

## CASE STUDY RELATIONS BETWEEN SUPPLIERS/DISTRIBUTORS AND TRADE NETWORKS IN REPUBLIC OF MOLDOVA

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### Abstract

*The developing market is characterized by competition, under the conditions of redistribution of market segments. This factor determines market actors to increase their economic efficiency, optimize processes, and diversify products to meet consumer requirements in order to maintain their competitiveness. In this context, competitive relations represent the mechanism of market movement and development. And maintaining a normal competitive environment is related to compliance to the rules and procedural regulations on competition by market players. On the other hand, the competitive environment is influenced by the market size peculiarities that create certain conditions for businesses.*

*A small domestic market due to structural and dimensional features influences the competitive behavior of economic agents. These conditions, in turn, can generate anticompetitive behaviors in the tendency of assertion in the market. Consequently, the establishment of competition rules and regulations must be adapted to the dimensional market conditions.*

*The paper presents an analysis of the influence of the dimensional market features on the competitive market relations. The study addresses the contractual relationships between the trade networks and the producers and/or distributors of products.*

**Keywords:** market size, market share, abuse of dominant position, contractual clauses.

**JEL classification:** K2, K4

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### 1. Introduction

Competition is considered a self-regulator of the market. This requires the continuous companies development by offering good quality goods and services at a low price to maintain market competitiveness. Under a normal

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competitive environment, market players are developing to the benefit of the final consumer, adapting to demand, diversifying their offers and setting acceptable prices for consumers. In a normal competitive environment, demand is of particular importance in the formation of supply. And the economical agents compete to capture the interest of the final consumer and to be accepted and wanted, so to increase their activity.

Unlike large markets where a large number of competitors on the market streamline self-regulation of the competitive environment, small markets require increased regulatory attention to keep competition on sectors where there is a small number of economic agents. The small number of competitors in some sectors leads to the possibility of creating concerted practices or economic concentrations that lead to the creation of dominant structures. These situations affect the relationship of market players and are detrimental to the development of the economic environment in general and of the final consumer in particular.

## **2. Theoretical Studies**

Regarding the effects of structural peculiarities and market size on the competitive environment has been made several studies [1]. The OECD studies emphasize that the market dimension has considerable impact on the competitive environment. In the case of small markets these effects are usually negative for competition, which leads to limiting competitive possibilities [2]. Due to this fact, market players are restricted in the opportunities of developing and maintaining competitiveness.

The advantages of business consolidation, justified by competition authorities to stimulate development, considering the existence of dominant market structures, may impede the competitive culture development. And in these situations, additional provisions are needed to monitor and prevent the distortion of the competitive environment[1,2].

Usually, small markets has market conditions such as:

➤ Natural monopoly in social utilities like electricity, gas and water lines and fixed telephony. It happens as the result of large general expenses that impede many entities to provide lasting services. Another cause that favors the existence of monopoly is the low level of natural resources, which leads to large imports. This may lead to the creation of dominating import channels otherwise monopolizing them, which develops a barrier to new entries (meaning parallel import channels).

➤ Barriers to entry on the market. Small markets are predominantly formed by SMEs. Particular to these markets is a large offer of different substitutable products. In demand-covered markets, with a highly varied offer, needs a hard effort to entry the market. Fragmentation can be quoted as a natural barrier also. Market players are limited due to the condition to purchase wholesale raw materials to avoid exceeding fragmentation.

➤ Sometimes, the government enforce artificial barriers in order to make feasible some market segments that need rich spendings.

➤ For markets needing licensing, this one can be considered as an entry barrier. Although however, the market is opened for other players.

➤ A small market has a stronger link between market players through a high level of social interaction, as well as the the prevalence of family ties due to the small number of actors. That is why on this type of market, a collusion between suppliers can be easily performed. This circumstance creates difficulties to authorities making the difference between self-governed actions and the concerted ones.

Under these market conditions, certain effects on the relationships between market players are identified. Some companies consolidated on the market adopt abusive practice in dealing with other companies [1,2]. For example, geographically extended throughout the Republic of Moldova trade networks, impose certain contractual conditions in relation with producers/suppliers/distributors of products. Due to the dimensional inability of these companies to produce for foreign markets, they have to accept the conditions proposed by the domestic trade networks, which are often expressed through abuse of a dominant position.

Violations occurring in contracts contain dominant points, where networks directly press suppliers or manufacturers push distributors; or cartel understanding, where parties voluntarily accept constraints, creating barriers to the appearance of new players on the market[3,5].

Anticompetitive contractual clauses typically contain conditions such as:

➤ Parties agreement on dividing the territory of the delivery of products and offering exclusive sales on it, which presents an anti-competitive agreement,

➤ Exclusivity on products,

➤ Conditions for restricting the territory of distribution, and customer arrival,

➤ Promotion and marketing conditions,

➤ Price formation and price changes conditions.

The use of these clauses distorts the competitive environment on the market, leading to the strengthening of dominant positions and the creation of entry barriers. The fact that affects the economic relationships of the market actors, and finally the consumer [5].

In the case study presented in the paper, the contractual relations between the market players on the consumer goods sector were analyzed. The study focuses on the contractual relationships between the trade networks and the domestic producers / distributors.

### **3. Case Study. Contract analysis.**

The study includes the analysis of the sale – purchase contracts between the suppliers / distributors and trade networks. The analysis was made on the sale – purchase contracts of 3 producers and 11 trade networks with distributors/suppliers.

Following the analysis of purchase contracts, several clauses that are contrary to competition regulations have been identified.

The anticompetitive clauses identified in the contracts are:

1. Pricing conditions.
2. Establishing marketing fees as a percentage of the volume of delivered products.
3. The condition not to distribute the products of other similar companies.
4. Sharing the territory of delivery of the products and offering exclusive sales on it, with penalties for violations of the territory.
5. Purchase condition for the exclusive distribution of the given company.
6. Prohibition of training new customers without company permission.
7. The Company reserves the right to form the distribution territory for the duration of the contract and to impose penalties for the violation.
8. The Company reserves the right to create a list of customers for whom distribution is prohibited.
9. In the case of incomplete supply of customers, the Company reserves the right to cancel the customer from the distribution territory to the third notice.
10. Establishing a mandatory payment at the inauguration of new trade points as well as payments for introducing new products into the list of delivered products charged for each store.

11. Determination of the minimum payment for the promotion actions, and the collection of these amounts as penalties in case they do not use them during the year, for promotion actions.
12. Determination of the minimum amount of marketing expenses, expressed as a percentage of the sales volume.
13. Conditions for changing payments for marketing services in amounts calculated in% of the value of the delivered goods.

The regulatory norms for the competitive relations between the market players are laid down in the Law on Internal Trade and Competition Law. Thus, the anticompetitive contractual points identified in the analysis contravene the provisions of these laws as follows.

According to the Competition Law no. 183 din 11.02.2012 [3]:

➤ According to art. 5 par. (3) lit. c, e, agreements relating to the sharing of markets or suppliers, also, actions that create barriers to market access and prevent the actors from achieving free competition as well as unjustified agreements that prevent sales from or to certain actors, are anti-competitive agreements[3].

➤ According to art. 11 par. (2) a, the imposition, the direct or indirect enforcing of abusive selling prices is considered as a dominant position abuse [3].

➤ According to art. 5 paragraph (3) g, and art. 11 par. (2) c, d, the condition of including additional services in contracts which are not related to the object of it, due to their nature or according to commercial usage, and allow the partners make unequal conditions to obtain equal benefits, thus creating some of them a competitive disadvantage, presents abusive practices. Setting a price for services as a percentage of the value of the products for which the services will be provided, creates discriminatory conditions for suppliers by setting different prices for the same service for different suppliers [3].

According to the Law on Internal Trade, no. 231 din 23.09.2010 [4]:

➤ According to art. 211, paragraph 2 (Published: 01.18.2013 in the Official Gazette no. 10-14 Article No: 41), the trader cannot ask the supplier and charge fees for services not included in the acquisition cost of goods ( shelf charges, costs for expanding the distribution network and arranging the sales area, costs for advertising and product promotion). The trader may not be required by the supplier to contribute to marketing costs of the supplier. This regulation does not prevent the supplier or the trader from participating

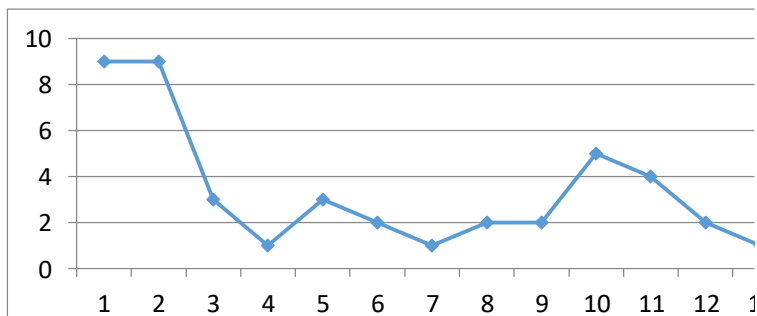
voluntarily and at the same time as marketing costs for the promotion of the products. The same article provides that the trader cannot condition the supplier to make sells to other traders at exactly at the same price than the one he sells to him. At the same time, the supplier cannot condition the trader to keep a certain shelf price [4].

#### **4. Evaluation of results**

Of the 14 contracts analyzed in the study, 11 contain anticompetitive clauses. These clauses create constraints in the activity of suppliers/distributors, and distort the competitive environment.

The frequency of occurrence of anti-competitive clauses by content is shown in Figure 1. On the X axis are the anticompetitive clauses identified in the contract, listed above, and on the Y axis, the frequency of their occurrence in contracts. As a result, we can see that the most frequent breaches are those that condition the formation of the sales price and those related to the promotion of products in the trading networks.

**Figure 1. Frequency of occurrence of competitive breaches identified in contracts.**



The practices of restricting competition through contractual conditions tend to occur due to imbalances in power between the contractual parties. These are possible by the lack of an alternative in the business relations of the weaker parties or by the dependence on their counterparts due to other factors such as technology and innovation. Another factor may be the power to exploit the informational advantages to the detriment of the other party.

For food retail market players, unfair practices presents a special case, which is now the so-called "fear factor". This factor occurs in perishable

products, and the supplier does not have a real alternative to the commercial relationship with the stronger part, the retail networks, which impose the unfair contract terms. This leads to the inhibition of the weaker parties from filing a lawsuit against their stronger partners due to costly and risky legislative processes.

As a rule, the issue of contractual clauses that lead to restricting competition for market players and the setting up of dominant powers by the other party under the legal framework is resolved by investigating cases and sanctioning companies that have set these clauses.

At the same time, the application of non-regulatory methods of remediation of the competitive environment, which are also growing in European markets, is also effective in small markets. Moreover, non-regulatory methods allow restoring competitive environment with many advantages. Applying non-regulatory methods involves informing and educating competitive culture among market actors, voluntary correction of unfair practices, and proves to be far less costly than applying regulatory methods.

With regard to the unfair practices present in contractual relations between market players, the Competition Authorities have adopted some non-regulatory measures to remedy the competitive situation. These measures express in the form of commitments assumed by the parties to the contract and provide for removing unfair clauses from contracts. At the same time, the commitments provide for the responsibility not to conclude contracts containing unfair terms in the future.

This method is an effective tool for actively involving market players in remedying and maintaining the normal competitive environment. At the same time, this method develops the competitive culture through information and the determination of the economic agents to contribute to the formation of the competitive environment. In addition, for a small market, informing and educating competitive culture is essential for creating and developing a competitive economic environment.

## **5. Conclusions**

Competitive authorities have the objective of creating and developing a competitive economic environment. The tools used to achieve these objectives are created and adapted to the dimensional market features.

The contractual relations between the market players are of particular importance in the development process of the economic environment. At the

same time, these relationships have a direct impact on the final consumer. That is why the adoption of non-regulatory measures to remove problems related to the relations between economic agents is of major importance due to their active involvement in establishing a normal competitive environment. This provides a twofold result: remediating the competitive environment and educating the competitive culture of economic agents. Another advantage of applying these measures is the removing of these violations in short period of time. Due to the parties' agreement to remove the anti-competitive clauses in the contractual provisions, they do not require a long period to be remedied.

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