

IMPULS FOUNDATION

The IMPULS Foundation sees itself as a think tank for the mechanical engineering sector and VDMA. The Foundation focuses primarily on constitutional economic policy (“Ordnungspolitik”) and innovation policy and has supported about 100 projects since its formation. Its most important body is a high-profile board of trustees of industry, science, media representatives and policy makers.

VDMA

VDMA represents more than 3,200 mostly medium-sized companies in the mechanical engineering industry. With over one million employees and sales amounting to approximately 220 billion euros (2016), the sector is the largest industrial employer in Germany and one of the leading German industrial sectors.

IW CONSULT GMBH

The IW Consult has been providing highly specialized services and contract research in the scientific field since 1998. The work does often involve close collaboration with the academic departments of the Institut der Deutschen Wirtschaft Köln, the parent company of the IW Consult.

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Edition
November 2017

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IMPULS *compact*

BENEFITS OF LABELS IN THE MECHANICAL ENGINEERING INDUSTRY

IMPULS

DEAR SIR OR MADAM,

Environmental aspects are playing an increasingly important role for the consumers in purchasing decisions. In these cases, labels act as an effective instrument for orientation and control. The influx of product labeling in the consumer goods area has risen accordingly. This is leading to more discussions on whether labels should be mandatory for industrial goods as well.

An important but often overlooked difference is that the market for machinery is not a consumer market. Generally, information asymmetry does not exist here. Traditionally, VDMA opposes the flood of certifications and is against third party certifications. But is this still in keeping with the times? And are labels also beneficial for investment goods?

At European level in particular, there is an openness towards the use of labels. A good example of this is the energy efficiency label. The recent energy efficiency label reform comprises consumer and investment

goods in equal measure. The most recent label initiative arises from the area of cybersecurity.

The mechanical engineering industry must therefore expect to be increasingly targeted by label initiatives in the future. The study “Benefits of Labels in the Mechanical Engineering Industry” looks at the complex issue surrounding the increasing significance, political drive and traditional skepticism towards labels. The study was carried out by IW CONSULT GmbH, with the VDMA department Technical, Environmental Affairs and Sustainability as a project partner. Significant findings are presented here.

The core result is that neither theoretical nor empirical arguments can be found to support the use of mandatory product labels in the mechanical engineering industry. Let the remarkable study results provide a scientifically sound orientation, not just for the affected companies, but also for politics and society. We are looking forward to exchanging ideas and viewpoints with you!

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LABELS — “EN VOGUE” IN PUBLIC AND POLITICS

Environmental aspects such as non-toxic clothes, energy-efficient household appliances or recycled paper are becoming increasingly important in purchasing decisions. Labels including the Blue Angel and the EU energy efficiency label aim to guide buyers through the jungle of purchasing options. In total, over 400 labels exist for environmental and social criteria alone. Even in the consumer goods sector however, labels are not a universal remedy. Consumers primarily look for functionality or watch out for strong brand names. In the end, purchasing decisions are not made based on one criterion such as the label, but are made based on a combination of technical and emotional criteria.

At least superficially, labels have a positive effect in the consumer goods sector. And against this backdrop, the introduction of labels for industrial goods is being promoted politically, particularly on a European level. Recently, the reform of the energy efficiency label was resolved, with a “catch all” scope that includes both consumer and capital goods. The most recent label initiative relates to cybersecurity. The increased interconnectivity of refrigerators and other household appliances creates a target for cyber attacks. Here, labels could be helpful.

Supporters of labels argue that companies and consumers have information needs that must be met. Not only should knowledge gaps be closed, but there should also be a deliberate influence on purchasing decisions towards environmentally friendly and resource-saving products. Labeling the properties of products means supporting the implementation of environmental and safety regulations or making the purchasing and sales processes of companies more efficient. For this reason,

some even argue that regulatory policy requires such labels and demand their obligatory introduction.

But do mechanical engineering companies really need the same level of information as the (presumably) naive end consumer? Is the buyer of a machine unable to evaluate the energy efficiency of the product without the right label? Does a label influence the purchasing decision in business-to-business relationships (B2B)? Under which conditions is the informative value of labels comparable? Are labels necessary from a perspective of constitutional economic policy (“Ordnungspolitik”) or useful in business practice? The IMPULS study “Benefits of Labels in the Mechanical Engineering Industry” provides answers to these questions.

NO JUSTIFICATION OF OBLIGATORY LABELS FROM A PERSPECTIVE OF CONSTITUTIONAL ECONOMIC POLICY

From a perspective of constitutional economic policy, the government should primarily create a good framework within which the market is free to develop. The framework should be created in a way that allows a price formation on the market so that limited resources are used efficiently. Traditionally, VDMA advocates a market economy based on constitutional economic policy, freedom of contract, open markets and entrepreneurial freedom and clearly opposes statutory obligations.

Government intervention would only be justified if relevant market imperfections detrimental to welfare, such as asymmetric information, were observed and could not be remedied by agreements and the voluntary actions of the private market players.

A market imperfection in this sense does not generally exist. Therefore, there is no cause from a perspective of constitutional economic policy for government intervention in the market activities and contract arrangement in the mechanical engineering industry.

SUBORDINATE IMPORTANCE OF LABELS AS A SOURCE OF INFORMATION

The mechanical engineering industry is a B2B market, where well-informed buyers and sellers come together. Unlike in end consumer markets, there is no potential for information

asymmetry. Thus, the companies are on equal footing with their customers and suppliers when exchanging information. Both sides have a high technical understanding of the products. At the same time, the companies often have long-standing business relationships. Additional information from external sources or the consultation of external expertise is usually unnecessary.

In business practice, there are better tools to either prevent information asymmetry from occurring or efficiently remedy it without labels. These tools include own tests, detailed manufacturer information and own experience with the manufacturers. The company survey that was conducted as part of the IMPULS study confirms these findings. Three fifths of companies either provide their suppliers with specifications for the machines or systems or define these together with the supplier. So information asymmetry cannot occur here.

For this reason alone, labels are of little importance as a source of information in the B2B area. In the survey, the companies ranked the importance of different information sources on a scale of 0 (irrelevant) to 100 (sole decisive criterion). Only 3 percent of all companies give the labels a value of over 80. A total of 1.3 percent give it over 90 points. This is clear empirical evidence of the irrelevance of labels in practice. Similar results can be seen from surveying only mechanical engineering companies.

Although the obligatory introduction of product labels cannot be justified from a perspective of constitutional economic policy, they can certainly be useful in business practice. About half of the surveyed mechanical engineering companies use labels for product safety, even though they are of subordinate importance. Three reasons for their use are particularly important: The

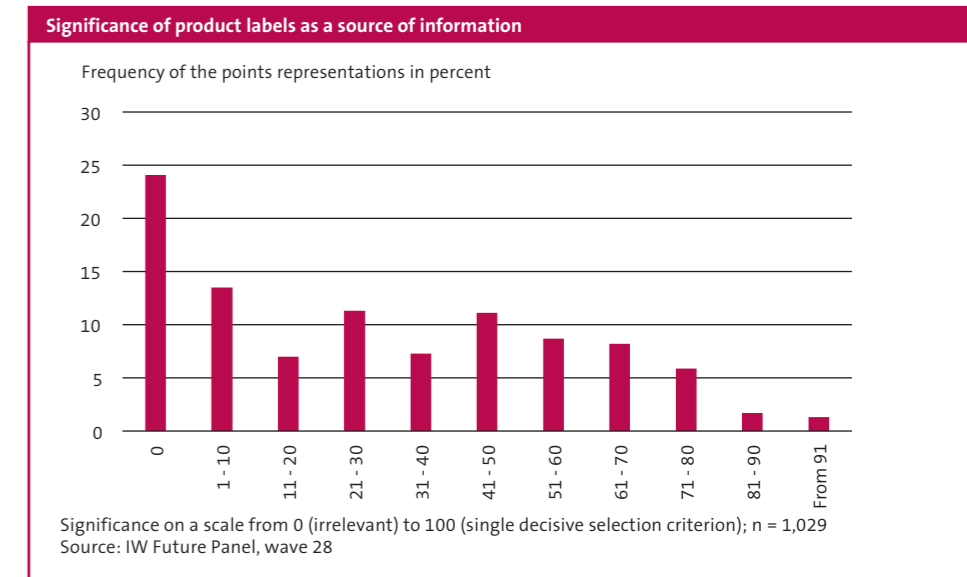
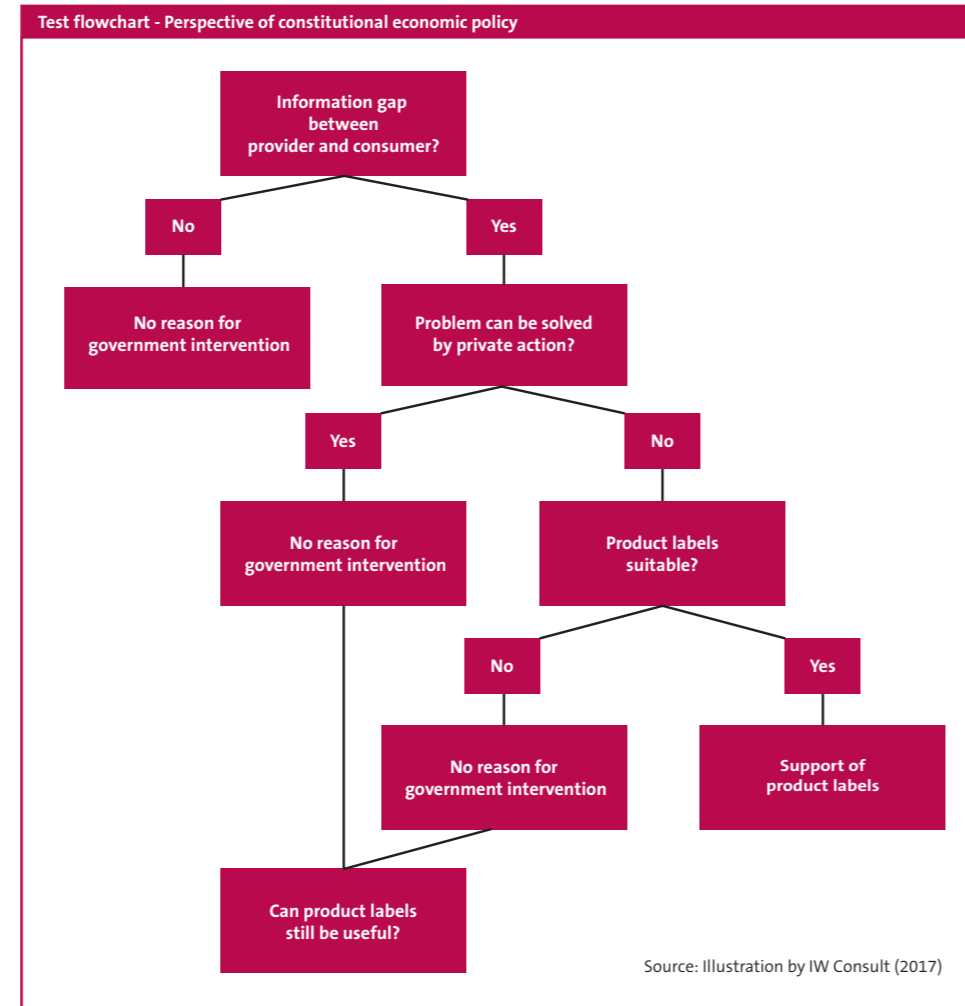
companies conform to the usual market conditions, they hope to have better assurance of product properties or use labels as an entry requirement for domestic and foreign markets.

WHAT NEEDS TO BE DONE

The bottom line of the IMPULS study is that politics should refrain from making product labels obligatory in the mechanical engineering industry. There is no significant information asymmetry between the market participants that they could not resolve on their own. Therefore, there is no market failure and no need for action in regulatory policy. Foregoing obligatory product labels is also advisable since the majority of companies deems the costs and administrative effort of introducing them as being too high.

The informative value of product labels on intermediate products for the properties of the end product is also very limited. Labels on intermediate products are mostly irrelevant for customers buying the end product. Product labels on intermediate products are rarely helpful as an information tool and should therefore be used on a voluntary basis, if at all. Furthermore, product labels inhibit innovation; determining the technical specifications of labels could prevent the development of better solutions. This particularly applies to externally tested labels. Here the implementation speed of the label process is relatively slow.

If policy makers still introduce obligatory product labels, certain conditions should be met. For example, the formulation of testing requirements for product labels should be based on real and relevant use cases of the customers. If these cannot be generalized, the informative value of a product label is limited. A recommendation to comply with such product labels can



then be misleading and should not be made at a governmental level. All labels generally need to ensure a high level of transparency regarding contents, assurances and test procedures used.

In the end, product labels could be useful if product information is conveyed that cannot be tested or verified by the companies. This also applies for intermediate products and services, the development and production of

which are not the core competencies of the purchasing companies. The introduction of obligatory labels is still strictly inadvisable. Government bodies cannot evaluate the competency of companies when it comes to assessing product properties. The companies should be able to decide independently whether they have the necessary expertise or should trust an auxiliary label.

Free download of the extended version of the study at WWW.IMPULS-STIFTUNG.DE/STUDIEN