“BUYER POWER”

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1. What is "buying power"?

- Classic definition:

  "situation which exists when a firm or group of firms is able to obtain from a supplier more favourable terms than those available to other buyers."

  OECD (1980) "Buyer Power"

- Recent (more unorthodox) approach, based on differential in bargaining power between supplier and retailer:

  "… a retailer is defined to have buyer power if, in relation to at least one supplier, it can credibly threaten to impose a long term opportunity cost (i.e. harmful or withheld benefit) which, were the threat carried out, would be significantly disproportionate to any resulting long term opportunity cost to itself…"

  "Retailer A has buyer power over Supplier B if a decision to delist B's product could cause A's profit to decline by 0.1 per cent and B's to decline by 10 per cent."

  OECD (1998) Roundtable on Buyer Power

2. The Modern Context

(a) Supplier perspective:

- Large retail chains ("RCs") and buying groups represent significant amounts of a supplier's ("S") sales.

- Usually S cannot easily replace those sales (which could be as much as 15% or more of its sales) in a short timeframe.
  - There may be only 3 or 4 RCs with comparable sales.
  - These RCs may already be selling competing products.
  - Other sales channels may not be alternatives (in scale or type of sale).
  - Loss of such sales can raise overall unit costs, threatening competitivity and, sometimes, the viability of the supplier (depending on investments made to meet RC orders, loans etc.).

- RC, on the other hand, can survive.
  - Usually has more suppliers to which it can turn.
  - Even though RC may account for a significant part of S's sales, S may account for a very small amount (1-2%) of RC's sales.

- RC may be one of a few players in a market channel which is key because it offers the high volume market of "one-stop-shopping".

- In many cases, S is chasing only 1 or 2 positions on the hypermarket shelf for branded goods.

2. The Modern Context (Cont.)

(b) Retailer perspective:

- Modern distribution offers very efficient systems, giving suppliers and customers what they want.

- Buyer power discrimination is a form of competition and can only occur if S has some market power (otherwise S would have to give the same terms to all). Buyer power is a plus to counteract this. Provided that there is retail competition (which there is): no problem.

- Although interested in range, RCs are now looking, above all, for the few key ("must stock") products and, for the rest, for good prices for the basket of customers' weekly household purchasing: that creates competition for slots on the hyper- or supermarket shelf which is healthy.

- Why shouldn't RCs bargain for more from suppliers?

- Impacts on the market are positive:
  - Pressure on the less efficient suppliers.
  - Demand driven change to the structure of distribution.
  - Smaller retailers forced to be more efficient and competitive (e.g. with different form of competition: wider range, more service, impulse buying, convenience stores etc.) and buying groups.

3. A vertical or horizontal issue?

- Buyer power is both.

- (Buyer) B^1 forces (Seller) S^1 to give it a non-cost justified advantage over other buyers. (Vertical issue)

- To better withstand B^1 s increased demands, S^1:
  (1) invests in brand advertising, and
  (2) buys S^2, giving S^{1+2}, a greater product offering, more key brands, greater sales volumes.
- To match the sort of advantages B^1 can achieve, B^2 buys B^3 and B^4 and B^5 form a buyers' group.
- (Horizontal issues)

- As a result of its greater buyer and sales power, B^1 opens more stores and buys B^6.
- And … S^{1+2} buys S^3, trying to make sure that it is selected as enlarged B^1 or enlarged B^2's branded choice.
  (Vertical/Horizontal issues)

- Vertical power forces supply concentration and facilitates/forces buyer concentration.

- Good question what comes first (supplier concentration or retail concentration).

- In any event, there is a "spiral effect", leading to ever-higher concentration on both sides.

4. Revival of Competition Authority interest

(a) Some Competition Authority action:

- UK: OFT/Competition Commission Enquiry (1999/2000) Annex 1.

- France: some cases, but difficulties of proof to show that S had no alternative distribution system available.

- Germany: many informal cases (fear of reprisals preventing formal complaints). Some merger control cases. Some unfair competition cases (e.g. requirement that S price tag without reimbursement (1977) (OECD report, 1980).

- European Commission: Systematic position that dominance cases exceptional (GEMA (1971), Eurofirma (1974) but some structural action in very concentrated markets (see below).

(See, in general, Proceedings of the European Competition Forum (1997), Ed.Ehlermann and Laudati; and the OECD Roundtable (1999).)

4. Revival of Competition Authority interest (Cont.)

(b) Regulatory action:

- France: Development of specific prohibitions, e.g. prohibition of sales at a loss, non-cost-justified listing fees, service agreements etc. Notice periods for breaking –off contractual relations.

- Germany: Recent strengthening of wording of provisions on abuse of economic dependency. Greater ability to make informal complaint.

- Italy: New economic dependency provision.

- Portugal: Strengthening of economic dependency provisions with per se prohibition of abusive bargaining practices.

- Spain: Economic dependency provision and law on retail trade dealing with (long) payment terms, selling at a loss.

And

- Exemptions for SME voluntary chains (block or individual exemptions).
  * Denmark, Finland, Germany, Sweden.
  * EC Vertical Restraints Block Exemption.

4. Revival of Competition Authority interest (Cont.)

(c) OFT Report (1998) Dobson, Waterson, Chu

- Distinction between buying power v. suppliers without selling power (likely welfare loss) and those suppliers with such power (position ambiguous: may be no welfare gain if retail concentration also).

- Advocates no general presumption that buyer power good:
  - Effects of buyer power depend on whether buyers are constrained to pass on benefits to consumers.
  - If not, and buyers increase their own selling power then, if no other efficiency benefits, welfare likely to be detrimentally affected.

- Advocates "rule of reason" approach (looking at circumstances).

- "Countervailing power in bargaining may offer social welfare benefits, but successive market power (i.e. upstream supplier power and downstream supplier power) may be expected to have an adverse effect".

- UK retailing, concentration and average gross and net margins have been increasing:
  - Retailers appear to be retaining the benefits from increased bargaining power rather than passing them on.
  - Market share of top 5 retailers: 1984–1994: 15.6% to 23.4%.
  - Average net margin of top 5 retailers: 1984–1994: 5.77% to 7.79%.
  - Internationally high.

4. Revival of Competition Authority interest (Cont.)

(d) OECD Roundtable (1999)

- Interesting background paper, survey of OECD Member State laws and discussion summary.

- Main themes:
  - Buyer power requires the existence of upstream supplier power, so often good.
  - But may no longer be true to regard retailers as basically competitive distributors of consumer goods.
  - In > 7 countries the top 5 grocers account for > 60% of retail sales.
  - Share of private label in combined food, household and clothes sectors > 40% in some countries.

- Retail chains enjoy substantial buyer power although retail market shares well below levels for single firm dominance.
  - Consumers often switch brands, rather than lose the convenience of the "one-stop-shop" (French report).

- Retail chains can block horizontal competition.
  e.g. RC requires S not to sell the same products to a discounter.

4. Revival of Competition Authority interest (Cont.)

(d) OECD Roundtable (1999) (Cont.)

- Pro:

  - Structural control (of mergers).
  - Refining traditional competition assessment to deal with buyer power (e.g. market definition: Do petrol stations and kiosks exercise an effective competitive restraint on large RCs? Or allowing rpm where retailer sells own brand?).

- Anti:

  - Limiting hypermarkets through planning law (gives advantage to those already implanted and raises entry barrier for other retailers).
  - Per se prohibitions rather than market effect based review (unfair competition rules > antitrust/competition assessments).

(Executive Summary in Annex 2.)

4. Revival of Competition Authority interest (Cont.)

(e) EU Report (1999) Dobson

- Difference between:
  - Situation where supplier concentration low and buyer concentration high (e.g. butter supply) and where both supply and buyer sides are concentrated.
  - Again theme that the buyer power of retailers is linked with their selling power, with one power reinforcing other.
  - Only consumer surplus if sufficient competition to force through the price gains from suppliers.

- Theme that, whilst the largest suppliers may be able to resist buyer power (because of their brand strength), the position for smaller manufacturers with secondary brands is more precarious (see also Vogel, 1998).

- Look at performance outcomes (margins): if retail margin $\Uparrow$ as supplier margin $\Downarrow$, $\Rightarrow$problem.

- European figures/National case studies (food retailing):
  - 43.7% of total EU food retailing in hands of the top 5 firms in each market in 1996; up 3% from 1993.
  - France: > 5 main retailers shared 67.2% of food market in 1997.
  - Germany: Top 5 concentration ratio: 59% in 1994; Top 10 (including important buying groups) was 78%.
  - Spain: Top 5 retailers shared 32.6% of market in 1996.

5. A countervailing force to dominance in Article 82 cases

- Should show that S had to give way to buyers' demands:
  - Evidence that did so.
  - Buyer initiated.

- As far as possible, no price discrimination:
  - Advantages given are cost justified (may have to be complex and detailed).
  - Real service provided (e.g. payment for end-of-aisle/gondola positioning because much more sales).
  - Authorities often do not regard listing fees, store opening payments, rebate modifications because of retail mergers (so-called "wedding gifts") and "Euro bonuses" (for sum of EU purchases) as cost-justified.

- Need to show payments are not loyalty practices.

- More a question of mitigation than a separate infringement, but could be the latter in some cases (with fines and damages suits?).

- Evidence of buyer power:
  - Top 5 buyer and retail sales concentration ratios.
  - Individual positions of buyer on procurement and resale markets.
  - % of S's sales in RC's turnover.
  - Inability to switch supplies to others in a timely manner.
  - Probably focus on sales channels (hypermarkets), but may be a concern because could put up S market shares also.

6. An (often) essential fact in merger control

(a) EC supplier mergers

- Suppliers argue they have to merge to scale up to modern distribution and cannot price independently of customers.

- Not accepted if brand very strong, "must stock" item (e.g. Coca-Cola Amalgamated Beverages (1997)), or if still leaves many small customers dominated.

- May be accepted as a competitive constraint with industrial companies, (e.g. Lucas/Eaton (1991) braking equipment - demand concentrated customers which had own production capacity).

- Has also worked in some recent cases (e.g. Enso/Stora (1999) - long term and mutual dependency).

6. An (often) essential fact in merger control (Cont.)

(b) EC retail mergers

Kesko Tuko (1996)

Concentration of 2 retail groups in very concentrated, static market (Finland); prohibited partly because of increase in buyer power in food retailing and cash and carry markets. As regards food retailing:

- Assessment of buyer power focused on sales market share (55% of sales of daily consumer goods; 3x nearest competitors).
- Distinguished supermarkets from other smaller shops (different assortments and types of shopping).
- Although single retail market, highlighted strength of K/T in large retail outlets.
- Gatekeeper effect (agreement with K/T only way to guarantee shelf space in retail outlets, representing at least 55% of the Finnish market).
- Dependency: Most suppliers depended on K and T for approx 50-75% of their total sales in Finland.
- Competitors would not offer an alternative solution in the short term (competitors could offer only 40% of sales and only in medium to long term).

6. An (often) essential fact in merger control (Cont.)

Rewe Meinl (1999) (Annex 3.)

Concentration of 2 retail groups in highly concentrated market (Austria); cleared only after significant reduction in nature and geographic scope of business acquired; objections based on retail concentration levels and increased buyer power on 10 procurement markets.

- Treated retail market as embracing all retailers, in particular supermarkets and hypermarkets (excluded some specialised outlets, such as butchers, bakers and petrol stations). Left open inclusion of discount stores.
- Noted increase in leading position in hypermarkets through R/M acquisition.
- Focus on situation in particular regions.
- Focus on 19 different procurement markets, decisive to the food retailing trade.
- Recognition that a lost food retailing trade consumer is difficult to replace.
  - Switching > 5% turnover difficult.
  - Switching to other sales channels difficult, costly and, in the short term, generally impossible.
  - Most producers already in most important sales channels ⇒ only small outlets left.
- Buyer switching easier than seller switching.
  - 22% of turnover with a given customer could only be replaced with heavy financial losses.
  - Merger gave sales at that level in certain food categories. ⇒ dependency.
    (Reasoning reflects Dobson reports, OECD, Vogel.)

7. Conclusions

- Recent pattern of reports expressing concern over high retail concentration levels.

- General recognition that there is buyer market power below the traditional thresholds for dominance, but complex to assess.

- Huge recent evolution in methodologies/studies and competition authority experience, focussing above all on:
  - Narrow markets - the different types of distribution services and different procurement markets.
  - Hypermarkets as a key channel.
  - Dependency concepts.

- Methodology applied in EC merger cases.

- Little formal action by competition authorities in Article 82 EC type cases so far.

- Competition and other regulators pursuing multi-path strategy:
  - Strengthen dependency controls.
  - Prohibition of retail sales at a loss.
  - Prohibition of specific unfair practices, e.g. long terms of payment, wedding gifts, listing fees.
  - Counterbalancing exemptions for SME voluntary chains.

NEXT: Focus on regions and force swaps in certain channels?

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Annexes

1. UK Supermarket Inquiry (Current Status).
2. OECD Roundtable Executive Summary.
3. Rewe Meinl, OJ L274/1, 23 October 1999.