, was gradually emerging. It was a more complex and sensitive business model because it relied on marketing mix levers (e.g. product portfolio, assortment, promotion, and product innovation) individual retailers were already managing in an autonomous way. Unfortunately, at the very beginning of this

evolution process, manufacturers tried to gain the upper hand on retailers by implementing biased policy levers.

Let me explain this better by stepping back a few years. Two years after the death of entrepreneur Pietro Barilla in 1993, the Barilla brothers hired former CEO of Procter & Gamble Edwin Artz as part-time Executive Director. Objectively, some of the changes made to the Barilla Group by Artz were, at the very least, contradictory. The first policy he implemented, the so-called 'Big Event', was indeed nothing but a 12% price cut on all Barilla's products. Clearly, an aggressive trade war tactic whose sole objective was that of competing out other pasta makers. The outcome of Artz's policies, which coincided with a growing presence of trademarks among Italy's large-scale retailers, was a blood bath with very questionable results, even for Barilla. Another innovation brought by Artz was the introduction in retail business practices of a new marketing strategy known as category management – a strategy that at that time was new to us Italians. This new approach to marketing consisted in breaking down, upon in-depth customer analysis, the range of products into discrete groups of similar or related products, which were called product categories (e.g. coffee, pasta, detergent etc.). The ultimate goal of category management was that of adding value to the product portfolio while maintaining brand consistency across product lines. Mr. Artz tried to entice Italian retailers through the captivating lectures of Brian Harris, the guru of category management. Furthermore, one of his 'procterian' managers, Manolo Gonzalez, pledged that the best retail business model was the one they were proposing. However, they did not realize that Coop as well as all other main large-scale Italian retailers had already gained complete awareness of their role in the marketplace and were already managing autonomously their own product portfolio.

Notwithstanding, category management was, and still remains, an excellent methodology, which perhaps marks the beginning of a new phase of retail business development called multichannel marketing. This new model revolutionized trade marketing practices by changing the 'I sell what I buy' philosophy into the 'I buy what I sell' logic. As a result, category managers, who were very knowledgeable about sales and marketing techniques of specific product categories, quickly took over from buyers, who had previously been in charge of the purchasing process.

Overall, the development of a category management methodology led to stronger sales of brand products, and, most importantly, to the development of private label products.

## **2. Birth and Evolution of Private Labels**

In 1896, Coop Lombardia launched its Christmas cake *panettone*, which became the first ever Italian private label product. In all fairness, it was the French who first launched private labels on a large scale thanks to a law enacted in 1857, which established private label industrial ownership. Subsequently, in 1869, Sainsbury's launched its first private label in the UK. However, it is not until the beginning of the 70s of the 20th century that we observe aggressive policies from French companies aimed at cutting ties with food manufacturers through private label product development. In a short time, the private label phenomenon spread all over Italy. For example, in 1974, Coop decided to aggregate its various generic brands

(e.g. Mares, Soldoro, Rivabella, and others) into a single Coop brand that still exists to this day. In just a few years, Coop, by taking advantage of its private label products – here it lays the difference and originality of our approach –, managed to launch highly effective advertising campaigns.

In this regard, until the early 2000s, the combined share of all private label sales of Italian retailers amounted to only 6-7%, whereas Coop had already reached a share of more than 23 %. As of now, the Italian (average) share of private label sales is about 20%, and it will undoubtedly match European levels that sometimes can go as high as 40%. The figures hiding behind these percentages amount to hundreds of billions and are therefore good indicators of the dramatic changes that have taken place along the food supply chain.

About 20 years ago, I paid a visit to the headquarters of Walmart, which back then was already was one of the leading large-scale retailers worldwide. While assessing their product portfolio, I was completely taken aback by the total lack of private label products. When questioned about that anomaly, they replied that their job consisted in just selling products made by others. Thus, I argued that for that very reason they could not define themselves a modern large-scale retail company, but rather an efficient ‘supply chain’. Ten years have gone by since that visit and, ironically, Walmart, which has in the meanwhile become a giant chain of discount with over 400 billion in revenue, has developed its own private label that accounts for a staggering 40% of total sales. Thus, there's no doubt in my mind that the exponential growth of private labels has changed the nature of trade marketing and will continue to do so for the foreseeable future. I do not think, though, that the acquisition of manufacturing plants by large-scale retailers might play a relevant role in such growth. That was indeed a mistake made by French Coops, and probably one that cost them dearly. Instead, I think that the growth of private label products should be based on a mutual cooperation between retailers and manufacturers. Furthermore, I strongly believe that such cooperation should be carried out only with those manufacturers who are better suited to comply with certain production design specifications. Thanks to this stringent selection criterion, small-size manufacturer has been able to suddenly become major players in the supply chain. For instance, nowadays, Coop is not only the first distribution chain in Italy, but also one of the top five food manufacturers in terms of private label turnover – Coop private label products are mainly produced by Italian food companies –, which amounts to about 3 billion euros. Moreover, private labels are likely to further expand into new and diverse product categories other than the traditional ones. For instance, Coop is already selling under its own brand products such as gasoline, medicines, telephone services, and so on. More and more consumers will be drawn to buying from retailers that offer a wider range of private label products and services.

However, there are some risks associated with private labels. One of them, as mentioned above, is represented by the acquisition of production plants. Conversely, food retailers could just simply become ‘food labelers’.

### 3. Conclusions

In my view, modern trade marketing should be based on a collaborative scheme rather than a conflictual one. Throughout my career, I have dealt with lots of manufacturers that were either highly collaborative or quite hostile, and in many cases the actions taken by the former ones proved to be inadequate.

Since its birth in 1983, trade marketing has evolved into such a complex process that the list of contractual obligations regulating it is now basically endless. Nevertheless, thanks to the joint effort of ECR, three major projects aimed at improving retailer-supplier relationships were launched:

- The first one concerned a new negotiating model, which greatly simplified annual contracts;
- The second one regarded the inclusion of new products with simplified contractual basis, thereby overcoming the infamous slotting fee, i.e. the fee charged by food retailers to display a product on their shelves. A fee that, on the contrary, was regarded by retailers as an ‘insurance policy’ given the high number of flops among new products – 90% out of 27,000 according to data from Nielsen;
- The third project was related to promotional activities with the aim of making them more effective and efficient. In this regard, sales promotions in the food retail sector now exceed 25% of total sales. Thus, it was highly unlikely that this issue could be resolved by legislative acts.

Although these three projects have been implemented by some of the most innovative companies in the manufacturing and retailing sector, achieving excellent results, other companies have relied upon the provisions of Article 62. Since I strongly believe Article 62 to be unconstitutional, I would welcome a joint request from both retailers and manufacturers for its repeal. The abolition of Article 62 would then restore a self-regulation mechanism whereby the smallest and weakest links of the supply chain and the retail sector would be better protected. I am truly convinced of the need for dialogue, but I am also aware that we need new ideas and projects together with the same feeling of belonging that we had back in 1993, when the ECR Italy was founded. This is the only way to win once again a challenge that spans the entire food distribution system. We will need to address a host of important issues, but, at the same time, we shall be ready to take advantage of the many opportunities ahead of us.

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