

# Impact of unfair purchasing policies on the retail price: A case study of individual goods in the food supply chain

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# IMPACT OF UNFAIR PURCHASING POLICIES ON THE RETAIL PRICE: A CASE STUDY OF INDIVIDUAL GOODS IN THE FOOD SUPPLY CHAIN\*\*\*

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**ABSTRACT** This paper provides empirical evidence of the negative aspects of unfairness within the food supply chain concerning the purchasing policies of a micro-food producer who is also a supplier of large retail chains in the Republic of Croatia. When looking at the business relations between micro-enterprises and retailers, the authors identify a problem in the form of purchasing policies of retailers that contradict the legislative intention of the Act on the Prohibition of Unfair Trading Practices in the Food Supply Chain and the Directive of the European Parliament and the Council on the same subject. The paper aims to point out to the legislators that their approach to the issue has not led to the economic sustainability of the vulnerable links in the food supply chain, i.e., the supply side companies, as the problem has mostly been diverted to unfair prices. The authors point out the undue rigidity of the legislation concerning market competition in prohibited vertical agreements and the undue flexibility in price intelligence. In addition, this paper points out that unfair purchasing policies may constitute inflationary pressures not yet recognized by macroeconomic theory. The limitation of the paper stems from the likely generalization based on inductive inferences based on a case study. There is the possibility of further research on this topic in the short term to make informed economic and policy decisions.

**KEYWORDS:** *food processing industry, SMEs, supply chain, unfair purchasing, retail prices, legislation*

## 1. INTRODUCTION

In the EU, the issue of the weak position of food suppliers within the food supply chain is highly topical. Legislators in the EU institutions and Member States, including the Republic of Croatia, have sought to pro-

tect micro and small suppliers of primary agricultural products and processed foods as the weakest categories in the food supply chain. This has been done through laws prohibiting unfair trade practices. However, the legal prohibition of trade practices that are also institutionally termed unfair has not contributed

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significantly to the economic sustainability of those who have been the focus of regulation. The concept of unfair trade practices is further extended from procurement policy to include logistics and general rules between contracting parties. In practice, the procurement policy has adjusted so-called gross purchase prices by reducing them by charges whose subsequent calculation seemed unreasonable when the legislation was introduced, while retail prices have remained unchanged. In this way, the issue of prohibited unfair trade practices has been diverted to current unfair prices. At the same time, the unfair prices are considered in the context of the low purchase prices, while the previous retail prices are maintained, which might prove to be unreasonably high in retrospect. However, this paper does not analyze the impact of the legislation in prohibiting unfair trade practices on the revenues and business results of food suppliers, nor does it anticipate the failure of regulation or the positive aspects of the legislation.

The problem has already been addressed by Markou et al. (2020), whose quantitative study conducted in Cyprus shows that the impact of costs incurred due to unfair trade practices represents 32% of the income of the injured parties. Moreover, most respondents have been victims of unfair trade practices in the last five years and expect legislation to protect them. Blizkovsky and Brendes (2017) introduce the concept of economic unfairness in terms of an unfair distribution of value generated in the food supply chain. Swinnen et al. (2019), of particular interest to this paper, address the issue of unfair trade practices in the EU and from the perspective of suppliers in the food supply chain due to increasing market concentration. Considering what has been defined, it can be concluded that purchasing policies are unfair even against the unethical background. Nevertheless, the terminology of unfair purchasing policy in this paper refers to the demands of large retailers to further reduce the purchasing prices of food suppliers or to increase the costs for the supplier in the form of other business conditions.

The subject of the study is the analysis of price changes and other trading conditions observed based on invoices under the purchasing policies of micro food suppliers and large retailers subject to legislation in prohibition of unfair trading practices. It also includes a simultaneous analysis of the retail prices of individual goods from the supplier's product range. Retailers sometimes resort to legal ambiguities and so-called grey areas to ultimately achieve the required negative shifts to the detriment of suppliers through additional services that are, in reality, imposed and presented as countermeasures. For this reason, all commercial clauses observed in invoices are analyzed,

from the invoice price to the items representing additional costs for the supplier. In a part of the research carried out, expressed through a case study, additional explanations were given on this subject.

This paper answers the questions in the introduction and provides a final judgment on unfair purchasing policies regarding their impact on retail price developments. Therefore, this paper provides answers to the following research questions:

1. Does an unfair purchasing policy in the relationship between a micro food supplier and a particular large retailer have a short-term effect on the increase in retail prices for individual goods in a particular retail chain, and how?
2. Does the expectation of continued acceptance of an unfair purchasing policy in the relationship between a micro-food supplier and a particular large retailer lead to an increase in the retail price of an individual commodity in a particular retail chain in the medium term?

If at least one of the first two questions is positively answered, a third question follows:

3. Can the increase in the retail price of a single commodity in a particular retail chain, resulting from an unfair purchasing policy within the relationship between a micro-food supplier and a particular retailer, spill over to the increase in the retail price of a single commodity in other retail chains that do not further deteriorate the supplier's position?

The authors of this study note that they do not examine situations where retailers raise prices on individual goods by exploiting moments when demand is less price elastic or having a high market share in a particular area. In these cases, retailers, as the last link in the food supply chain, are directly connected to the consumer and make an additional profit. At the same time, however, retailers also reduce the profits of micro suppliers, as they sell less while purchasing conditions remain unchanged. A significant academic contribution lies in the synthesis of evidence to inform policymakers about the impact of legislation in practice and evidence with implications in macroeconomic theory, which fails to recognize the problem of changes in retail prices of individual goods at the micro level. At the macro level, if generalized, this can represent perceived inflationary pressures. This paper addresses a new area of research.

After reviewing the literature and describing the research methods, the research findings are presented using a case study of a micro food supplier (and at

the same time manufacturer) of large retailers with significant market share in the national or local market to answer the questions stated in the introduction. The findings represent a timely contribution to macroeconomic theory and practice to provide an effective legal framework for the emerging issues of unfairness in the food supply chain. Finally, the last part of the paper briefly summarizes the conclusions.

## 2. LITERATURE REVIEW

The paper draws on legislation in the EU. It addresses the issue based on the recent experience of small food suppliers without waiting for the necessary passage of time, which makes the issue tangible for researchers with indirect involvement. For this reason, the authors have tried to place the paper in the context of other research crucial to the research topic.

### 2.1. Political and Sustainability Literature Review

The problem presented and the proposed solutions are consistent with Rawls' (1971) assertion that social and economic inequalities should be regulated by state intervention to ensure benefits for the most vulnerable, fair, and equal opportunities in attaining positions. This contrasts with the neoliberal position of Nozick (1974), who argues for non-interference by the state in relations between economic entities, emphasizing freedom of choice and not forcing agreements between consensual parties in a business relationship. Such an approach is criticized because it ignores the real circumstances in the global business world, where great differences exist in countries' development and economic entities. It turns out that in a global, open world, relations cannot be left exclusively to economic entities when it is clear that they do not have equal starting positions. Moreover, the approach neglects the existential implications of the dominant link in the supply chain controlling a significant part of the placement of products and commodities in the market. It ignores the negative consequences of the free market in terms of increasing market concentration on the demand side in the food supply chain. The political economy of agricultural products and food predicts state intervention in the market. For a deeper insight into this context, Anderson et al. (2013) provide an overview and summarize the literature examining trends and variations in agricultural and food policy distortions.

Swinnen (2021) points out that in developed countries, state interference to contribute to the economic sustainability of the vulnerable often takes the form of subsidies. In their work, the authors point

out the pitfalls of such economic policies because the subsidies are converted into extra profit for the dominant link in the food supply chain. The authors are positive about the intentions of the EU institutions and Member States to protect actors on the supply side of the food supply chain. The authors believe that economic progress should be achieved through the economic development of many subjects in the food supply chain and should not be based on the economic power of a few, which is also evident from the findings of this study.

To confirm the accuracy of the terminology used in this paper, the work of Markou et al. (2020), Blizkovsky and Brendes (2017), and Swinnen et al. (2019) is acknowledged concerning unfair trade practices and prices in the EU. This paper presents the second regulation segment related to primary agricultural production.

This paper also concerns the context of promoting fair trade. Two decades ago, Nicholls (2002) recognized the opportunity for retailers by embracing the concept of fair trade in the context of Corporate Social Responsibility (CSR) to target a niche consumer market. The importance of fair trade to consumers in preventing the exploitation of suppliers from less developed countries in the supply of traditional foods through the prism of fair trade, such as bananas, coffee, and cocoa, is recognized by Petljak et al. (2015). However, based on the postulates of fair trade, the authors of this paper advocate for the concept of economic fairness in the food supply chain, which positively impacts the implementation of the concept of socially responsible business at the entire food supply chain level. Petljak et al. (2015) explain that fair trade should lead to sustainable and equal terms of trade, with prices for fair trade products that consider all relevant costs, including sustainable production, externalities, conservation of natural resources, and further investments in production. Such trade should be based on fair and sustainable cooperation, dialogue, transparency, and respect in the negotiation of long-term contracts. It is symptomatic that in parallel with the promotion of the concept of Fair Trade and the general increase in the importance of CSR in the retail sector, practices are being developed that deteriorate the position of suppliers in the food supply chain. These practices are defined in this paper as unfair purchasing policies. The need for an institutional framework confirms that the CSR paradigm, and in this context, the concept of fair trade, has a significant marketing character to attract a niche of customers, as Nicholls (2002) suggests. Petljak and Štulec (2015) indirectly confirm that retailers do not consider the economic component of CSR contribution when achieving economic sustainability

with suppliers. However, this is crucial when implementing the CSR concept at the level of the entire supply chain, as shown by the employment or wages of their employees, dividends paid to shareholders, retained earnings as a basis for long-term profits, and taxes paid. This is also confirmed by Lazibat et al. (2015), who highlight EU retailers' commitment to the environment, employees, customers, and the community in implementing the concept of CSR. This is also shown by the findings of Sumathy et al. (2019), who conducted an exploratory analysis of CSR in India and concluded that CSR activities have influenced employee work culture and motivation, community well-being, environmental protection, and customer well-being. The authors conclude that, in practice, retailers are perceived as desirable employers who care about social and environmental issues. However, suppliers' social and market responsibility is questionable when knowledge of the institutional prohibition of trade practices labeled as unfair is considered. This ultimately harms the economic sustainability of food suppliers and reduces the ability to implement the concept of socially responsible practices at the level of the entire food supply chain.

## 2.2. Microeconomic and macroeconomic literature review

In the Croatian retail market, authors have identified a trend of increasing market concentration over the last decade. This is the result of acquisitions and an increase in the share of national retailers due to the expansion of their business to the detriment of smaller local retailers. There is a growing interest from researchers in this area, referring to Smith (2019), who uses the US retail market as an example to identify situations where a retail chain operates exclusively locally and has significant market share and influence in a particular region. In addition, Smith (2019) for the US market and Meinen and Raff (2018) for the Danish market point to a significant impact of direct importing by large retailers on the growth of retail market concentration. They note that direct importation is a source of price competitiveness, so it should not be seen as a benefit of greater assortment diversity.

Furthermore, Smith and Diaz (2020) find that the growth of retail concentration in the US is not associated with significant price increases and does not harm the purchasing power of the final consumer's production of goods and services, particularly when examined under challenging supply conditions. The increasing market concentration in the Republic of Croatia is partly the result of the disappearance of local retailers, which usually have a smaller store format and are limited to placing domestic national

and local suppliers due to their long-term business relationships. Their bargaining position is more similar to that of domestic suppliers, and consequently, their profit margins are lower, and their purchasing policies are far from unfair trade practices. Their market share has already been taken over significantly by larger retailers, who either enter their small-format store segment or open large-format stores in city centers rather than just on the outskirts of cities.

It is found that retailers strive to achieve the lowest possible purchase prices to ensure higher profitability through the pursuit of stable retail prices followed by higher markups. This issue needs to be considered in the context of economies of scale, as Linden (2016) finds that one of the sources of lower average costs is lower input prices for large purchases. Large, integrated purchases are characteristic of highly concentrated markets and dominant players in the supply chain, giving them a competitive advantage at the expense of supplier positions.

To place this paper in a macroeconomic context, the authors come across the work of Eyster et al. (2021), who examine various price policies from consumers' perspective and their impact on sales. They conclude that when monetary policy is loose, and inflation is rising, customers mistakenly perceive markups to be higher and feel unfairly treated, so firms mitigate this perceived unfairness by lowering markups. The authors may agree but from the supply-side perspective of a micro-food producer. The manufacturer will try to raise prices by the absolute amount of the increased input prices, thereby reducing the relative margin. However, this does not mean the retailer will follow the same policy. In their paper, Eyster et al. (2021) analyze unfair prices from the consumer's perspective, who punishes those who raise prices. The practical problem in retailing arises from the uninformed end consumer who punishes the supplier, the victim of the retailer's purchasing and selling policy. This view stems from the awareness of the problem of economic injustice in the food supply chain in the Republic of Croatia. \*Therefore, it is important to show the background of the retail price paid by the final consumer, on which the small supplier has no additional influence. Gielissen et al. (2008) show that price increases due to subsequent cost increases appear to be fair from the consumer's perspective, while price increases due to high demand do not. When it comes to retail prices, the importance of promotional sales should also be considered. Buying on promotional terms is a frequent choice of end consumers. Suppose it is the practice of retailers to participate, at least in part, in promotional terms at a lower profit margin. In that case, the supplier's decision to set a slightly higher regular selling price

to maintain more frequent promotional sales seems logical.

In the short term, possible fraud of the final consumer in the form of false discounts following a prior price increase is prevented by the national legislation of the EU Member States following the European Parliament's and the Council's Directive (EUR-lex 2019/2161).

This issue certainly needs to be considered from the perspective of the retail markup. In the absence of competition, De Loecker et al. (2020) see an opportunity to gain market power and impose high prices, ultimately leading to a lack of confidence in monetary policy and income redistribution.

In the US retail market, they found a significant increase in markups above cost from 21% in 1980 to 61% in 2016. Only a few large companies have high markups, while the majority of companies have not seen an increase in markups and are losing market share. This finding can be linked to the findings that in the retail sector, direct imports that provide cheaper inputs contribute to the increase in retail concentration by enabling higher margins and profitability. On the other hand, higher prices may indicate the future direction of movement of retailers who now behave much more like oligopsonists and oligopolists only regarding the consequences of their oligopsonistic behavior. A growth trend in retail markups was also found by Anderson et al. (2020), but their calculations show a growth of 2% in the 1980s period and more than 3% in the last decade. In this context, Koppenberg and Hirsch (2022) address the methodology for estimating retail markups, using the analysis of markups in the EU from 2010 to 2018 as an example. They find significant discrepancies between the results of the Stochastic Frontier Approach (SFA) and the Production Function Approach (PFA), ranging from 58.14% to 313.13%, with the PFA leading to significantly higher markups. Again, the conclusions focus on concerns about reducing consumer surplus due to a further increase in concentration and a concomitant reduction in market competition. The case study presented here on retail costing, using the example of individual goods of a micro supplier in the food sector, shows that the markups are significantly higher than those stipulated in the Talmut law. This law provides for markups of 20% or one-sixth of the retail price (Friedman and Hershay, 1984) and is more in line with De Loecker et al. (2020) findings.

### 2.3. Legal literature review

The unavoidable literature used in this paper is legislation, primarily the Law on the Protection of Market Competition (NN 79/09, 80/13, 41/21), the Law

on the Prohibition of Unfair Trading Practices in the Food Chain (NN 117/17, 52 / 21), Directive 2019/633 on Unfair Trading Practices in Business-to-Business Relationships in the Agricultural and Food Supply Chain (EUR-lex, 2019/633) and the Directive on Price Indications for Consumer Products (EUR-lex, 2019/2161). As part of an academic review conducted by the European Commission, Baltussen et al. (2019) note the concerns of societal stakeholders and policymakers on the issues identified in this literature review. We use the research results of Pecotić (2012) and Patrlj (2012) concerning vertical and horizontal agreements to discuss the legislation and its impact. Restrictions on vertical agreements should not exist if they are not aimed at preventing market competition and are not directed against the interest of end consumers. Unfortunately, large retailers reject any possibility of cooperation in the pricing policy framework, invoking the limits of vertical agreements and the right to determine the price themselves. Thus, their procurement policy often boils down to pursuing the lowest delivery and the highest sales prices, which benefits neither the supplier nor the end consumer.

### 3. METHODS

Using descriptive, causal, and analysis of empirical data, observations from the business environment are summarized. The case study approach is used, based on the authors' personal experiences, i.e., their partial involvement in the business relationships they describe. Therefore, ethnography is invoked as a qualitative research method. A small food producer from Croatia with long-standing business experience was observed and their experience concerning unfair prices was compared to the practices of large retail chains. This was then related to the theme of sometimes irresponsible purchasing policies and relevant regulations.

The primary data consists of the accounting documentation of the micro-enterprise in the food processing industry and focuses on invoices to and from retailers with a significant national or local market share. In the Republic of Croatia, large retailers (from turnover exceeding HRK 100.000.000,00, or EUR 13.272,280,84 at first, to a turnover of just over EUR 2.000.000,00), are subjected to the legal framework regarding unfair trade practices in the food supply chain. In this context, the authors have drawn conclusions based on invoices subject to tax processing and recorded as such by the competent institutions. Additional data consists of the micro-enterprise's records of the retail prices of its product range, over which the micro-enterprise as a supplier has no

influence and, according to the interpretation of the law in the context of market competition in the field of vertical agreements, should have no influence. This data is selectively updated from secondary sources, including flyers from retailers announcing special sales. The results are presented as a case study based on observational data from a micro-enterprise in the food industry from 2018 to 2022. A period of five years is sufficient for the analysis and presentation of the results in the form of a case study, especially since this period covers the pre-Covid pandemic and the post-Covid period, accompanied by significant inflationary trends. The period covers the entire validity of the legislation prohibiting unfair trade practices in Croatia.

Considering the research approach based on many years of experience in entrepreneurship, all the summarized explanations are also considered to be the result of the so-called experimental method. The result of the qualitative approach is a model of the price increase mechanism. A case study proves that inflationary tendencies caused by economic unfairness within the food supply chain can be described from the perspective of unfair trade practices. The conclusions arise from the author's logical synthesis to create a correct economic understanding based on a positivist approach worthy of general acceptance (Friedman, 1953).

The authors argue that there is no characteristic flaw in the research results for numerous reasons: the three-decade-long tradition of the observed company in the field of food processing, the presence of the company's assortment on the national market of the Republic of Croatia in six of the seven largest retailers, the company's business success in terms of product quality, the value of human resources that do not change frequently, the stable financial situation and the success in raising funds from EU sources.

The research problems and conclusions are based on the author's experience, leading to a so-called probable generalization of the problems and conclusions based on inductive reasoning. The results should be generalized at the level of all micro-enterprises but after insignificant differences for small food suppliers in the Republic of Croatia doing business with retailers covered by the legislation prohibiting unfair trade practices.

Finally, a case study based on data from a microenterprise in the food industry can enrich other research on its findings on this topic, complement the findings of this paper, and generalize this topic by examining the similarities with the experiences expressed, regardless of the size of the company on the supply side within the food supply chain. For the time being, similar problems faced by smaller suppliers and

large food suppliers in relation to large retailers can be identified mainly from the media reports and the public discussion on legislative changes and amendments.

The authors would like to point out that unfair purchasing policies, as an element of economic injustice within the food supply chain, can represent inflationary pressures that are difficult to read from aggregate financial data and prove with other scientific methods.

#### 4. RESULTS

Legislation in the Republic of Croatia regarding unfair trade practices was defined in 2017 by the Act on the Prohibition of Unfair Trade Practices in the Food Supply Chain, while the issue was defined at the European Union level two years later, i.e., in 2019, by Directive 2019/633 on unfair trading practices in business-to-business relationships in the agricultural and food supply chain. Despite the constant intention of the legislators in the Republic of Croatia to protect suppliers of primary agricultural and food products when they are placed on the retail market with oligopolistic characteristics, the latest legislative amendments from 2021 have not prevented retailers from continuing to act in an economically irresponsible manner towards suppliers and end consumers. As noted above, this paper does not address the issue of unjustified price increases by retailers exploiting their monopolistic position in the micro-location market or the timing of increased demand when supply conditions remain unchanged. It also does not examine the direct impact of acquisitions within the retail sector regarding changing supply conditions for suppliers, nor does it analyze the impact of legislation on the revenues and business results of both parties, suppliers, and retailers in the food supply chain.

An insight into the data has perceived the intention of the retailers to reduce the so-called gross invoice price of the supplier so that the invoicing is reduced to the so-called net principle. Since the retail price to the end consumer is not reduced, it can be argued that unfair trade practices have morphed into the issue of unfair pricing in the form of unreasonably high markups by retailers. This could also explain the noticeable increase in markups in the retail sector, as the cost of goods to the retailer is reduced by items that represent revenue for the retailer compared to the supplier. In addition, it should be noted that the regulations at the level of the EU Member State, the Republic of Croatia, do not prohibit all bonuses in calculating costs that the retailer can pass on to the supplier. For example, the regulations do not prohibit

the transfer of marketing costs to suppliers. Directive 2019/633 places the so-called marketing bonuses in the grey zone, not the restricted black zone.

Specifically, and in line with Directive 2019/633, the legislation in the Republic of Croatia, for example, provides for marketing financing, but at suppliers' request. The legislator has misjudged retailers' bargaining power, especially regarding micro and small food suppliers. In practice, marketing costs are only formally imposed at the supplier's request, and the legislator has not defined the circumstances under which the retailer can change the prices for the services it provides to the supplier from its perspective. Leaving certain levies in the so-called grey area and allowing pressure for lower purchase prices is the motivation for writing this paper, which examines the continuation of unfair purchasing policies in the context of purchase price reductions or levy increases that affect retail prices.

Based on the study of primary and secondary data, the results are presented that answer the questions posed in the introduction. The business relationship between micro food suppliers and retail companies with which they do business was observed from 2018, when the legislation came into force in the Republic of Croatia, until 2022. Observing the business relationship requires the analysis of suppliers' initial prices and other supply conditions, as a small number of retailers have not initiated a full-price conversion to the net principle but, in part, continue to apply the bonus calculation policy. Given the sensitivity of the data and the company's obligation to keep information on each business relationship, it is impossible to present the data and research results graphically. This can be done through a matrix, but such a representation could indicate a business relationship with a particular retailer. This is due to the small number of retailers in the market with oligopolistic characteristics, the fact that the company has not yet worked with all retailers in the first years of the analysis (which would characterize this retail chain more clearly), and the termination of the cooperation with two smaller local chains. This was taken over by one of the six leading ones with which the company currently has a business relationship, out of the first seven largest at a national level. The article aims not to identify retail chains whose business can be considered irresponsible in the context of an unfair purchasing policy to suffer social harm as a result. Rather, it aims to draw the legislator's attention to the need to define more clearly the business relationships within the food supply chain to promote the development of the food production and processing segment. It is also important to avoid negative effects related to the erosion of end consumers' purchasing power.

The authors examined the prices and other details of business relationship of the analyzed company with nine retail chains, six national and three local ones, for the period from 2018 to 2022. Observation of the business relationships with the two local retailers acquired during the observed period revealed no subsequent deterioration after the legislation came into force. In these two cases, there was no deterioration of supply conditions related to additional downward pressure or burdening the supplier with additional costs. The observation of the business relationship with one remaining local retailer did not reveal any problems related to the focus of this work.

#### 4.1. Analysis of the general context

The observation of business relations with the remaining six national retailers shows (in two cases) a subsequent deterioration of supply conditions in connection with demands for a further reduction of the invoice price. From the retailer's perspective, this is related to the services they provide to the supplier. In both cases, there was a repeated deterioration of supply conditions as part of the retailers' unfair purchasing policy. In one case, there was a continuous deterioration of supply conditions by up to 2% per year, focusing on increasing the bonus burden from the so-called grey zone, poorly defined in national legislation. In the second case, a deterioration in terms and conditions of up to 2.5% per year was observed as a direct reduction in the invoice price. For other retailers, the increase in supply prices is due to increased production costs or other inflation adjustments, or at least to the strategic commitment of suppliers to increase prices to gain space in the calculation to maintain promotional sales whose importance for the business is obvious (which is generally related to the issue of unfairness but is not directly the subject of this article). The price increase is also related to the situation where the increase in the supply price is indirectly caused by the retailer continuing its policy of unfair purchasing practices based on intelligent price monitoring. Price intelligence or price monitoring requires gathering information about the market price segment's main competitors to understand each pricing decision better. On the other hand, with the increase in supply prices in two identified cases, the micro food supplier intends to follow the deterioration of supply conditions in the short term by increasing prices to bring the supply price back to its previous level. In such a situation, the retailer certainly increases the retail price while maintaining the newly established relative markup after the supplier's supply conditions have deteriorated and before its price consequently increases to reach the previous net level.



The observation of the business relations (in the two cases where the continuation of the unfair purchase price policy was found) shows that the retailer who preferred the net business principle continued to implement the purchase policy in the form of calls to reduce invoice prices. In contrast, the retailer (who, after the adoption of the legislation on the prohibition of unfair trade practices among a few, continued to operate according to the principle of calculating additional bonuses with the planned counter-action) continued the policy of increasing bonuses from the so-called grey zone. In the latter case, the retailer's markup in the form of the difference between the selling and purchase prices is the same, but the retailer earns additional revenue through bonuses.

Within the period from 2018 to 2022, the last two years (2021 and 2022) are the most important in terms of inflation trends. Specifically, during the observed period, the micro-food supplier proposed to one of the two retailers, which was accused of an unfair purchasing policy, to maintain prices at the expense of its profitability to maintain the retail price, but with the guarantee that supply conditions would not deteriorate further. The retailer rejected such a proposal, at which point the micro-food supplier raised supply prices to reflect the expected deterioration in conditions in the coming year. Faced with the additional wave of increased operating costs due to rising energy prices and the additional increase in input prices, the micro-supplier finds itself in a situation where supply prices will continue to rise. The retailer must abandon its unfair purchasing policies, especially during significant inflationary turbulence, thereby minimizing the overlap with the retail supplier's profit positions. Thus, the retail supplier cannot suffer from having to accept deteriorated supply conditions at its expense.

Compared to the two retailers with unfair purchasing policies, the food micro-provider increased prices minimally during the first wave of significant inflationary trends in 2021 to bring prices back to pre-deterioration levels in 2021 to maintain economic sustainability. The reason for this was the expectation that the price changes would soon be accepted due to the obvious increase in commodity prices and that more correct further relations and less difficult business negotiations for the year (2022) would be forthcoming in the foreseeable future (precisely because of the obvious inflationary trends). However, the retailer in question rejected the price increase and, after repeating the prices with a detailed explanation, rejected it again, justifying the rejection with intelligent monitoring. The micro supplier did not increase prices for all products in the range for all retailers, which is a strategic option of the supplier, and it also did not

increase prices for retailers with tolerable supply conditions in the first wave of inflation. The retail chain has given itself the right to analyze the retail prices of other retail chains, namely those not recognized by this work as those that continued to worsen the supplier's supply conditions after the legislation.

Only one item for which no price increase was found in a larger part of the retail market in the Republic of Croatia was a sufficient argument to reject the price increase for all items. Thus, the procedure was extended to five months for all products in the relevant assortment, not only for those for which no price increase was detected at the level of the wider retail market. For five months, the retailer maxed out the supplier by refusing to accept price increases when inflationary trends emerged, prompting it to raise the price level of its products across the board. This was true for individual goods in the broader retail market before it accepted price adjustments in early 2022 to return to prices before the last deterioration in 2021. So, the retailers increased their final prices. Still, in the meantime, one particular retailer again demanded a deterioration in supply prices, which was unexpected from the supplier's point of view, as inflation began to accelerate. The supplier hoped that this retail chain would stop its irresponsible actions. In fact, in early 2022, the retailer accepted the increase in supply prices with an automatic request for a price reduction by the amount of the 2022 price increase.

Therefore, the supply price for the retailer remained the same as it was at the end of 2021, but retail prices have increased. In 2022, inflation became double-digit, and a new problem emerged. In the face of double-digit inflation, retailers raise prices to maintain or expand their relative margins. On the other hand, suppliers face rising energy, labor, and raw material costs and try to attract the attention of end consumers by maintaining their absolute margins. Suppliers (especially the small ones who also face unfair purchase prices and unfairness in food supply) are in a difficult position under these circumstances, as their products are becoming too expensive. At the same time, their margins are unattractive to continue business.

#### 4.2. Quantitative analysis of a single commodity

The entire flowchart is described mathematically below using the example of a single commodity for the last two years and the current year (m). It illustrates the undoing of such an unfair purchasing policy by surplus suppliers and surplus consumers. The following abbreviations are used:

- X (constant invoice purchase price m-2)
- Y (retail sale price m-2)

- X - deterioration of supply conditions  $m-1 = Z$  (constant invoice purchase price  $m-1$ )
- Y + price increase based on internal redistributions in the calculation and intelligent pricing = W (retail sale price  $m-1$ )
- Z + accepted purchase price increase overlap ( $m-1$  to  $m$ ) = H - deterioration of supply conditions  $m = M$  (invoice purchase price  $m$ );  $M = Z$ ;  $H = X$
- W + price increase based on accepted purchase price increase and intelligent pricing = K (retail sale price  $m$ ).

The analyzed empirical data shows that  $M < X$  and  $K > Y$ .

### 4.3. Analysis of research questions

The answers to all three research questions posed in the introduction are affirmative. It follows that an unfair purchasing policy aimed at increasing retail profitability primarily by reducing the cost side leads to an increase in retail prices for individual goods at the level of the broad retail market. The increase in supply and the resulting retail prices are since the retail chain relies most on intelligent monitoring and conditions the general increase in prices for individual goods to accept subsequent increases in supply prices because of its unfair purchasing policy (see Figure 1, which visualizes the above results using a mathematical approach).

Moreover, by avoiding the annual growth in their prices, suppliers will calculate future expectations re-

garding the deterioration in their supply conditions and increase their supply prices at a reasonable and convenient time and more than justified. The authors believe that the inflationary pressures thus expressed, which have been observed since the second half of 2021 and during 2022, are also due to the issues raised in this work. The paper's findings, if generalized, would indeed show that economic unfairness in unfair purchasing policies, especially in the food supply chain, leads to inflationary pressure(s).

## 5. DISCUSSION

The value of this paper is that the case study It shows the bitter truth that the economic and social promotion advocated by the most developed countries in the world is increasingly leading to higher market concentration with negative effects for a growing part of the population.

### 5.1. Implications for society and business

The results clearly illustrate the negative impact of an unfair purchasing policy on reducing surpluses among suppliers and final consumers. The research shows, somewhat unexpectedly, that an unfair purchasing policy increases retail prices for a single good. This paper essentially shows (from a micro perspective and using research evidence pointing to the growth of retail markups, De Loecker et al., 2020) that markups increase in the business of large retailers whose market share is growing. However, this paper focuses on

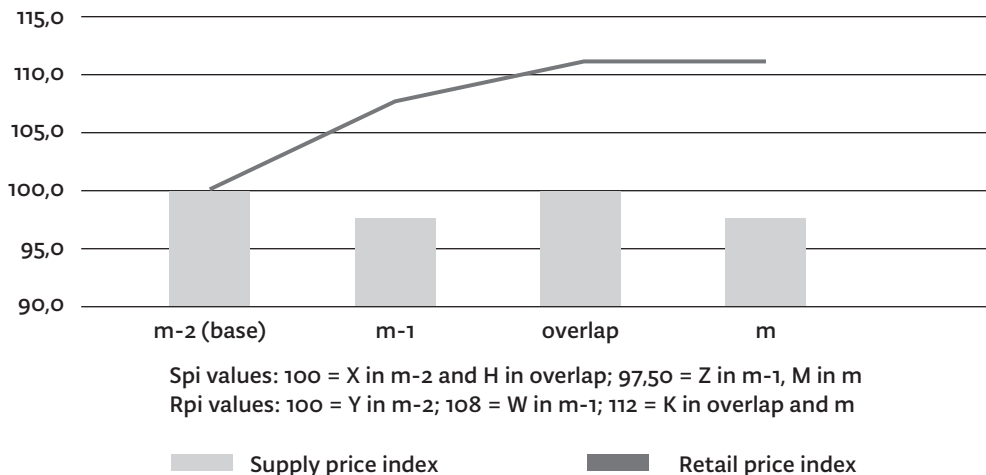


FIGURE 1. Price rising mechanism (indices)  
 Source: Authors.

further increasing margins at the expense of supplier positions. This is consistent with research showing that large national retailers seek direct imports, which is the source of their price competitiveness against smaller local chains that lose market share or are bought out. In this particular case, the micro food supplier does not achieve economic sustainability in its business but relies on the policy of co-financing by the local government and funds from the state or the European Union.

This paper illustrates the futility of supporting micro and small enterprises in food production and processing in the Republic of Croatia, since taxpayers' money benefits corporations in the oligopolistic retail market. These corporations use a PR strategy, falsely perceived as socially responsible, in terms of social and environmental commitment at the expense of the economic sustainability of suppliers. Market concentration will continue to increase in the future, but also on the supply side. The significant inflationary trends observed for 2021 and 2022, driven by energy price developments and the evidence described in this paper, have been driven by the supply side. A significant increase in market concentration can be observed in primary production of food and raw materials for further processing of food. The authors believe that such a situation will lead to lower profitability in the food processing segment, due to so-called market competition, in terms of control over resources on the one hand and control over placement on the other. This will lead to a crowding out of smaller companies and an increase in concentration in this segment. Ultimately, a further reduction in consumer surplus and greater population stratification in terms of income is inevitable. In this context, the authors already see a niche for future research to investigate the income gap between workers in the same or similar occupations in different companies in the food supply chain. This gap is crucial to the study because it represents an economic injustice in the form of a worsening of the position of weak companies by dominant companies such as retail chains, which affects workers' working conditions and wages.

The findings in this paper show that the intention of the legislation continues to be circumvented and indicate that business ethics should not be relied upon in this era of neoliberal capitalism that characterizes the corporate world. Very often, corporate ethics serves marketing, and it is not desirable if it is not useful. The results show that the micro-supplier of food is guided in adjusting supply prices by expectations primarily aimed at a future deterioration of supply conditions and that it usually reacts after the previous deterioration. An unfair purchasing policy was continued in two out of nine cases. However, for

a retail chain with a significant market share, it is sufficient to condition price changes based on intelligent monitoring by confirming the increase in retail prices so that the price of a single product increases in the wider retail market.

Despite the legislation, some retailers have a clear tendency to continue to pursue oligopsonistic purchasing policies. This unfair behavior further jeopardizes the economic sustainability of manufacturers, which is already questionable as the legislation has not improved their position in increasing their profit margins to achieve economic sustainability. Given the already weakened position of suppliers, they are forced to adjust prices, which ultimately leads to an increase in retail prices and undermines the purchasing power of end consumers. Thus, the legislation banning unfair trade practices in the food supply chain did not stop the policy from further deteriorating the position of suppliers, as it had not prevented those who are highly unethical and malicious from circumventing the law. The legislation failed to understand and anticipate retailer behavior. As a result, it did not establish a clear relationship between the supply price (and other supply terms) and the retail price. Regulating markups or special tax treatment seems inappropriate at this stage, as the state should interfere in business relationships and regulate business, especially with retailers. However, the current legislation is insufficient to protect vulnerable categories in the food supply chain on the supply side.

## 5.2. Proposed courses of action

The case study findings suggest that targeted and balanced legislation prohibiting unfair trade practices should prevent the increase or maintenance of retail prices in the following situations. This should also be done in the area of consumer protection. In the first case, when supply prices and conditions do not change, or in the second case, they move in a direction that should lead to a reduction in the retail price. In this context, the retailer would only be entitled to suggest to the supplier that there is a tendency to reduce the retail price if he finds by intelligent observation that prices are higher than those of competitors, considering his markups. Thus, the legislator may not rely on the bargaining power of suppliers to authorize a change in the retail price. This follows from the experience with marketing costs, which, according to the legislation, may not be imposed on the supplier but must be initiated by the supplier. In practice, marketing costs are expected and sometimes a hidden condition of business continuity, and at the same time, the retailer's price list for marketing services is arbitrary. It is also suggested that the retailer

must inform the food supplier of the change in retail prices, except in the case of special, i.e., promotional sales. In this way, the control of implementing the rules on unjustified maintenance or increase of retail prices would be done by the food supplier as an intermediary partner of the competent institutions. The latter would also be a good mechanism to control the impact of tax policy by reducing VAT on retail prices.

The results of this study should, in practice, prompt action by the institutions, responsible for adopting and implementing legislation prohibiting unfair trade practices in the food supply chain and protecting competition. The lack of a response could harm suppliers and end consumers if the described policy is collectively re-implemented by retail chains to eliminate the possibility of gaining an advantage over their competitors in an unethical way. The legislation defines unfair trade practices exhaustively. In Croatia, the Agency for the Protection of Market Competition, which oversees legislation enforcement, strictly adheres to the legal definitions of unfair trade practices. The legislation lacks several important elements beyond those described in this paper, especially in penalties for (non)delivery or delay and financial compensation, which the purchasing policy cannot strictly prescribe.

When analyzing the legislation on the protection of competition and its understanding with the help of the work of Pecotić (2012) and Patrlj (2012), the authors note that the legislation is partly in contradiction with the ideas of the authors, who see many restrictions for micro and small food suppliers compared to large retailers. The authors suggest a higher degree of business process integration and transparency in retail pricing policies. Vertical agreements are prohibited by law, but the prohibition is exempted if the agreement improves production or distribution, promotes technological or economic development, and provides a relative advantage to consumers. The authors' idea is to make the products of micro and small food suppliers more accessible through a higher degree of integration and transparency in the pricing policies of retail chains. This would benefit the end consumers and producers, who would achieve higher production and invest in research and development of new products. Certainly, the intention of a transparent and ultimately coordinated pricing policy between small suppliers and retail chains would not harm competition but primarily contribute to the economic sustainability of the weakest links in the food supply chain. To achieve cooperation between micro and small food suppliers and the largest retailers, the legal prohibition of vertical agreements in situations where the retailer's market share exceeds 30% seems completely wrong.

Moreover, competition law gives the buyer the right to determine the product's retail price freely. If the supplier is given the right to set a maximum retail price, it is clear that he would not use this tool in the negotiations with the retail chain because he would risk being excluded from the market. Instead, the supplier only gives a recommended retail price that is reasonable for the end consumer. The legislation focuses on the prohibition of selling products below cost. From the supplier's perspective, it is less unclear how such a provision affects the supplier who sold the products to the buyer, except that the government is protecting its tax revenues in this way. Sales below cost by a single retail chain would potentially harm the stability of product sales in the wider retail market and encourage other retailers to charge lower supply prices due to smart price monitoring.

Intelligent price monitoring strengthens the bargaining power of the retailer. It partially prevents vertical cooperation on assortment between supplier and retailer. Logically, a higher degree of cooperation allows the supplier to make certain concessions on the purchase price for a single good. Therefore, it would be desirable for the retailer to pass on the advantage to the end consumer according to the supplier's ideas. By analyzing such practices, another retailer who monitors prices intelligently can impose impossible purchasing conditions on the supplier by referring to other retailers' prices.

## 6. CONCLUSION

This paper addresses the issue of how unfair purchasing price policies affect changes in retail prices for individual commodities in the food supply chain. The issue is important given the enacted legislation prohibiting unfair trade practices and the significant inflationary trends (from the second half of 2021). The case study shows that unfair purchase price policies aimed at increasing retailers' profit margins lead to an increase in the retail price of the individual goods of a micro food producer at the level of the entire retail market in the Republic of Croatia, as a result of intelligent price monitoring between retailers. The food supplier, wishing to avoid the sometimes lengthy and stressful process of increasing prices, will calculate future expectations of a deteriorating supply situation and significantly increase its delivery prices at an appropriate and favorable time. The authors assert that the inflationary pressures emerging from the second half of 2021 through 2022 represent the outcomes and challenges addressed in this paper. They suggest that if the findings are generalized, there is evidence

of economic inequity due to unfair purchasing pricing policies in the food supply chain, which constitute unexamined sources of inflationary pressure. Finally, the authors discuss the existing legislation prohibiting unfair trade practices in the food supply chain and legislation to protect competition. The research findings consist of a call to homogenize the two legislations to fulfill the legislator's intention, namely, to protect the weak links in the food supply chain on the supply side and the end consumer as much as possible.

The authors argue for transparent pricing policies between suppliers and retailers and for targeted legislation to limit the growth of retailers' markups at the expense of suppliers' or consumers' surpluses. This paper focuses on a narrow slice of unfair pricing in the context of prohibiting unfair trade practices, which is still an under-researched area. There are many opportunities for research to confirm the case

study findings, so generalizing the topic would shed light on economic unfairness in the supply chain as an inflationary pressure. Furthermore, this work can be considered in the context of corporate social (ir)responsibility. The results identified propose a strategy for the survival of food production under unfair conditions by suggesting innovation and the development of new products that can withstand additional bonuses as end consumers are willing to pay a higher price for them. This proposal and view(s) also suggest that retailers in the food supply chain are the ones who benefit most from the price skimming strategy when food producers sell new innovative products to end consumers through retailers. The power of end consumers in terms of motivation to buy a particular brand is becoming less and less important due to the market power of large retailers, also given the oligopolistic and oligopsonistic characteristics of the retail market.

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## UTJECAJ NEPOŠTENIH NABAVNIH POLITIKA NA MALOPRODAJNU CIJENU; STUDIJA SLUČAJA INDIVIDUALNOG DOBRA U LANCU OPSKRBE HRANOM\*

## SAŽETAK

Ovaj rad empirijski demonstrira negativan aspekt nepravednosti unutar lanca opskrbe hranom vezan uz nabavnu politiku prehrambenih proizvoda mikro proizvođača u Republici Hrvatskoj, zemlji članici EU. Razumijevajući odnos mikro poduzeća iz segmenta prerade hrane s maloprodavačima, autori identificiraju problem u vidu nabavne politike maloprodavača koja je suprotna intenciji Zakona o zabrani nepoštenih trgovačkih praksi u lancu opskrbe hranom i Direktive Europskog parlamenta i Vijeća. Cilj rada je ukazati zakonodavcima da njihov pristup problematici nije rezultirao ekonomskom održivošću ranjivih karika u lancu opskrbe hranom, odnosno tvrtki na strani ponude, jer se problematika nepoštenih trgovačkih praksi ponajviše preusmjerila na užu problematiku nepoštenih cijena. Autori uočavaju neopravdanu rigidnost zakonodavstva vezanog uz tržišno natjecanje u području zabranjenih vertikalnih sporazuma te neprimjerenu fleksibilnost u području cjenovnog praćenja između maloprodavača. Svrha ovog rada je ukazati da nepoštena nabavna politika može predstavljati inflatorni pritisak koji makroekonomska teorija još ne prepoznaje. Ograničenje rada proizlazi iz vjerojatne generalizacije temeljene na induktivnom zaključivanju iz studije slučaja. Poželjna su daljnja istraživanja na ovu temu u kratkom roku kako bi se donijele pravilne ekonomske i političke odluke.

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**KLJUČNE RIJEČI:** *prehrambeno-prerađivačka industrija, MSP, lanac opskrbe, nepoštena nabava, maloprodajne cijene, legislativa*

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