

## THE IMPACT OF GLOBAL TRENDS ON CZECH TRADE IN AGRARIAN AND FOODSTUFF PRODUCTS

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### Abstract

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The Czech retail market has changed its structure and form during the last twenty years. The influence of two factors is especially significant. The first one is the growth of internationalization and the second one is market concentration growth. The significant opening process of the Czech economy, accompanied by the liberalization of the Czech market process, enabled the international retail companies to penetrate the national retail market. The most powerful European retail companies are now present in the Czech market. The available shopping area/cap is also one of the largest in Europe. Retail chains have taken a dominant position in the market, and because of their market power they are able to determine trade/contract conditions for domestic suppliers. Retail chains' sales have been constantly growing. While in 2006 the value of sales was about 258.5 billion CZK, in 2008 it was about 312.2 billion CZK. The impact of the economic crisis on the Czech retail market has not been as stressful as it was abroad. In 2009, a slowdown of the Czech retail market was recorded, but the value of sales decreased by only 3 billion CZK (in comparison with 2008). The highest sales (59 billion CZK) were recorded by the Lidl & Schwarz-Gruppe, which is the owner of two dominant retail chains in the Czech retail market (Kaufland and Lidl). The main aim of the paper is to evaluate the selected aspects, which have been influencing the relationship between multinational companies (retail companies – supermarkets and hypermarkets) and local (Czech) suppliers of agrarian and foodstuff products (farmers and foodstuff companies). The paper analyses the problem of abuse of multinational companies' significant market power in relation to their suppliers. Based on a pilot project, the efficiency of market force law, and its use in practice, are analysed. The main idea is to analyse the following problems: the impact of 30 days payment period for goods delivered, under cost prices required by retail companies, and the structure of fees and charges required by retail companies.

Czech Republic, market, power, supplier, retailer, relationship, legislation

The existence of multinational companies (MNCs) is connected with the globalization process. Multinational companies are the key agent of the world economy integration (Siebert, 2000). The MNCs improved the effectiveness of the world economy functioning, but on the other hand the owners of individual MNCs found out, that through the globalization process they gained the significant market power.

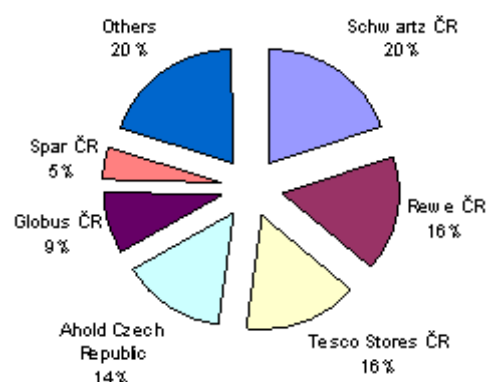
The United Nations defined MNCs as an enterprise which controls assets, factories, mines,

sales offices and the like in two or more countries (Bartlett, 2003). One of the most important motivations for companies to expand their operation internationally is the low-cost factors of production in developing countries (Venetova, 2006). A very important problem connected with the existence of multinational companies is the abuse of their market power. The influence of MNCs on the competitive structure of the host market was explored by Hymer and Rowthorn (2009). Market power is the key issue in the industrial economics

and competition law. In particular, antitrust law and some other legislation supporting the high level of market competitiveness (the aim is to control the abuse of market power) are used to minimise the social cost of exercise of market power (Mackenrodt, Gallego, Enchelmaier, 2008). The MNCs play an important role in many countries around the World. However, in many cases their influence on market development is positive; there are existing many cases when these companies abuse their significant market power to take control over individual national or regional markets (Horská, Nagyová, Rovný, 2010). This paper is concerned with the abuse of multinational companies' market power in the Czech agrarian and foodstuff market.

During the last 20 years (since 1990) the Czech retail market has significantly changed its form and structure. Many changes have occurred (Hes, Šálková, Regnerová, 2010). Amongst the most important changes influencing not only the Czech retail market we can include for example the growth of internalisation and market concentration, strengthening of global effects influencing not only national economy, and also the global environment (Bielik, P., Horská, E., 2008). The significant process of the opening up of the Czech economy together with market liberalisation (liberalisation process has been influencing not only Czech market, but also European and World markets) enable the integration of multinational retail companies into the local retail market. Because of high levels of competition from powerful multinational retail companies, many small private shops and in particular local companies (those mainly trading in foodstuff products), were forced to finish their activities and leave the market (Operating in the united EU market lays increased demands on the adoption of the competition rules in the European market, the art of acquiring competitive advantages against one's rivals and an early identification of the future development on the operating markets (Horska, Krasnodebski, 2009)). They were unable to compete with the constantly growing number of supermarkets and hypermarkets in ownership of multinational companies (SCHWARZ ČR, REWE ČR, TESCO STORES ČR, TESCO STORES etc.) in categories such as: the range of products offered for sale, the price of products, operating costs and so on.

The current situation in the Czech agrarian and foodstuff market can be described in the following way. The Czech market is controlled by the buyers.



1: The structure of retail market (the shares of individual main retailers) – 2009

Source: INCOMA, 2010

There is a huge prevalence of buyers over producers. This state is quite evident especially if we compare the mutual relationship between suppliers (in this case food producing companies) and retailers (big multinational companies controlling the Czech foodstuff market). On the supply side many producers exist, however on the demand side only a few big players (usually multinational companies) exist.

The first six the most dominant players (SCHWARZ ČR, REWE ČR, TESCO STORES ČR, AHOLD CZECH REPUBLIC, GLOBUS ČR, SPAR ČR) control over 80% of total foodstuff retail market. While the production part of the market works under perfect competition (Suppliers have only limited market power and they have to accept prices and conditions which are dictated by big multinational retail companies.), the demand part of the market is influenced by the existence of the limited number of retailers (Retailers have a significant market power, and are able to control the situation in the market).

## MATERIALS AND METHODS

The main aim of the paper is to evaluate the selected aspects, which has been influencing the relationship between multinational companies (retail companies – supermarkets and hypermarkets) and local (Czech) suppliers of agrarian and foodstuff products (farmers and foodstuff companies). The paper analyses the problem of abuse of multinational companies' significant market power

1: The structure of agricultural and foodstuff sector – the number of subjects operated in agrarian and foodstuff sector

years	Agrarian sector					Foodstuff sector
	Companies in personal entities' ownership	Agricultural co-operative	Business entities	Others	Total	Number of entities operated
2000	23 460	746	2 107	174	56 487	xxx
2008	41 440	588	2 609	196	44 833	6 609
2009	44 028	585	2 739	212	47 564	6 528

Source: Ministry of Agriculture CR and UZEI, 2010

in relation to their suppliers. Based on a pilot project, the efficiency of market force law and its use in practice are analysed.

The analysis is focused on the Czech retail market. It covers the period since 1990 to the present day. On the basis of an analysis of the development and structure of multinational retail chains, the authors decided to estimate the impact of globalisation effects in the Czech foodstuff market. Special attention is given to the approach of multinational retail companies (supermarkets and hypermarkets) to their Czech suppliers (the representatives of Czech agrarian sector and foodstuff industry). The authors of this paper addressed the representatives of selected companies – main retail chains suppliers, and on the basis of controlled interviews, the main problems were identified. The representatives of three different sectors (according to OKEČ nomenclature – Branch Classification of Economic Activities) of the food industry were interviewed (OKEČ 15.61 – production of flour-milling products, OKEČ 15.51 – processing of milk, production of milk products and cheese, OKEČ 15.1 – production, processing and conservation of meat and meat products).

Representatives of the selected companies were asked to reply to questions connected with the following topics:

1. Do you know any additional retailers' financial requirements in relation to supplier – speaking about trade contract (fee for registration, fee for product placement into shelves, advertisement contribution, and sponsorship)?
2. What is the term of maturity for invoices paid by retailers?
3. What is bargaining position of suppliers?
4. What is the bargaining position of retailers in relation to suppliers during the negotiation process connected with trade contract conditions?
5. What is your opinion about retailers' attitude to new Act No. 359/2009? Do they respect it?

The analysed problem is quite difficult and very sensitive. The data provided by representatives of individual companies were given in confidence. The individual suppliers depend on the big multinational retail chains. To receive data and information for the analysis, it was necessary to promise to individual providers that the source of data will be anonymous (they are afraid of the negative reaction of their partners (big multinational companies), if they discover the source of data provided). This situation can also be identified as one of the negative factors of globalisation.

## RESULTS AND DISCUSSION

Many of the powerful European retail chain companies are located in the Czech Republic, and the sales area/capita is one of the largest in Europe. Retail chain companies occupy the

dominant position in the market and because of their economic and financial power they are able to determine conditions for domestic suppliers (The problem of domestic suppliers is the fact that they are not able to cooperate. Every local company follows only its own interests. Suppliers are not able to enforce their prices and sales conditions and they have to accept price and conditions of their key customers – usually big multinational companies which took a control over the Czech retail market). During the last 20 years, the position of individual multinational companies in Czech market has become significant. The Ahold company opened its first supermarket in the Czech market in Jihlava in 1991. Nowadays Ahold controls 280 supermarkets and hypermarkets (Albert) in the Czech Republic. A similar situation can be seen in the case of some other retail chain companies, for example – Penny Market represents over 300 shops and supermarkets, Lidl represents over 200 discount shops and Billa represents 194 supermarkets.

The following “players” have the strongest position in the Czech retail market. The most dominant position is occupied by the German retail group SCHWARZ CR (Kaufland, Lidl). The other players are REWE CR (Billa, Penny Market), TESCO STORES, AHOLD CR (Albert), MAKRO CASH CARRY, GLOBUS, SPAR CR (Interspar, Spar supermarket, Spar Šumava) (Hajnová, 2008).

The sales value of individual retail groups has a growing trend. While in 2006 the value of sales was about 258.5 billion CZK, in 2008 the value of sales increased to 312.5 billion CZK. The impact of the economic crisis in 2009 was minimal (The Czech retail market stopped growing, and the value of sales decreased by about 3 billion CZK). The highest sales (59 billion CZK) were achieved by Schwarz, which operates hypermarkets (Kaufland) and discount shops (Lidl).

Multinational companies are significant market players. Their main goal is profit generation. They are able to take all the advantages of the European Union internal market and world market, especially for the process of buying (for low price) and selling (for high price) their products. They are able to provide a huge range of products and are able to use their huge network of contacts and distribution channels.

Domestic suppliers have to face the constantly growing competition of imports especially from other EU countries. Because of the free movement of goods within the EU internal market, the value of imports of agrarian and foodstuff products has been constantly increasing and the share of imported products in the domestic market has been growing quickly. Prices of imported products are very often below the cost level of domestic producers. This development trend is quite negative for Czech producers, however it can be positive (provided the characteristics of the imported products comply with the legal conditions such as quality, hygienic

norms and Czech national standards) for consumers (low price, huge choice of products).

The big problem is the price of imported products. This price is lower than the production and operating costs of our producers. The problem is that the EU market does not work under the state of perfect competition. Regarding the agrarian market, it must be stressed that individual EU countries provide different forms of direct and indirect supports and subsidies to help their own producers, yet huge differences still exist when comparing the system of subsidies in the EU15 (old EU members) and the EU12 (new EU members – countries which became EU members in 2004 and 2007). Differences in the system of subsidies are not only the problem of the EU12 and EU15. Huge differences also exist between individual EU12 countries (for example between the Czech Republic and Poland). This problem can be illustrated, for example, by the import of low price poultry meat from Poland to the Czech Republic. In Poland a different system of social and health insurance for farmers and small producers was established (while in the Czech Republic farmers have to pay insurance by themselves, Polish farmers do not have to pay insurance, and instead the State pays insurance for the farmers). They (Poles) also have a different system of VAT (lower rate of value added tax – while in the Czech Republic the agrarian and foodstuff products VAT is 10%, in Poland it is only 3%) and income tax (lower rate) for farmers and smaller producers (In comparison with Czech agrarian producers, small Polish agrarian producers have a significant competitive advantage, because they do not have to pay any income tax.) (European Commission, 2007, ASZ 2010).

The Polish State supports farmers more than in the Czech Republic and the result of these activities is a lower unit price of production in Poland in comparison to the Czech Republic.

Czech poultry meat producers are not able to fight against Polish imports, because they cannot compete with poultry meat which is subsidised. Another problem of the Czech market is the import of poultry meat chilled by water (mainly from small slaughterhouses). In the Czech Republic this technology is forbidden (because of the health hazard), but meat yield of this technology is about 2–3% higher in comparison with the usual technologies applied in the Czech Republic. In the period before the Czech accession into the EU, the water cooling system was forbidden and companies were obliged to invest a significant amount of their financial resources to change their cooling system. The application of this different technology is connected with the decrease of meat yield and the increase of the final product price.

The nice example of this problem is the price of poultry meat import from Poland to the Czech Republic between the 48<sup>th</sup> and 51<sup>st</sup> week of 2009. During this period, the price of Polish imports varied between 28 CZK and 30 CZK for 1 kg (CZSO,

2010). It was not possible for the Czech producers to compete with this price (The price of Czech agrarian producers was over 40 CZK for 1 kg (SZIF, 2010).).

Polish chicken meat production is approximately 4 times higher than in the Czech Republic. The volume of Polish production is equal to the number of population living in Poland. But for example if Poland exports its chicken meat overproduction representing about 5% of total Polish production to the Czech Republic, this 5% represents about 20% of Czech chicken meat production. This volume of chicken meat imports has been influencing meat price in the Czech domestic market and Czech meat producers are not able to compete, with the result that domestic production has been collapsing. It must be also emphasised that there is no defence against Polish subsidised chicken meat exports. A similar situation exists in the case of pig meat, which is imported to the Czech Republic from Germany.

Apart from this, the Czech poultry meat market has to face to some other problems. A significant volume of poultry meat is imported to the Czech Republic without appropriate documents (missing veterinary certificates, missing mark of origin, bad information about trade price and quantity, invoice price and volume of traded products do not correspond to the real value and volume of import operation).

While meat imports to the Czech Republic have doubtful quality, Czech suppliers are strictly controlled to achieve the best quality of traded products. Products have to meet all requirements and international standards (in many cases Czech suppliers have to meet individual client's standards, which are very often much more strict than in the case of international norms like ISO, HACCP etc.). Another problem is represented by insufficient control mechanisms. While imports of the majority of products are strictly controlled by customs and other authorities, in the case of meat products the level of control is very low. If customs authorities are not accompanied by representatives of the veterinary authority (the veterinary authority must be responsible for the control of all food imported to the Czech Republic), there is no guarantee that Czech consumers will be able to buy only high quality food.

The position of power which exists in the case of many multinational retail groups is very often connected with the arrogant and undignified behaviour of many high positioned managers in relation to their suppliers (especially those suppliers who are dependant on only a few customers).

Because of their position of power in the market, representatives of the individual retail groups showed an absolute lack of interest in, and did not attend, a meeting organised by the Czech ministry of finance (the main purpose of which was to mediate constructive discussion between suppliers and retail companies). It is therefore quite evident that even



the highest state authorities are not accepted as an appropriate partner for multinational companies.

The unnoticed approach to state authorities can be explained by the inconsistent behaviour of individual state administration bodies, agencies and even officers. Individual state administration agencies are not able to enforce law-abidingness and it is the reason why they have such a low level of respect by the big market players. If state authorities were to improve their activities, they would be more respected. For example – One of the most pressing problems is the fact that state revenue authorities are not able to manage the consistent inspections of accountancy law and nor are they able to ensure that the tax law is being followed. It is stated in the law that promotion costs can be charged to budget only by those subjects which sell goods (but in fact in many cases promotion costs are paid by suppliers). A similar problem can be found in the case of payments for new shop equipment. It is stated in the law that equipment costs must be paid for by the shop owner, but in many cases suppliers are asked by retailers to share the costs of new shop equipment, or even for establishing a new shop. Another problem of mutual relationship between retailers and suppliers is the charges for the delivery of goods. Suppliers are obliged to pay 2–8% of sales revenue value to retailers for the possibility of being able to sell their products to the retailer (In the previous period this payment represented 12% of sales revenue (In the case of one company, which provided us with data for this paper, the value of sales was more than 7 billion CZK and the value of payments for the possibility to sell its products to retail net was over 30–40 million CZK.)). It must be also mentioned that retailers do not face any risk if the products are not sold. On the basis of mutual agreements, suppliers are obliged to take back unsold products (for unsold products the retailer is not obliged to pay any money to supplier). Apart from these problems, suppliers are also requested by retailers to pay for advertising actions in supermarkets and hypermarkets. They have to provide not only the product for free, but they are also requested to join in paying the costs for the advertisements, broadsheets and billboards. Retailers also pressure suppliers into sponsorship. The level of participation in such a sponsorship has a direct impact on the volume of trade contracts. A representative of one analysed company provided us with information that if they decided not to provide a sponsorship gift several times, one third of their products were refused by the retailer. A permanent problem existing between suppliers and retailers is the term of payment for delivered products, sometimes being more than 90 days. Implementation of new labels (in many cases a new product was asked by the retailer) of food products was connected with a price decline of about 30%. The price decline was explained by the fact, that traded products do not have a brand name. Further problem for suppliers is represented by a high rental

fee for sales areas. Prices for renting sales areas in supermarkets and hypermarkets are usually three or four times higher for suppliers, than usual prices in the same region.

The situation of Czech suppliers of agrarian and foodstuff products in the domestic market is very difficult. They have to carry out their business under a high level of competition. The Czech market is open to free imports from all EU members. Czech producers are not able to cooperate and are fighting with each other. Big foreign retail companies control the Czech market and are able to use their market power against domestic suppliers. Retailers force their suppliers to sell their production for a very low price. In many cases the final price of the contract is lower than the production costs.

The Czech market is market is controlled by the customer. There are many producers, but only a few customers (in this case only a few retailers). It means that if we analyse the supply side we can see that almost perfect competition exists, but if we analyse the demand side we can see that there are only a few buyers (oligopoly) (Vološin, 2007).

### **Abuse of Significant Market Power**

To make relationships between suppliers and retailers more equal, the government initiated a new act on market power (Act No. 395/2009 on the Abuse of Significant Market Power (UHOS, 2010) came into force on Feb. 1, 2010). The idea of this act is to prevent retailers abusing their market power in relation to suppliers (Horák, Chvosta, 2010).

This act is the result of numerous discussions among retail businessmen, suppliers and Czech authorities, as well as lawyers. It is very important to say that the act is only focused on food products, while non-food products are unaffected (UHOS, 2010).

On the basis of the new act, the abuse of buyers' (retailers') significant market power against their suppliers is forbidden. The abuse of significant market power is connected with the following buyers' activities. In many cases buyers do not respect the terms of payments or trading conditions. They do not respect that, on the basis of legislation, every trade transaction must be the subject of invoicing. In the case of every transaction, the term of payment must be specified. It is also obligatory to specify payment conditions for the purpose of late payment (payment later than that written in the contract).

The invoice has to include all the information about price reductions (if reductions are provided) or some other services connected with the transaction. The only exception is represented by unpredictable reductions.

The new act also defines the general payment conditions including the terms of transaction, price terms, price reductions and payment conditions. The term of payment for goods delivered must not be longer than 30 days from the date of delivery of the goods. The buyer cannot sell the same products

for a lower price compared to the real contract price (The real contract price is the price invoiced.). It is forbidden to request any payments which are not covered by appropriate trade services. Buyers cannot ask sellers to co-finance any trade activities without appropriate counter value. It is also forbidden to press a partner to pay or co-finance advertising campaigns, investments activities, renovations of existing shops or even establishing new shops, fee for product registration etc.

According to the new act, significant market power is defined as a situation in the market when a supplier is dependent on a buyer, and the buyer can enforce advantageous terms and conditions. The following criteria are used to assess significant market power: the structure of the market, obstacles to entering the market, market share of suppliers and buyers, the financial power of suppliers and buyers, the buyer's business network size and number of stores. Under the act, specific market power belongs to a buyer that has a turnover of over CZK 5 billion (€195 million) (Smutný, 2010).

The first thing that has changed for every buyer is the term of maturity for invoices, which cannot be longer than 30 days. A buyer also cannot force a supplier to pay for a nonexistent business service or to pay without any consideration. It is also prohibited for a buyer to subordinate a supplier to obligations that are in an imbalance due to supplier's obligations, especially an imbalance in contract fines. The authority responsible for overseeing the observation of this act is the Office for the Protection of Economic Competition (ÚOHS). This office is authorised to prohibit certain behaviours from buyers that are in conflict with the act. ÚOHS also has the legal authority to impose a fine. The limit of the fine is CZK 10 million or 10 percent of the buyer's annual turnover (Smutný, 2010).

The reaction of retailers to the new act is very simple. They force their suppliers to sign a declaration stating that they are not dependent on a buyer. If they do not want to sign this declaration, the contract between the retailer and supplier is usually broken. The majority of domestic suppliers are not able to face to retailers' pressure (because they have to sell their production to cover their costs) and in the end they agree to sign a document confirming that they are not dependant on the

buyer. This declaration includes the following information: supplier's total turnover of agricultural and food products in the Czech market (excluding exports), supplier's total turnover of agricultural and food products (including exports), supplier's overall turnover of agricultural and food products with the specific company, the share of supplier's agricultural and food products supplies to the specific company in relation to the suppliers' overall agricultural and food products supplies in the market of the Czech Republic, the estimated share of supplier's agricultural and food products supplies in the total market of the corresponding product categories of the Czech Republic, the number of customers to whom agricultural and food products are supplied by the supplier and supplier's distribution channels.

The suppliers must also confirm that they are familiar with the Act on Abuse of Significant market power. At the end of the declaration, suppliers must clearly declare whether they are dependent or not on the buyer. At the moment when suppliers declare that they are not dependant on the buyer (they have to declare it, because they need to sell their products), the sense of the new act existence is eliminated. Contract conditions are given by the buyers, and there is no legal possibility to complain if buyers do not respect the legislation.

It is the reason why many buyers do not respect the 30 days payment conditions (especially in the terms of maturity for invoices), instead of fee for products registration (this fee is forbidden by legislation) buyers ask suppliers to pay some other fee or charges. Suppliers must respect buyers' conditions. It is not unusual that if suppliers ask buyers to pay on time (with respect to legislation), the buyers insist on a 5% discount. If suppliers want to have good relationships with buyers, they are very often obliged to sell their products for under cost prices.

As the reason for advertising campaigns is to attract more final consumers, low sales promotion prices are used by the buyers (retailers). Suppliers are obliged to participate in these promotions (they have to subsidise the final price for consumers instead of the retailers). In many cases the promotion prices are below the contract prices, which is forbidden by law.

## SUMMARY

Czech retail market has changed its structure and form during the last twenty years. The significant opening process of Czech economy accompanied by the Czech market liberalization process enabled the international retail companies penetrated national retail market. The most powerful European retail companies are present in the Czech market. Available shopping area/capita is also one of the largest in Europe. Retail chains took the dominant position in the market and because of their market power they are able to determine trade/contract conditions for domestic suppliers. Retail chains' sales have been constantly growing. Because of high levels of competition from powerful multinational retail companies, many small private shops and in particular local companies (those mainly trading in foodstuff products), were forced to finish their activities and leave the market. They were unable

to compete with the constantly growing number of supermarkets and hypermarkets in ownership of multinational companies (SCHWARZ ČR, REWE ČR, TESCO STORES etc.) in categories such as: the range of products offered for sale, the price of products, operating costs and so on. To improve the position of small local companies in relation to big multinational companies, Czech government decided to enact a law (Act No. 395/2009).

Based on the above mentioned findings, we can see that Act No. 395/2009 on the Abuse of Significant Market Power (SAGIT, 2010) does not fulfil the main sense of its existence. The idea to protect suppliers is not achieved. The dominant position in the Czech market enables individual powerful retail companies to dictate contract conditions to suppliers (the idea is to maximise profits and to make the supplier weaker). Suppliers of agricultural and food products are heavily dependent on retailers, and they have to agree to the buyers' terms. The mutual relationships between suppliers and buyers (retailers) are influenced by globalisation processes. Similar problems are visible in many countries around the World (especially in the EU). All retailers and even many lawyers have an opinion that the new act is indefinite and it is almost impossible to recognise when a specific buyer in a specific case has significant market power. As a result it will be hard to prove an abuse of significant market power. We can clearly see that the act is a problematic law. The original idea of protecting small suppliers and supporting small tradesmen has come to nothing. We will see what the application of the new act brings in practice and in specific situations. We will also see how the ÚOHS deals with supervision over the act.

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