

ASSOCIATION DES INDUSTRIES DE MARQUE  
EUROPEAN BRANDS ASSOCIATION  
EUROPÄISCHER MARKENVERBAND

# AIM® BRIEFING PAPER



## THE ORIGINS OF CONSUMER PRICE DIFFERENCES IN EUROPE



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# The origins of consumer price differences in Europe

## Introduction

The Euro helps compare prices between countries. Such comparisons show that prices vary, as indeed they do between shops, towns and regions. This paper explains why, concluding that the Euro will not harmonise prices and that price differences are due not to market failure but diversity within Europe.

### - price and value

Price is of interest to consumers concerned with getting a good deal, to policy makers concerned with the convergence of European economies, and to manufacturers and to retailers.

Price is one of two factors which determine “value”, the second being quality. Quality is assessed by consumers in many ways, for example by performance, design, materials used, anticipated life span or associated services. A brand competes on quality *and* price.

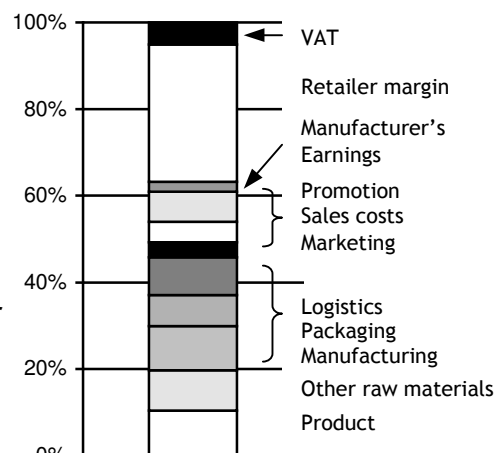
Consumers assess value by comparing quality and price against alternatives. Increasingly, price and therefore value, is being assessed by comparing prices across countries, as people travel more and such comparisons become easier with the internet and the Euro.

### - the component parts of price

The final price paid by consumers is the culmination of many factors that impact on the item down the supply chain. These factors are primarily costs, taxes and margins.

The final consumer price will comprise the cost of raw materials, processing, packaging, transport, marketing and retailing, amongst many others. Each company involved along the supply chain, including original producers, packaging suppliers, processors, and retailers, have the commercial imperative to cover costs and earn sufficient returns to sustain their business. Governments impact prices further, through taxation, subsidies and regulation.

Throughout Europe, suppliers are not permitted to set the final price paid by a consumer. The final link in the supply chain, the retailer, sets the price consumers pay.



Cost breakdown of typical food brand Source: Nestlé

### - recent evidence on price variations in Europe

In June 1999, Dresdner Kleinwort Benson found consumer prices varying within Europe by an average 14%, with strong evidence of price convergence.

|                | 1990      | 1994      | 1996      | 1999e     |
|----------------|-----------|-----------|-----------|-----------|
| Goods          | 17        | 12        | 11        | 9         |
| Food           | 22        | 17        | 15        | 13        |
| Rents          | 39        | 34        | 32        | 28        |
| Communications | 36        | 31        | 20        | 18        |
| <i>Total</i>   | <i>22</i> | <i>18</i> | <i>16</i> | <i>14</i> |

Source: Dresdner Kleinwort Benson based on OECD and Eurostat data

It concluded that prices varied considerably less for goods than for services because of the better “tradability” of goods.

In October 2000, the UK’s Competition Commission published a study of prices for grocery products in the UK, France, Germany and the Netherlands. It found price differences of 15.8% between the four countries.

In May 2001, the Swedish and UK Governments published a price comparison of 133 non-food items across four European countries and the US. It found price variances of 23% within Europe. None of the 133 items was the same price across Europe.

### - prices vary also within the United States

Substantial price differences occur within the United States, even though it enjoys a single currency, a single language, and an established single market. While differences of over 40% may occur in specific categories, overall price dispersion is 11.8% (compared to 14.6% in Europe<sup>1</sup>).

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<sup>1</sup> Supplement A, Price Levels and Price Dispersion in the EU, DG Economic and Financial Affairs, 2001

| Branded goods index | Atlanta | Boston | Dallas | Houston | Los Angeles | New Orleans | New York | Washington |
|---------------------|---------|--------|--------|---------|-------------|-------------|----------|------------|
|                     | 100.7   | 113.3  | 99.5   | 97.0    | 110.7       | 95.5        | 135.0    | 112.8      |

Source: 1998 Statistical Abstract of United States, Table 775, and LECG 2000

### - price comparisons are difficult to do

Comparing prices across countries is deceptively difficult. Price comparison studies often lack credibility for a number of reasons<sup>2</sup>:

- small, unrepresentative samples of products compared across a small, unrepresentative sample of stores and cities;
- price comparisons at a snapshot in time, taking no account of exchange rate movements or promotional activity;
- comparing products that are not like-for-like. Research in the French magazine *LSA* found only 0.03% of SKUs<sup>3</sup> in six European countries to be identical, and therefore comparable;
- comparing products in different pack sizes through pro-rata price adjustments;
- construction of a basket of products where a few products have a disproportionate effect on the total basket price;
- excluding demand-related factors, by not weighting baskets according to the preferences of consumers in the countries surveyed;
- basing results on tax-inclusive price levels.

### Reasons for price variations

While comparing prices accurately may be problematic, it is clear that prices do vary across Europe, just as they do within countries. A number of factors give rise to price differences, the extent of any one of which being dependant on the particular product under scrutiny.

### - differences in retailing

This is the starting point as retailers set the final consumer price, with the difference between wholesale and retail prices being due to retailer costs and competitive strategies.

#### Differences in retail proposition

Retailers adopt a range of propositions on which to compete, such as low service/low price, high service/high price. Consumer preferences for the service/price equation vary, as much between as within countries. Retail propositions can also vary from heavy use of price promotions to an everyday low price strategy.

#### Differences in cost and efficiency

Large stores have different scale and efficiencies to small stores, with an operation offering a selection of 10,000 goods being very different to one offering a few hundred.

<sup>2</sup> Chapter 9, UK Competition Commission report into supermarkets, 2000

<sup>3</sup> Stock keeping units

Efficiency is also affected by structural factors. Grocery retail space per inhabitant is 1.5 times higher in France, Belgium and the Netherlands than in the UK. As a result sales per m<sup>2</sup> are 50-70% higher in the UK than in Continental Europe.<sup>4</sup>

Furthermore store location impacts on costs, with city centre rental costs differing from out-of-town and rural rental costs.

### Concentration

Levels of retail concentration vary across Europe, with the result that economies of scale and buyer power also vary. In Norway, Finland and Switzerland, only three food retailers control more than 80% of the market. In Germany, UK and France, three enterprises control 50-60% of the market. In contrast, in Italy or Greece, three major companies control about 30% of the food market.<sup>5</sup>

### Differences in margins

Retail margins vary from country to country, reflecting different consumer offerings, costs, productivity, store sizes and other factors.

| Distribution margins (food) | Austria | France | Netherlands | Sweden |
|-----------------------------|---------|--------|-------------|--------|
|                             | 21.4    | 29.5   | 31.8        | 21.7   |

Source: OECD 1997

### - demographics

In the Netherlands and Belgium, 90-95% of the population live in urban areas, compared to only 60-65% in Finland and Greece. Put another way, the difference in population density between Finland and the Netherlands is in the order of 1:25.

Such differences have significant implications for the efficiency of distribution, where and how people buy things (people in the country can buy direct from farmers), and the ability to support larger store formats.

### - differences in EU regulation

Regulation continues to differ across Europe, despite progress on harmonisation. In its 8<sup>th</sup> single market scoreboard report, the European Commission stated “price differences often arise from barriers to the free movement of goods and services”, quoting restrictions on pan-European marketing campaigns and commercial communications as examples. Differences in employment regulations also lead to differences in prices.

| Employer social security contributions % | France | Italy | UK   |
|--|--------|-------|------|
|  | 15-18  | 30-34 | 3-10 |

Source: Tax Misery Index, Ernst & Young, October 1999

### - differences in tax and duty

Value-added tax differs between countries, a further example of how significant differences continue to exist within the single market.

<sup>4</sup> source: Deutsche Bank, 1999

<sup>5</sup> source: A.C.Nielsen

Furthermore, Member States have the freedom to apply reduced rates on certain goods and services. Some apply these rates while others do not, giving rise to differences in consumer price of up to 20% on goods such as food, personal hygiene products and baby care.

| VAT      | A     | B  | De | F    | D  | Gr | Eire | I  | NL   | P    | E  | SW   | UK   |
|----------|-------|----|----|------|----|----|------|----|------|------|----|------|------|
| Standard | 20    | 21 | 25 | 20.6 | 16 | 18 | 21   | 20 | 17.5 | 17   | 16 | 25   | 17.5 |
| Reduced  | 10/12 | 6  | -  | 5.5  | 7  | 8  | 12.5 | 10 | 6    | 5/12 | 7  | 6/12 | 5    |

Source: European Commission DGXXI, 1999

Duty has an impact, most notably on tobacco and alcohol. Spirit duties for example are 5,000 Euro per hectolitre in Finland and Sweden, and under 1,000 Euro in Austria, Greece, Italy, Portugal and Spain<sup>6</sup>.

Duty differences also exist for new cars and fuel. High duty accounts for UK fuel being 18% more expensive than French<sup>7</sup>, with repercussions for transport, heat and power costs.

#### - differences in consumer tastes

Consumer tastes differ across Europe and this has an impact on prices. Consumer-related differentiation is particularly sophisticated for foodstuffs where, in addition to meeting nutritional requirements (which themselves differ according to climate and living conditions), products must satisfy the senses: look, smell, taste, sensation on the tongue and between the teeth, and the sound when bitten. Consumers will forgive no mistakes and accept no European average.

Consumers face enormous choice and there are variants of almost every product. This allows consumption to differ, certainly between countries but ultimately between individuals.

Different tastes across Europe lead to very different patterns of consumption of the same product. UK consumers eat many more **KitKat** bars per head than their French counterparts. The reverse is true of non-instant coffee. The Dutch eat nine times as much natural yoghurt as the Irish. Such differences have an impact on manufacturing and distribution costs, and ultimately on prices. Olive oil consumption is significantly higher in Spain than in Germany and as a consequence is a third lower in price in Spain.

#### - differences in cost

Cost differences across Europe give rise to consumer and wholesale price differences. Differences in salaries between member states is one example.

| Manufacturing labour costs | Germany | Nordic states | Benelux | UK | France | Italy | Spain | Portugal & Greece |
|----------------------------|---------|---------------|---------|----|--------|-------|-------|-------------------|
| EU=100                     | 132     | 114           | 105     | 99 | 91     | 86    | 70    | 34                |

Source: Dresdner Kleinwort Benson, 1999

<sup>6</sup> source: European Commission, Reuters

<sup>7</sup> Shell survey

In the case of brands, where communication is an important element in competition and bringing new offers to market successfully, costs vary widely.

| Media Costs               | EC av | Germany | N'lands | Belgium | France | Italy | Portugal |
|---------------------------|-------|---------|---------|---------|--------|-------|----------|
| <i>Cpt 30 sec peak tv</i> | 100   | 100     | 157     | 175     | 79     | 77    | 52       |

Source: Zenith Media; Lehman Brothers, 1998

There are also significant cost differences in the recovery of packaging waste from country to country as a result of different national schemes<sup>8</sup>.

## The future - continued price convergence

The analysis of reasons underlying price differences in Europe suggests that prices will continue to differ between countries, as they will within regions and communities. Nevertheless, there are forces that continue to put pressure on consumer prices to converge.

### - cross-border shopping

Consumers are increasingly aware of price differences across borders and will continue to seek to benefit from them. Differences in duty on tobacco and alcohol for example has sparked significant trade between the UK and France, with stores opening in France specifically tailored to the UK consumer.

### - better information

The internet and the Euro provide not just opportunities to purchase across borders more easily but also to compare prices. This information is being used by both consumers and retailers in their negotiations. It is a benefit that applies down the length of the supply chain.

### - pressure from retailing

For many years, retailers have been comparing prices across Europe and using this data in their negotiations with suppliers to secure the lowest prices. The introduction of the Euro will increase this pressure.

Furthermore, retailers have been able to purchase goods from low priced countries, particularly since the advent of the single market in 1992. This prevents a supplier - branded or otherwise - charging a retailer disproportionately in any one European country as the goods will simply be purchased from a cheaper country.

### - branding

Branded goods, being of consistent quality and supported by guarantee, are more easily tradable across national boundaries than non-branded items such as retailers' own label goods, resulting in more transparency and stronger international price competition. This explains why price

<sup>8</sup> *Europe Goes Green* Dot Duales System Deutschland AG 2001

differences for branded goods tend to be less. The UK Competition Commission for example found grocery price variances of some 18.5% across four countries, while branded goods differed in price by only 5.7%.

## **Conclusions**

Price differences are not an indication of market failure but of market diversity. They reflect differences within Europe, of state regulation and taxation, of costs and consumer preferences.

The factors explored in this paper help explain why prices vary - within towns, within regions, within countries, and within the single market. Brands however, being easily comparable, are less subject to price variances.

The Euro, along with other factors such as the internet, contribute to easier price comparability and price convergence. Price differences however will remain, reflecting the diversity within the single market.

## ***AIM***

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AIM is the European Brands Association. It represents the branded goods industries in Europe on key issues which affect the ability of brand manufacturers to design, distribute and market their brands. AIM's membership groups 1600 companies of all sizes through corporate members and national associations in 20 countries. These companies are mostly active in fast moving consumer goods.

AIM's mission is to create for brands an environment of fair and vigorous competition, fostering innovation and guaranteeing maximum value to consumers.