BUYER POWER AND ITS IMPACT ON COMPETITION IN THE FOOD RETAIL DISTRIBUTION SECTOR OF THE EUROPEAN UNION

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FINAL REPORT

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May 1999

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CHAPTER 1 - INTRODUCTION

The last couple of decades has witnessed considerable changes in retailing across most developed countries with the emergence of new store formats, the increased prevalence of retail chains, the development of out-of-town and edge-of-town retail parks, and significant investment in new technology (such as Electronic Point of Sale) and improved logistics. At the same time, the sector has seen the rise of giant corporations controlling significant proportions of overall domestic retail sales, and the emergence of internationally operating retail groups. The size of these retailers now ranks them amongst the largest companies in their country of origin. For instance, the largest Belgian company, Delhaize "Le Lion", is a retailer, Britain's Tesco and J. Sainsbury both appear in the UK top 10 companies; Germany has the giant Metro group; whilst Wal-Mart Stores, number four in the US, is the eighth largest company in the world with US$119bn turnover and 825,000 employees (*Fortune*, 3/8/98).[1]

Amongst all the areas of retailing, it is food retailing which stands out as having seen the most profound changes, and where, by its sheer size and importance, the developments have had the greatest impact on consumers. Heavy investment by retailers has allowed them to reap economies of scale, witnessed by the rapid growth in superstores and hypermarkets offering consumers as many as 20,000 product lines, supported by sophisticated logistics and distribution systems and improved efficiency with greater sales per outlet and per employee. At the same time there has been considerable consolidation at both the national level and for Europe as a whole as large retail chains have become prevalent. For instance, the top ten grocers in Europe accounted for 27.8% of the market in 1992, but 36.2% of the European market in 1997, according to the retail analysts M+M Eurodata.[2] Moreover, while increased retail concentration has been a feature of developed countries around the world, it is notable that ranked in terms of *world* revenue in food retailing the top three places in the *Fortune* list are taken by European retailers - Metro of Germany, Carrefour of France and Tesco of Britain - raising the prospect that such large firms may be able to command market power over suppliers and consumers alike and earn super-normal profits as a result.[3]

Potentially then, retailer power is an important issue in Europe. The subject was raised in the context of developments in retail distribution in the European Commission's Green Paper on Vertical Restraints, released in January 1997 and from which policy proposals are being drawn at the time of writing. It has

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1. Figures relate to rankings by revenue.
2. Press release (8/8/98) - see http://www.mm-eurodata.de/english.
3. It should be noted that Wal-Mart Stores, even though much of its sales come from food retailing, is classified by *Fortune* as a general merchandiser. In this category Britain's Marks & Spencer is ranked number one in terms of profitability, earning nearly double the profit margin of any other major general merchandiser. Interestingly, the most profitable major food retailer in terms of profit generated as a proportion of revenue is also a British company - Asda group.

arisen in the context of investigations into merger proposals, for example the proposed consolidation of two of Finland's largest food retail groups (*Kesko/Tuko*). Also, at the national level, retailer power is seen to be of concern and the subject of inquiries by competition authorities - for example, in the UK, the Office of Fair Trading (1999) has recently concluded an investigation of the profitability of leading food retailers and subsequently a referral has been made to the Competition Commission. Moreover, the issue is likely to remain at the fore, given the tendency for consolidation through merger[4] and concern over market practices including vertical arrangements with suppliers.

However, while all European countries have experienced considerable changes in the food retailing sector, there are substantial differences in the structure across different countries and as a result different policy issues arise. In some countries like the UK, a handful of integrated store groups control most of the market and as a consequence both the buying and selling side of the market tends to be concentrated. Though, in other countries, buyer groups representing (technically) independent retailers (e.g. as "voluntary chains") are prevalent with the consequence that at the national level the buyer-side of the market is more concentrated than the seller-side. This feature is quite common in Europe where buyer groups can be the leading food buying organizations - for instance, Germany's Markant Handels is the organization whose turnover makes it the country's largest food buyer, Spain's large purchasing groups Euromadi and IFA Espanola are ranked numbers one and two, and France's Intermarché is, again, the largest in the country in terms of turnover. Yet, in some countries like Greece and Italy, the market remains relatively unconcentrated on both the buying and selling side where independent retailers remain dominant.

Consolidation in food retailing does, though, appear to be quite a general feature across most EU countries and while there has been clear associated benefits from improved efficiency and service, there may be cause for concern that increasing concentration may facilitate the ability of retailers to exercise market power, as both buyers and sellers.

In the absence of off-setting efficiency benefits, seller power by retailers could conceivably result in higher prices for consumers and perhaps reduced choice (of service/product combinations) than would be the case where normal competitive conditions prevailed. This would generally be viewed as detrimental to the economic welfare and harmful to the public interest. In contrast, the economic welfare effects arising from the exploitation of buyer power are less certain as suppliers (producers) will generally suffer if the prices they obtain for their goods are reduced while consumers might gain if lower intermediate (transfer) prices

4. As Appendix 2 shows, at the end of the report, there has been a large number of mergers involving major retailers across Europe, tending to increase concentration at both the national level and the European level, particularly as cross-border mergers become increasingly common.

result in retailers setting lower final (retail) prices, so that the net economic effect is not clear a priori. As a consequence of this uncertainty over the net effect there has been considerable debate over the appropriate policy treatment towards buyer power. This debate has become more informed as economics has begun to shed new light on the welfare trade-offs involved, highlighting the importance of how the form, nature and behaviour of the buyers and the economic agents they trade with in ascertaining net effects. The present study is specifically concerned with the buyer power of retailers and seeks to draw on these new economic insights to develop a framework for examining buyer power, to determine the net economic effects, in particular instances and with regard to specific manifestations of buyer power, while also serving as a general framework of reference for an empirical study of the food retailing sector in the European Union.

In the context of retailing (and without any presumption of the net economic effects) buyer power is viewed here as arising from the ability of retail firms to obtain from suppliers more favourable terms than those available to other buyers or would otherwise be expected under normal competitive conditions. Apart from the ability to extract discounts on transactions from suppliers, buyer power may manifest itself in the contractual obligations (as vertical restraints) which retailers may be able to place on suppliers. These could take a number of forms such as listing charges (where buyers require payment of a fee before goods are purchased from the listed supplier), slotting allowances (where fees are charged for store shelf-space allocation), retroactive discounts on goods already sold, buyer forced application of most favoured nation (MFN) clauses (with contractual obligations for the supplier not to sell to another retailer at a lower price), unjustified high contribution to retailer promotional expenses, and insistence on exclusive supply.

Buyer power may exist in isolation - where the selling power of retailers is limited by intense competition. This might be the case, for example, where retailing is highly fragmented on the selling side but coordinated (through buyer groups) on the buying side. But often it might be that the buyer power of retailers is linked with their selling power, where one power reinforces the other, and thus the effects of one on the other and their combined influence on economic welfare take on some importance.

In regard to public policy, the buyer power of retailers is not a new concern for competition authorities. Yet the policy treatment clearly remains a contentious area of competition policy. In the United States, the growth in mass retailing in the 1930's prompted the Robinson-Patman Act, which sought to prohibit suppliers from offering preferential terms to selected buyers. Buyer power was then viewed as threatening the competitive structure of retail markets. Yet this legislation has received considerable criticism for serving to impede the competitive process and development of efficient forms of distribution. In contrast most other countries have not adopted similar *per se* rules, but instead have chosen to rely on a rule-of-reason (case-by-case) approach. However, whether there should be a general presumption in favour or against buyer power in this approach is far from clear, and different countries have in practice taken different stances. Nevertheless, the continued consolidation of the retailing sector has brought the issue to the fore, where there is growing concern that the buying power of retailers may have adverse economic effects on the viability and efficiency of suppliers and also, as noted above, that such power may go hand in hand with increased selling power and thus potentially have adverse effects on consumer welfare.

Nevertheless, while it is recognised that retail concentration, particularly in the grocery sector, has risen sharply in recent years, it may be argued that this can be socially beneficial where it results in buyer power which can be used to counter the market power of manufacturers. Here, the exercise of this power prevents manufacturers from exploiting their position as fully as they could if they were faced with a less concentrated retail sector. Then, if buyer power could exist amongst retailers without those retailers having significant market power of their own, it is possible that buyer power could lead to lower wholesale prices which, as a result of effective retailer competition, would be passed on to consumers in lower final prices. Lower final prices would mean higher output and higher welfare.

The contrary view to this benign picture is that buyer power may ultimately damage economic welfare. Although it may lead to lower prices in the short run, there may be longer term detrimental effects resulting from buyer power. In the context of retail grocery markets the effects may be to force manufacturers to reduce investment in new products or product improvements, advertising and brand building, and eliminate secondary brands and weaken primary brands while strengthening the position of private-label (store) brands, and in the process cause wholesale prices to small retailer to rise, further weakening them as competitors. In other words, buyer power may have the effect of considerably distorting both retail and producer competition.

The fear is that ultimately competition in food retailing would be between a small number of fully integrated retailers supplying private-label only. This would mean reduced choice and, depending on the nature of competition between these exclusively dealing integrated retailers, possibly higher prices.

Given these two sets of opposing arguments, it is clear that evaluation of buyer power may therefore involve a series of trade-offs.

The first trade-off is an exclusively short run trade-off between increased buyer power and increased retailer market power. Specifically, if two retailers merge they may have more buyer power which can be used to put downward pressure on wholesale prices, but they may also have more market power which can be used to raise rather than lower final prices. If the latter outweighs the former, prices may rise to the detriment of consumers and economic welfare generally.

The second trade-off is a trade-off between the short run benefits of lower prices and the longer term damage to manufacturer competition from weakened brands and greater own-label penetration and the distortion of retail competition in favour of large retailers.

Given such trade-offs, it is not clear *a priori* what will be the net economic welfare effect of buyer power - but this can be expected to vary according to market conditions and other factors, lending support to the argument in favour of case-by-case policy approach. In this regard, insights gained from economic theory may prove useful in providing some policy guidance into the conditions for which buyer power may be socially benign or, in contrast, be deleterious to economic welfare. This is the subject of Part I of our report, examining the theoretical and policy underpinnings. Part I contains four chapters. We begin, in chapter 2, by reviewing and analyzing the economic theory of buyer power as our starting point. From this analysis we put forward, in chapter 3, a set of buyer power propositions and a structured framework for considering the net welfare effects of buyer power. Further, the term "buyer power" itself has been the subject of much debate. Its definition is considered in chapter 4, along with its economic measurement and definition of the relevant market. This is then followed in chapter 5 by a brief commentary on present competition policy and law towards buyer power.

The emphasis in the chapters of Part I is specifically limited to concerns about buyer power and its manifestations, but, recognising that there are important broader themes concerned with retailer power and its potential impact on suppliers, three separate appendices at the end of the report supplement this analysis with detailed consideration of three key aspects, which in light of current developments have particular policy relevance. The appendices, in turn, consider policy towards retail mergers, the competition effects of cross-border retailer alliances, and the competition and welfare effects of the employment of Efficient Consumer Response (ECR) and other partnership activities between major retailers and key suppliers.

Part II of our report moves on from the theoretical and policy analysis to consider the actual structure and nature of food retail distribution in Europe. It presents a formal statistical analysis of retailing across the European Union, providing a bridge between the theoretical discussion of Part I and the case studies of Part III. Thus, one purpose is to quantify some of the concepts like buyer and seller concentration featured in the discussion in Part I for the EU retail food sector - both for individual member states and for the EU in aggregate. In addition, it provides a backcloth for the more in-depth case study analysis which focuses on specific countries developed in subsequent chapters. Part II includes two chapters. The first, chapter 6, draws on existing statistical sources to build up a picture of the key structural dimensions of the sector. Chapter 7 takes the statistical analysis further by constructing an entirely new database - the EU Retail Food Market Share Matrix - which is designed to yield an integrated, and internally consistent, statistical mapping of the structure of the sector at both the aggregate EU and national levels, and for the leading firms therein. This provides additional insights on some elements of structure, such as aggregate EU concentration and cross-border production, whilst improving the quality of information on others, e.g. measures of concentration at the national level. It also provides background information of relevance to our selection of case studies in Part III and the analysis (in the Appendices) of merger activity and cross-border alliances.

Part III of the report provides case analysis from four representative countries - France, Germany, Spain and the United Kingdom - which considers for each country the characteristics and evolution of market structure, competition in food retailing, retailer and buying group buying power, own-label development, and any other special market features. Each of the country reports also contains specific information on the production and distribution of three representative product groups - washing detergents, coffee (instant and roast/ground), butter and non-butter spreads (margarine) - as illustrations of the nature of supply and buyer activity in the sector. The four cases are provided in successive chapters (8-11) and our conclusions from the cases, both in terms of cross-country comparisons and product comparisons, are provided in a summary chapter (12).

Chapter 13 concludes the report, taking account of the results and conclusions of the three parts of our analysis to draw some general conclusions about the state of competition and the extent and effects of buyer power in the food retail distribution sector of the European Union.

PART I - THEORETICAL AND POLICY UNDERPINNINGS

In this part we develop the relevant theoretical material needed for an examination of buyer power. It might be thought that this material is unnecessary, that it is part of the received body of theory of the subject. In fact, however, even the basic theory is often not spelled out in intermediate microeconomics texts. Therefore, we make no apology for starting at a quite basic level, with models of monopsony (a monopoly buyer), bilateral market power, and so on in Chapter 2. This leads, rather more interestinglyinto a set of "buyer power propositions" in Chapter 3. We see that even commonly-held views, such as "buyer power is desirable" must be carefully treated and subjected to caveats. Arising out of these propositions we have one of the central elements of the report, a proposed framework for the analysis of buyer power in a public policy context. This feeds closely into the later analysis, particularly our case studies of particular markets, where it guides us in our assessment of the empirical findings.

It is a commonly-held view that to examine something, one must be able to measure it. Therefore in Chapter 4 we exposit and develop measures of buyer power, leading to our outlining a set of practical procedures which might be used in assessing whether buyer power is a significant problem, worthy of more detailed investigation, in particular cases which may arise. We also tackle the somewhat vexed question of market definition in the context of a relevant market on the buying side, drawing on the Commission's recent Notice on market definition on the selling side.

Chapter 5 concludes this part with a discussion of public policy towards retail buyer power in Europe. It highlights some of the different approaches taken across member states in the EU with regard to the exploitation of power by dominant buyers, the effects of the economic dependency of suppliers to retailers, and the policy treatment of retailer associations.

CHAPTER 2 - THE ECONOMICS OF MONOPSONY AND BUYER BARGAINING POWER

The analysis of monopsony (where a single buyer faces competitive suppliers) and bilateral monopoly (where a single buyer faces a single supplier) is extensively covered in standard microeconomics textbooks. However, rarely is consideration given to more general market forms involving buyer power and the related empirical and legal questions. One source which does extensively deal with these issues is Blair and Harrison (1993), which seeks addresses the economic theory of buyer power and relates this to relevant competition law cases (at least as applied in the United States). This source is quite comprehensive in its treatment of monopsony, dominant buyer firms, buyer cartels, and bilateral monopoly, yet does not cover more complicated bargaining situations, nor does it discuss empirical and, more specifically, econometric studies.

The summary analysis contained in Dobson, Waterson and Chu (1998) is intended to give broad, but less detailed, coverage of the economic issues - setting out the basic economics of unilateral and bilateral market power as a basis for developing a policy framework for examining buyer power. Given the relevance to the present project, we draw directly on this analysis to illustrate the key arguments. This analysis will prove useful for the general insights it provides and as a basis for our specific buyer power propositions, which are set out in the next chapter.

The focus here is on price and quantity effects arising directly from the exercise of buyer power (as opposed to indirect efforts arising through other contractual terms - see OECD (1998) and Dobson et al. (1998)). In addition, the approach is standard comparative static (i.e. snapshot) analysis with supplementary comments on dynamic aspects.

We begin with the case of unilateral market power, where there is at most imperfect competition on the buyer side but perfect competition on the supplier side. We then move on to discuss bilateral market power where competition is limited on both sides of the market.

2.1 Monopsony

The most straightforward case of buyer power is that of a single buyer facing (perfectly) competitive sellers - so-called "pure monopsony". The economic analysis of this case is directly analogous to that of pure monopoly (where a single seller facing competitive buyers). As such, the welfare implications arising from their exercise of market power are illustrated in a similar fashion. We begin by demonstrating the standard textbook treatment of monopsony, before developing the discussion to cover oligopsony and related market structures where buyers operate in imperfect competitive conditions (so still may be able to exercise market power) while sellers are perfectly competitive (and thus have no corresponding market power).

For base reference, consider the situation of a competitive (supplying) industry which faces familiar demand and supply curves, D and S as represented in Figure 2.1. The competitive equilibrium is where D and S intersect, resulting in quantity x_C and factor price w_C. Then assume that we are dealing in an input market where the product is used by buyers in later stages of production, so that demand curve D represents the average revenue obtained from the input which is later used to produce the finished product, referred to as the "derived demand" for the input and denoted dD which is equal to average (net) value (revenue) product of the factor (AVP).

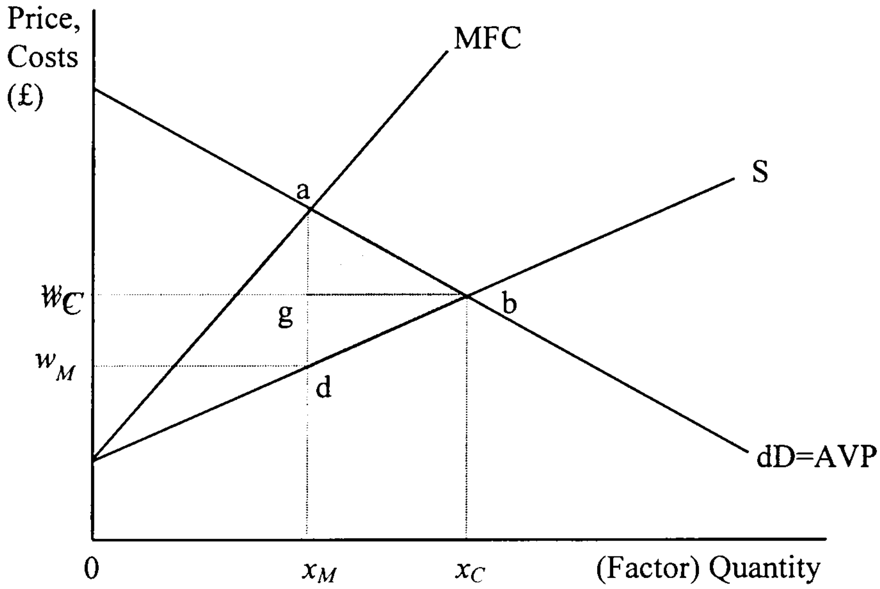

Figure 2.1 - Monopsony Welfare Losses

We can now consider the impact of a monopsonist's buying behaviour on market prices. Referring to the upward sloping supply curve S in Figure 2.1, as the (single) firm buys more units of the input, there needs to be a higher level of production to accommodate the increased demand, resulting in an increase in the unit cost of production. However, the increase in unit price needs to be paid not only for new production but also for existing levels of production.[5] Accordingly, each marginal unit costs more than the average cost, thus

5. The assumption is that compensation for higher unit costs of production can be obtained for all levels of sales. Specifically, price discrimination is ruled out, for example because of arbitrage activities.

we are left with the marginal factor cost curve, denoted by MFC, which lies above the supply curve S. Suppose further that the (single) buyer is a price-taker in the downstream market - for example it is the archetypal monopsony employer in a "one-mill town" which sells in a competitive product market. Its profit maximising output would then be determined by the intersection of its derived demand curve dD and its marginal factor cost curve MFC yielding equilibrium price w_M and quantity x_M. The associated welfare loss from this scenario is represented by the shaded triangular region *abd*.

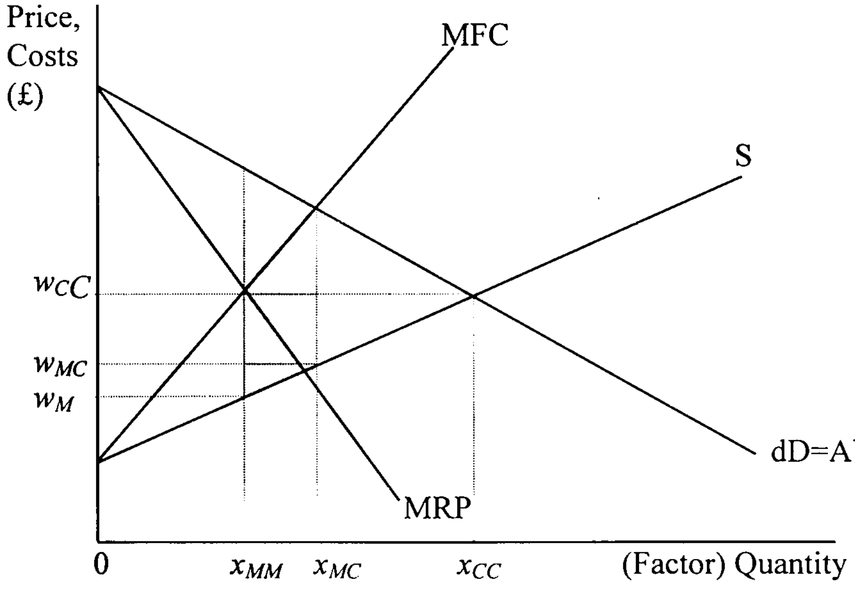

Figure 2.2
Additional Welfare Losses From Monopsonist Possessing Monopoly Power

As Figure 2.1 illustrates, the monopsonist restricts purchases below the competitive level, so that from a social welfare perspective too few resources are employed (i.e. there are unrealised gains from further trade) resulting in an allocative welfare loss. As a consequence, the input price paid falls (below the competitive level), but as the monopsonist competes in a competitive output market, the going price (say, p^*) is unaffected by its purchasing behaviour. As a consequence, producer surplus declines by the area w_Cbdw_M, while purchaser (consumer) surplus rises by the difference between the rectangle w_Cgdw_M and triangle *abg*, leaving deadweight social welfare loss as the area *abd*.

In the situation where the monopsonist is also a monopolist in the downstream market, for which Nichol (1943) uses the term "monemporist" (i.e. a monopsonist-monopolist), then there would be a downward-sloping derived demand for the input, along with a second curve, marginal to this derived demand curve, that reflects the marginal revenue product of the input, shown in Figure 2.2 as MRP.[6] The intersection of the MRP curve with that of MFC indicates the profit-maximising input quantity for the monemporist. Again, equilibrium levels of both purchase price (w_{MM}) and quantity (x_{MM}) in the input market are below the competitive equilibrium. In this situation, the welfare loss from exercising buyer power is compounded by the presence of seller power, with the additional welfare loss (due to seller power) represented by the shaded region in Figure 2.2.[7]

Although this discussion is presented primarily in terms of a monopsonist, as the only buyer in the market, the principles are readily applicable to situations where some buyers (either singly or jointly) recognise their ability to influence market prices. In such instances, three conditions appear necessary for the exercise of buyer power: (i) the buyers contribute to a substantial portion of purchases in the market; (ii) there are barriers to entry into the buyer's market; and (iii) the supply curve is upward sloping. Under these circumstances it is straightforward to apply the principles of oligopoly theory to model situations of oligopsony where strategic interaction occurs between a few buyers competing in a market - see for example the seminal analysis of Stackelberg (1934) and Fellner (1949). Similarly, the dominant firm model (Forchheimer, 1908) can be readily applied for consideration of dominant buyer behaviour, where the leading firm faces a competitive fringe of other buyers, e.g. Blair and Harrison (1993, pp. 49-51) and Veendorp (1987).[8] For both extensions, the welfare results translate directly. In the case of oligopsony, generally the greater the concentration of buyers then the greater is the distortion in factor price and quantity below the competitive level, all over things equal.[9] Similarly, in a dominant buyer framework, the greater the market control by the key buyer, in terms of its market share with respect to that of the competitive fringe, the greater is its ability to exert power to reduce price below the competitive level. Moreover, as general result, applying to monopsony, oligopsony or a dominant buyer situation, it should be observed that, for a given (derived) demand curve, the lower the elasticity of supply (essentially, the steeper the supply curve), the greater is the welfare loss resulting from buyer power.[10]

6. MRP is defined as the revenue obtained from the sale of an additional unit. The MRP curve necessarily lies below the downward-sloping derived demand curve dD because of the additional revenue generated by each marginal unit, over and above average revenue product, when all units are sold at the same price (i.e. price discrimination is infeasible, say, due to arbitrage activities).

7. Note that x_{MC} indicates the quantity purchased by a monopsonist which acts competitively in the output market, while x_{CC} refers to the quantity when the firm acts competitively in its input and output market.

8. Equally, one could also readily adapt the dominant cartel model, developed by Saving (1970), to analyze the situation where a colluding group of buyers compete with a competitive fringe of other buyers.

9. The notable exception is where (symmetric) oligopsonists compete on price setting for a homogeneous input. In this case, the result is analogous to Bertrand oligopoly such that the firms, even when there are only two of them, compete to the extent of driving price down to the competitive level.

10. This corresponds directly to the notion of the Lerner index measuring monopoly power as the reciprocal of the (modulus of) elasticity of demand, η, such that the price-cost margin is $(p - \mathrm{MC})/p = 1/\eta$, which obviously increases as demand becomes more inelastic (essentially, the demand curve becomes steeper). In the case of Cournot oligopoly, with constant returns to scale production, then this is index is modified such that the weighted average price-cost margin

In the case of joint action by buyers, where they seek to maximize joint profits, the analysis corresponds directly to that of a cartel controlling sales. Buyer coordination to reduce factor prices by restricting collective purchases serves, *ceteris paribus*, to reduce social welfare and the deadweight welfare loss is equivalent to that generated by a monopsonist, i.e. as shown in Figure 2.1.[11] The detrimental effect on welfare is compounded if collusion also spills over into the buyers' output market, with the result equivalent to the monopsonist-monopolist (monemporist) outcome illustrated in Figure 2.2.

Thus for a range of circumstances, we may conclude that buyer power exerted against competitive sellers is likely to have a detrimental welfare effect where it involves buyers acting singly or jointly to restrict purchases - where buyer surplus is increased but does not compensate (if surplus is equally weighted) for the loss (supplier) producer surplus resulting in foregone economic surplus.[12]

The question which naturally follows is how likely strong buyers are to find themselves in the position of being able to exploit an upward sloping supply function. For instance, it may be considered that many industries are characterized by constant or even increasing returns, and accordingly buyers may not face an

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is $(p - \Sigma_i MC_i s_i)/p = H_Q/\eta$, where s_i represents the share held by firm i (i.e. $s_i = q_i/Q$) and H_Q is the Herfindahl concentration measure (i.e. the squared sum of market shares), and thus as concentration rises the weighted average price-cost margin rises (Clarke and Davies, 1982). With monopsony we find an equivalent expression, which Blair and Harrison (1993, p. 48) refer to as the Buyer Power Index (BPI), which measures the percentage deviation from the competitive result. Here, BPI = $(VMP_X - w)/w = 1/\varepsilon$, where ε is the elasticity of supply measuring the responsiveness of the quantity supplied to changes in its price. The greater the value of ε, the greater is the deviation from the competitive price. In the case of Cournot oligopsony, again with constant returns to scale, then an equivalent expression can be derived in terms of the weighted average VMP to input price margin, such that $(\Sigma_i VMP_i \sigma_i - w)/w = H_X/\varepsilon$, where $\sigma_i = x_i/X$ is the share of total purchases made by firm i, implying that higher buyer concentration (H_X), is positively related with greater departures from the competitive outcome - see Dobson (1990, pp. 50-53). In the case of a dominant buyer framework, Blair and Harrison (1993, p. 51) derive the buyer power index BPI = $S/[\varepsilon + \eta_f(1-S)]$, where η_f is the elasticity of demand facing the fringe (assumed to be greater than that facing the dominant buyer) and S is the market share, such that the index is increasing in S and decreasing in ε and η_f.

11. As with collusion amongst sellers, there may be structural conditions which facilitate or, alternatively, impede collusion among buyers. For example, Blair and Harrison (1993) identify four factors which may facilitate collusion: (i) fewness of buyers (which keeps down decision-making costs for the group down and enhances the ability to police agreements), (ii) product homogeneity (which simplifies the agreement to control of one price rather than a complex price schedule), (iii) sealed bid auctions (which prevents cheating on an agreement going undetected), and (iv) inelasticity of supply (since purchases only have to reduced by a small amount to achieve a significant price reduction and the rewards from collusion are greater).

12. Here some qualification needs to be made particularly regarding joint purchasing behaviour since there may be obvious transaction cost savings associated with pooling resources to search and then negotiate contracts giving rise to efficiency benefits from coordinated buying behaviour. Moreover, as Mathewson and Winter (1996) show, in the context of a monopolistically competitive selling market, a buyer group can gain by offering exclusivity contracts to a sub-set of potential sellers in exchange for a lower price with the result that welfare may increase. Here the parties to the agreement are better off but those consumers and firms outside of the agreement may be worse off. However, total welfare may increase as the buyer group may be a means of (partially) off-setting the tendency for a monopolistically competitive market to yield an inefficient trade-off between product variety or availability and lower prices. Specifically, where a market may yield too many suppliers (from a social welfare perspective), buyer groups can be a means of reducing the number of viable suppliers. For an alternative analysis and similar application to

upward sloping supply. However, an important empirical study which has some bearing in this regard is that provided by Shea (1993), which found that for twenty six U.S. manufacturing industries studied, only three exhibited downward sloping supply functions; relating to prepared feeds, construction equipment, and aircraft. Of the rest, more than twice as many were upward sloping as were flat. Sixteen industries (such as lumber, drugs, paints, tires, stone, clay and glass, cement, and electronic components) were found to have upward sloping supply functions, while seven other industries had flat supply functions (such as plumbing and heating products, floor coverings, and animal and marine fats and oils). Accordingly, the assumption of an upward sloping supply may actually have some broad empirical relevance, even to manufacturing industries where increasing returns might have been more commonly expected.[13] However, as yet there have been no equivalent studies on retail goods markets - e.g. examining supply conditions for manufactured final goods. Nevertheless, it is apparent for a number of agricultural markets that upward sloping supply may be a feature and consequently powerful retailers may be in a position to exploit buyer power if they deal directly with producers.

In summary, welfare is likely to be adversely affected by the exercise of monopsony power in conditions where buyers have the ability to exploit a competitive supplying industry to depress market prices below competitive levels. The associated welfare losses are due to reduced producer surplus, and unless the buyers have market power when selling their output, there is no direct effect on final consumers. However, where buyer and seller power are jointly held (e.g. by a monemporist) then the outcome is likely to be allocatively inefficient and in particular the welfare of both factor producers and final consumers is likely to be adversely affected.

However, the conclusion that the exercise of monopsony power is socially detrimental needs to qualified in terms of two important caveats. Firstly, there may be off-setting efficiency benefits. The market may, for example, be a "natural" monopsony where productive efficiency requires that there be a single buyer of an input and thus a welfare trade-off results, analogous to that of monopoly (e.g. Williamson, 1968), involving productive gains but allocative deadweight welfare loss. For example, network economies may be present in purchasing and collecting, e.g. in agricultural markets such as for milk, implying that the activity is most efficiently undertaken by a single firm but such a firm may then have monopsony power. In the context of retailing, logistical economies may yield similar benefits. Similarly, with a buyer cartel

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managed competition in health care markets, see Che and Gale (1997).

13. With flat supply curves, the buyers have nothing to exploit as price is the same for whatever level of purchases they decide upon. When the supplying industry is characterized by increasing returns it obviously has natural tendencies towards being a monopoly, or at least an oligopoly structure, in which case it is less likely that buyers will be in a position of (unilaterally) setting prices, and it is rather more likely that prices will be determined through negotiation. Consideration of this case, with market power on both sides of the market, is given in the next section of the report.

there may be cost-savings from joint purchasing behaviour, e.g. regarding reduced transaction costs or achieving economies of scale in production and warehousing, and other efficiency benefits (e.g. Mathewson and Winter, 1996). This argument is particularly strong in the context of retailing where purchasing groups have become increasingly common - with competition authorities and courts recognising the efficiency benefits that these organizations may offer.[14] Secondly, it should be apparent from examination of Figure 2.1, for example, that if the monopsonist could practice (first degree) price discrimination in making its purchases, i.e. pay each unit its exact cost of production rather than setting just a single market price, then the purchaser can obtain the entire economic surplus which would be generated under competitive market conditions (thus eradicating any deadweight welfare loss in the factor market).

As a final point, it should be noted that the above discussion has been cast in terms of static welfare considerations. In addition, attention needs to be given to possible dynamic effects and here concern is often expressed about possible detrimental welfare effects arising from the damage to the long term viability of producers resulting from the exercise of monopsony power. This can have an economic impact when, for example, buyer power reduces prices for suppliers, and thus their income, making it difficult for them to finance required investments, which might then be postponed or even foregone completely. Similarly, suppliers may be reluctant to undertake investments when they anticipate (post-contractual) opportunistic behaviour by powerful buyers seeking to exploit supplier commitments. In both cases, supplier efficiency may suffer which might ultimately feed through to higher prices for consumers than would otherwise be the case in the absence of such problems. These points touch on the welfare problems which may arise from *economic dependency*, where an agent (a supplier) relies on a powerful principal (a buyer) for its economic survival when it has aligned its production to meet exclusively the needs of the buyer, and whereby it has cut off the possibility of supplying other buyers (at least in the short run).

2.2. Bilateral Market Power

Thus far, we have considered the exercise of monopsony power against competitive suppliers. Matters become more complicated in markets where seller power is also present on the other side of the market. Analysis of this situation has focused primarily on the case of "bilateral monopoly", where an upstream monopolist is the sole producer of a factor required uniquely by a downstream monopolist in undertaking its production.

14. For example, this latter point was made by the U.S. Supreme Court in its ruling on *Northwest Wholesale Stationers, Inc. v. Pacific Stationery and Printing Co.*, 472 U.S. 84 (1985). Here, Northwest Wholesale Stationers was a purchasing cooperative comprised of about 100 office supply retailers and was viewed as allowing its members to enjoy the economies of large-scale purchases.

Figure 2.3 presents the standard diagrammatic treatment of bilateral monopoly where a monopoly producer of a factor trades with a monopsony purchaser (e.g. Bowley (1928) and Morgan (1949)). If the buyer acted in a perfectly competitive manner in its output market, the derived demand for the input would equal average (net) value product of the factor, represented by the curve AVP = D_C.[15] However, if the monopsonist buyer acts as a monopolist in its output market then the derived demand for the factor will be MRP, the curve marginal to AVP. As in the previous section, MRP is the marginal revenue product of the factor, that is the additional revenue obtained from employing an additional unit of the factor. The curve labelled MMRP is marginal to MRP, and represents the marginal revenue associated with selling the factor to a buyer which has monopoly power but no monopsony power. The curve AC denotes the seller's average cost for producing the good, and MC its marginal cost. If the seller behaved as a perfect competitor, then MC represents its supply curve, S_C. Finally, the curve MFC is marginal to MC, and as before, indicates the marginal factor cost of the input to a monopsonist buyer, treating the seller as having no market power.

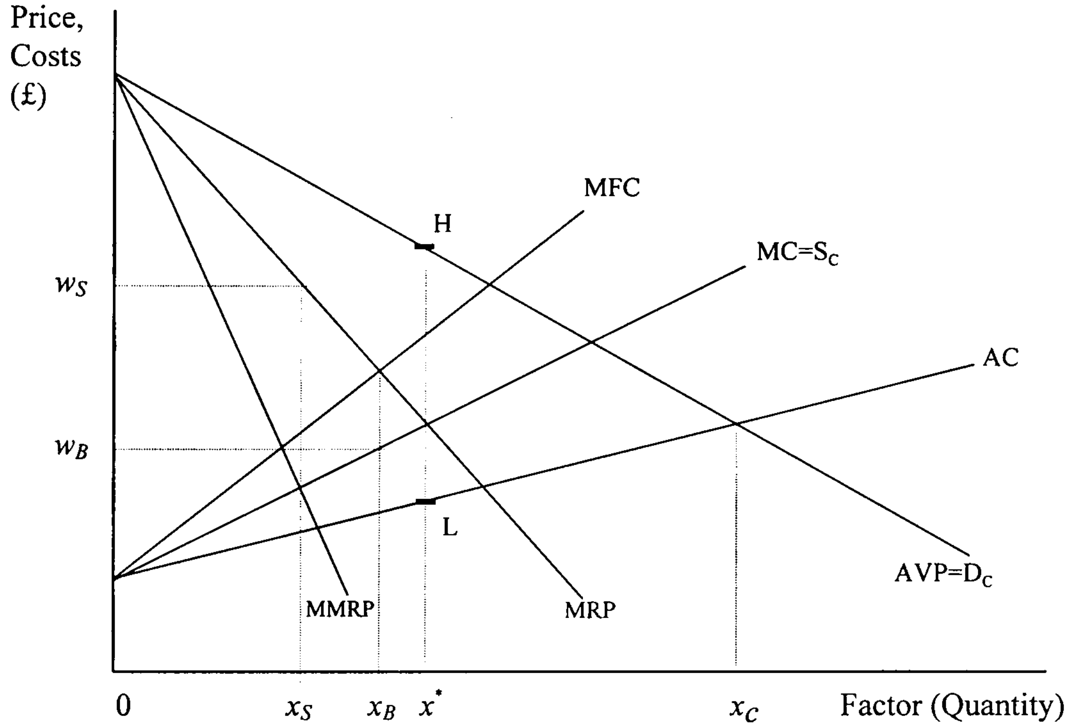

Figure 2.3 - Bilateral Monopoly

Let us first note the non-cooperative solutions which would arise if only one party held market power and sets price to which the other party simply responds by determining the quantity. In the *monopoly outcome*, the seller dominates and sets price and the buyer responds by purchasing in a competitive manner. In this case, the seller equates MC with MMRP, with the result that quantity would be x_S and price w_S. On the other

15. Here, we are assuming that the monopsonist prices in its output market at a level equal to average cost (p =

hand, in the *monopsony outcome*, the buyer dominates and sets price leaving the seller to determine the output level. If the buyer also acts as monopolist in its output market then it equates MRP with MFC, resulting in quantity x_B and price w_B.

However, with both firms recognising their mutual interdependence and with neither side being in a position to impose a price and let the other respond by determining quantity, we may expect both parties to agree on setting quantity at a level which maximizes their joint profits (i.e. Pareto optimal from their joint perspective) and then divide the spoils through bargaining over the trading price. In this case, the quantity would be x^*, where MC is equal to MRP. In terms of the price at which the two parties would trade, we can note that this could be so high as to leave the buyer with zero profit from the transaction, i.e. when the price equals the buyer's average value product at point H in Figure 2.3. Alternatively, it could as low to equal the seller's average cost of producing its output, at point L, in which case the seller derives no profit from the transaction. Which point on the contract curve (i.e. the line between H and L) would be chosen depends upon the outcome of a bargain between the two agents.[16]

As shown in Figure 2.3, the joint-profit-maximizing level, x^*, is higher than both x_S and x_B.[17] In some sense, then, with agreement on this level, there is a social welfare gain from having opposing selling and buying power compared to power existing on only one side of the market. However, it should be pointed out that while x^* is Pareto optimal from the firms' perspective in maximizing joint profits, it does not imply that social efficiency is accordingly maximized. For example, when the buyer is a monopolist in its output market, joint profits are maximized when the buyer uses its monopoly power and quantity is restricted below the competitive level. Indeed, it can be observed that the firms are able to earn profits up to the point which corresponds with the intersection of AVP and AC, i.e. x_C. Nevertheless, the analysis does indicate that the welfare consequences of bilateral market power may be less severe than the cases where market power is unopposed. For example, the level x_S corresponds *mutatis mutandis* to "successive monopoly" where an upstream monopolist sets price to a downstream monopolist, which in turn takes this price as parametric and treats it as a cost level when determining its own output price. Alternatively, the level x_B corresponds to the "monempory" (i.e. monopsony-monopoly) solution whereby the firm exercises both (unopposed) monopsony and monopoly power.

AC_Q), implying that it earns zero profits from the selling side of its operation.

16. A now standard approach to resolving this problem, is, following Rubinstein (1982), to assume that the bargaining process is one in which parties make alternating offers/counter-offers and both are impatient to settle (that is, pie received at a later date is less valuable than the same amount of pie received earlier). Then with complete information regarding each other's preferences, etc., and constant discount rates, the parties will (immediately) agree on a division of joint profits which yields them a share of the surplus generated according to their relative eagerness to settle.

An obvious extension is to consider the case where the buyer has monopsony power, but no monopoly power in the final market. An example of might concern a buyer alliance which acts united for the purposes of negotiating but compete independently as sellers. In this case, AVP becomes the relevant base curve on the demand side, with MRP becoming the marginal curve. Negotiation in the bilateral monopoly situation would then be over the transaction price for the quantity corresponding to the intersection of AVP and MC, i.e. a quantity exceeding that of x^* and thus socially more preferable. An interpretation would be that, for all other things equal, a buyer alliance with members competing as sellers would offer a higher level of societal welfare than a single buying firm which also had monopoly power on the selling side. In the context of food retailing, this suggests that buyer groups may be of less welfare concern (where groups members compete against each other in the retail market) than store groups which have both buying and selling power.

Beyond bilateral monopoly, we could consider market structures with more than one firm on either side of the market. For instance, Dobson and Waterson (1997) develop an analysis based on a (single) supplier bargaining with (differentiated) oligopolistic retailers and examine the effects of increased consolidation in the retail sector on consumer prices and economic welfare. Here there are two opposing forces. On the one hand, consolidation may increase retailers' power over the supplier sufficiently to reduce transfer prices, which can feed through to lower final prices when there is intense competition in the retail market. On the other hand, retailer consolidation can lead to increased selling power at this level which may allow retailers increased margins, tending to undermine their bargaining strength given their greater ability to afford bargaining concessions with the consequence that transfer prices may not be significantly reduced and as a result higher final prices may ensue. Which effect dominates is shown to depend greatly on the intensity of retail competition - the former effect is stronger when competition is intense, other the latter effect dominates and consolidation leads to higher prices for consumers.

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17. Whether x_S is less than or greater than x_B clearly depends on the slopes and positions of the two sets of curves.

CHAPTER 3 - BUYER POWER PROPOSITIONS

Flowing from our analysis of models of the effects of buyer power and following the standard welfare economic practice in chapter 2 of considering social welfare without regard to distribution, we may develop the following propositions:

1. It is not the case that buyer power, by itself, is desirable. In fact, it is undesirable. To be specific, label a buying firm with buyer power as "B", firms from which it buys as "Si". Assume that the Si are in an essentially competitive industry, also that B has no selling power. An example might be a buyer who purchases all lettuces from growers in a particular region of England, to sell on via wholesale markets. The analysis shows that social welfare, measured without regard to distribution, is lower than in the situation where the middlemen (firms like B) are numerous, all other things equal. Prices to growers are screwed down below those that would exist in a competitive market, but this causes output to be cut back and does not result in final consumers paying lower prices.

2. Furthermore, if the firm with buyer power, B, has selling power as well, the situation so far as social welfare is concerned is worsened by comparison with the position in 1. above. To adapt the example, assume that lettuces only grow in one part of England, that part where B buys and that because of their perishability, the market for lettuces for sale in England largely consists of home-grown lettuces. Figure 2.2 shows the additional welfare loss created in this case.

- Because these results, particularly the first, go against common beliefs, it is important to qualify them.

3. It is relatively uncommon for there to be a single buyer, more common in food retailing for there to be a small number of powerful buyers. We may assert that the direction of the effects identified above will be maintained, although they are likely to be smaller in magnitude. One particular circumstance is where a form of "bidding war" between buyers, Bi, develops, such that they offer better and better deals to suppliers. The likely limiting result in this case is where prices paid to growers approaches the level they would expect in the absence of buyer power.

4. There may be organisational economies in having a single large buyer or a small group of such buyers. For whatever reason, perhaps the transport technology, the timing and quantification of demand, or the availability of information about consumer preferences, there may be static and or dynamic benefits in the supply chain taken as a whole from having dominant buyers. To extend the example, the buyer may

notice in the market that lettuces coming from abroad differ somewhat in their characteristics, and that particular types are favoured by consumers. It is then feasible that the buyer suggests production strategies to the growers which will enhance their income. The example may seem fanciful, but charities which specialise in bringing goods from less developed economies to the West make a feature of their role in this respect.

- It is where the selling stage, S, has an element of monopoly power that "second best" results come in to play and buyer power becomes much more important. Let us first take the case where the buyer, B, has monopoly power.

5. Subject to caveats, where there is upstream seller power, the presence of a powerful buyer improves the position over what it would be if the buyer has no power. This happens for the following reason: Left to their own independent devices, a powerful buyer facing a powerful seller would be unable to agree on an appropriate transfer price or, save by chance, on an appropriate quantity to transfer. However it is very likely that they would have sufficient appreciation of the position to be able to negotiate an outcome which improves both their positions. There is an obvious point of agreement on quantity, and the level at which the bargain on price settles, although important to the two parties, does not have an impact on overall social welfare. Assuming they reach this agreement, the quantity they transfer will be greater than the quantity either would envisage selling/ buying were the other party to have no power. Thus the position with a powerful buyer is better than the situation with a powerful seller, S, alone.

6. Even when S has monopoly power, this does not mean that social welfare is greater with the presence of a powerful buyer B who *also* has monopoly power in its own sales to customers than it is where S's monopoly power is the only distortion in the system. In fact, in simple cases these two scenarios (B as a monemporist, S as a monopolist, or S as a monopolist alone) are equivalent from a social welfare viewpoint. Again, the idea that buyer power is necessarily good must be qualified.

7. However, B's buyer power is definitely desirable when B has no monopoly selling power and S has selling power. Here again, each of the players individually has a view about quantity exchanged and price for that exchange which are mutually incompatible, but we may expect them to recognise their mutual benefit in bargaining to a solution. This solution is also socially more desirable than either of the individual positions.

8. There is an important further implication from this point. If it is inevitable that many suppliers of goods (say, powerful manufacturers) have some monopoly power, then it is also desirable that there exist

buying groups which, whilst having no particularly powerful position in their final market, nevertheless have significant monopsony power.

9. We may expect that in reaching bargaining solutions, given the range of uncertainties and other factors existing in practice, there will likely be significant non-linearities in pricing and other constraints in contracts. Thus, such aspects of contracts between the S and B levels should not necessarily be treated with suspicion, but rather on their merits and on the relative degree of concessions and constraints on each side.

10. However, if one party makes all the concessions and the other accepts significant constraints, this would appear less like a genuine bargaining outcome and more like an imposition to enhance monopoly. For example, exclusivity agreed to by only one party may be an arrangement to enhance monopoly power through removing the possibility for substitution.

11. All the above remarks relate to general tendencies given a set of underlying assumptions. It is clear that relative magnitudes of various effects will be influenced by such factors as relative degrees of market power, relative elasticities of the underlying curves, etc.

These propositions lead to the following suggested approach to investigating buyer power for policy purposes. This approach draws upon our (Dobson, Waterson and Chu, 1998) work for the Office of Fair Trading and it takes the same format of a table containing a series of questions and relevant evidence to answer them. However, it refines that approach to some extent in the particular context of a European approach to the issue. In particular, we note some additional points in italics where distributional factors may cause specific concerns, where buyers may be regarded as exploiting their market power in an unfair manner.

The approach, set out in Table 3.1, is framed around five key questions dealing firstly with signs of market power at (i) the buyer level, (ii) the supplier level and (iii) the downstream level where the buyers sell on the goods/services, followed by consideration of the underlying economic conditions in production/distribution, specifically the nature of costs in the buying process, and lastly consideration of market behaviour with regard to the nature of trading relationships and potentially anti-competitive practices.

TABLE 3.1 - A Proposed Framework for Analysis of Buyer Power

Question/Source	*Relevant Evidence*
• Is there significant buyer power? This is essentially a qualifying question: if not, the considerations of this report are not relevant. By significant power is meant the ability to have a material effect on prices set or negotiated, quantities exchanged, the viability of traders at one or more stages of production.	• Significant proportions of the product as a whole purchased by this firm. • Significant arrangement of terms of purchase by this firm, such as upfront fees for distributing a product, in the form of slotting allowances.
• Is the buying power against relatively powerless suppliers? If so, further investigation may be warranted, since there are more likely to be policy implications. *Competitive firms may also be more at risk than corresponding oligopolistic firms which might be a specific concern.* Alternatively, if there is also significant upstream seller power, there is less likely to be a problem. (This question relates to points 1, 4 and 5 above).	• Absence of evidence that suppliers dictate terms of sale. • Low seller concentration in the upstream market.
• Does the buyer itself have significant selling power? If so, then buyer power may serve as a means of strategically enhancing seller power in the downstream market with potentially adverse effects. On the other hand, if the buyer has no appreciable seller power, and the final market is generally competitive, its buying power is more likely to be socially desirable. (This question relates to points 2, 7 and 8 above).	• Measures of assessing seller power in the downstream market. Here it will be important to investigate inter-relationships between the various actors involved.
• Are there significant productive efficiency gains associated with buyer power? If so, then there may be an efficiency justification for buyers having power. (This question relates to point 4 above).	• Pecuniary or organisational economies of scale indicating a natural tendency for there to be few buyers, since average transactions costs are thereby reduced.
• Does the buyer attempt to constrain its suppliers' other actions *or deliberately create a dependency relationship*? If so, such an arrangement should be treated with suspicion. (This question relates to point 9 above).	• Evidence of exclusive supply requirements, specific custom designs or arrangements, idiosyncratic specification etc. • *Charging structures not obviously related to the cost structure of the goods specified.*

Source: adapted from Dobson, Waterson and Chu (1998)

The first question relates to the existence of buyer power. Unless one or more buyers have the ability materially to influence prices set or negotiated, or quantities exchanged, or impact on the viability of suppliers or competing buyers (so that it may be the case that the buyer acts against the public interest) then buyer power may be presumed to have no (notable) adverse welfare consequences.

However, given the presence of significant buyer power, the second and third questions respectively involve determining the extent of seller power at the supplier level (i.e. facing the buyers) and the extent of the selling power of the buyers (i.e. at the downstream level). In regard to the first aspect, if the buyer power is against relatively powerless suppliers then there are concerns about abuse of monopsony power, which might include a detrimental effect on producer (suppliers') surplus and the long term viability of suppliers. On the other hand, if buyer power is linked with significant seller power at the upstream level then it is more likely, *ceteris paribus*, that the existence or enhancement of buyer power is beneficial, that is buyer power may have a socially beneficial countervailing effect by negating the detrimental effects of upstream seller power. However, the overall effect on welfare in these circumstances will turn on whether or not the buyers themselves have significant selling power.

If it is the case that the buyers operate in a competitive output market as sellers, then buyer power is likely to have a benign countervailing impact on upstream selling power. In contrast, if buyer power is linked to (downstream) selling power then there are concerns that while buyer power may allow for a more (allocatively) efficient transfer of goods at the upstream stage there will be a detrimental welfare at the downstream level as the firms exploit their selling power. Judgement on the overall effect rests on which of the two effects is the stronger, i.e. the successive power arising from selling power at successive stages or the countervailing power effect arising from the presence of opposing (bilateral) market power. If final prices rise as buyers increase their bargaining power then the presumption is that the former effect dominates, *ceteris paribus*.

The fourth question is of particular relevance in assessing the impact of a merger between key buyers or cooperative buyer behaviour (i.e. the formation of a buyer group). Specifically, pooling resources to make purchases may yield efficiency benefits from reduced costs and consideration needs to be given to how great such benefits are when set against any anti-competitive effects. For example, there may be circumstances where the most productively efficient (i.e. least-cost) market structure on the buying side is a monopsony. In addition, pooling resources to make purchases such as through the formation of a buyer group may allow for reduced administrative and distribution/warehousing costs. However, for there to be a clear welfare benefit it should be the case that this collective purchaser power does not transfer through to increased selling power downstream, so that the benefits of any reduced costs are passed on to consumers. This might be the case, for example, regarding international (cross-border) retailer buying alliances in the EU where these are characterised by one alliance member in each member state (i.e. generally not direct competitors in selling output) - further consideration of the competition effects of such alliances is contained in Appendix 2 below.

Given the structure of power relations in the market addressed by the first three questions in Table 3.1, and efficiency effects associated with buyer power considered by the fourth question, the final question is specifically related to consideration of (potential) anti-competitive practices as a result of the buyer attempting to constrain its suppliers' other actions (i.e. beyond simple quantity exchange at a fixed or negotiated price per unit). These actions are effectively vertical restraints induced by the buyer. Here the anti-competitive effects, which may serve to raise barriers to entry or mobility or serve to relax competition between existing rivals, need to weighed against potential efficiency benefits to determine the overall welfare effect.

It is envisaged that such a structured approach will prove particularly useful when undertaking case analysis, allowing for consistency in the analysis and effective comparisons to be made.fp

CHAPTER 4 - DEFINITION AND MEASURES OF BUYER POWER

In order to operationalise the buyer power framework outlined above, it is important to be clear as to what is meant by the term buyer power and how it can be measured, in particular to respond to question 1 in Table 3.1. In this regard, this section considers the definition and various means of measuring buying power as well as commenting on the question of market definition as it relates to a *purchasing* market. Concerning measurement, we look at three potential classes of measure: buyer concentration, elasticities of supply and performance measures (such as price-cost margins). Whilst all of these measures are potentially useful, from a practical point of view buyer concentration is likely to be most useful (a) because data on it are more readily available and (b) because there are difficulties of interpretation (and/or difficulties in collecting data) for the other possible measures. With these points in mind, we argue that buyer concentration measures, whilst they should not be used in isolation, are useful first indicators of possible buyer power problems.

4.1 Definition of Buyer Power

It is useful to start with a general definition of buyer power. In their report on buyer power in 1981, the Committee of Experts on Restrictive Business Practices defined buyer power as "a situation which exists when a firm or a group of firms, either because it has a dominant position as a purchaser of a product or service or because it has strategic or leverage advantages as a result of its size or other characteristics, is able to obtain from a supplier more favourable terms than those available to other buyers" (OECD, 1981).

Firms will have market power as buyers, typically, when they have a dominant position in the market and they use this to extract favourable prices and other terms and conditions from suppliers.

However, this is not the only feature of buyer power that one might want to stress. From a policy point of view, buyer power is likely to be more of a problem where it results in discounts and additional favourable conditions which *are not linked closely to savings in costs.* If this is the case, price discounts will be discriminatory and larger, more powerful buyers (or buyer groups) will benefit at the expense of smaller firms. This, of course, was an important issue in the US in the 1930s, leading eventually to the 1936 Robinson-Patman Act which (controversially) outlawed such discriminatory behaviour.

In addition, buying power is also likely to be important, from a policy viewpoint, where *firms have monopsonistic (or oligopsonistic) power.* This will arise typically where there are broadly competitive conditions on the supply side of the market, and the supply curve is not perfectly elastic. If this is the case, the monopsonist (or oligopsonists) can exert their buying power by restricting demand and, thereby, purchase at less than the competitive price. Again, therefore, one might want to capture this aspect of the market in some measure of buyer market power.

Taking account of these factors, the Secretariat of OECD has more recently offered an alternative definition which reflects differences in underlying negotiating power among contracting parties and is outcome-driven:

> ....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. By disproportionate, we intend a difference in relative rather than absolute opportunity cost, e.g. 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, para.20).

4.2 Measures of Buyer Market Power

In measuring the concept buyer power, different families of measure focus on various specific aspects. The "ability to have a material effect on prices" (Table 3.1) and more generally, the social impact of buyer power, relates both to the relative size and strength of buyers and the scope for exercising that strength. In principle, both matters are relevant to buyer power. The first set of measures discussed below refers to relative size, the second set to scope. The third set of measures focuses on outcomes rather than potential.

1. Buyer Concentration

The most straightforward summary measure of buyer power is buyer concentration. As the definition in the last section makes clear, buyer power is most likely to arise where one or a few firms (or buyer groups) dominate the buying side of the market. Therefore, we expect buyer concentration to be a useful first indicator of possible buyer power. As noted above, however, the existence of high buyer concentration need not imply that *significant* buyer power is being exercised (although, in many cases, it probably will) and hence other factors need also to be considered (e.g. the structure of the selling side of the market) before any strong conclusions can be drawn. Generally, buyer concentration can be said to relate both to numbers of buyers (negatively) and to size inequalities between them (positively).

There are various possible measures of buyer concentration, all of which are directly analogous to measures on the supply side of the market. One possible measure is the number of buyers who account for (say) 50% of the purchases of a good. This measure is attractive because it is easy to calculate and has clear intuitive appeal. Whilst, as with other concentration measures, the 50% measure is largely arbitrary it also has intuitive appeal. If, as is the case for some products, the leading 5 firms, say, purchase 50% of some good, one might infer that buyer concentration is high. On the other hand, if, say, 10 or more firms control 50% of the market, then there is less evidence, all other things equal, that buyer power exists.

It is important, however, to qualify this in one way, in that, within the top 10 firms, say, one (or several) firms may dominate the market (e.g. the leading firm may have 40% of the market by itself). Hence, it is desirable to pay attention to the leading firms' market shares as well as this (or other) measures. Thus size inequalities are important, although it is relevant to note that there is no obvious or unique way in which to combine the two elements - particular concentration indexes do this various ways.

The most common summary measure (which we use in this study) is the buyer concentration ratio. In this case, the focus is on the market share of the largest r firms buying in the market. If r = 5, then we measure the market share of the leading 5 firms. This measure is also easy to calculate and has strong intuitive appeal.

Other measures of buyer concentration include the Herfindahl index, the entropy index, and so on.[18] The Herfindahl index measures the sum of the squared market shares of firms*purchasing* a particular product. While this measure has some advantages over traditional concentration measures (e.g. it takes account of all firms in the market), it is more difficult to calculate since (estimates of) all market shares are required. In fact, the Herfindahl index may be viewed as a special case of a more general weighting scheme defining a class of indices, each of which satisfies a set of criteria which are desirable for concentration indices to posses, as explained by Hannah and Kay (1977). For these reasons, we make use of the simpler concentration ratio (combined with data on leading firm market shares) in this study. It is a measure which we suggest can always be used in a first pass examination of a market's buyer power.

2. Elasticities of Supply

In a recent paper, Blair and Harrison (1992) argue that buyer power can alternatively be measured by what they call the Buying Power Index (BPI), based on the elasticity of supply. The argument is as follows. If we take the case of a monopsonist buyer of a good, then, in equilibrium, the extent of buyer power (measured as the difference between the amount the monopsonist is willing to pay for a good at the margin and the price that it does pay) is equal to the reciprocal of the elasticity of supply. Hence, one can measure the *extent* of buyer power by looking at (the reciprocal of) the elasticity of supply. This is a similar argument to that used by advocates of the Lerner index on the selling side of the market (Lerner, 1934). It examines the scope for buyer(s) to have an effect on the market, rather than their size.

18. See for example Clarke (1985).

The intuition underlying the point is that if a good is in perfectly elastic supply, even a monopsonist (with BCR=1) cannot exert buying power, despite being the dominant buyer in the market, through restriction of supply. However, if supply is less than perfectly elastic, the monopsonist can restrict demand and lower its buying price, and hence make monopsonistic returns. The less elastic is supply, the greater is a monopsonist's buying power. The authors also show that if there is a dominant buyer *together with a competitive fringe*, a similar argument can be made, although in this case the buyer power index depends also on the market share of the dominant firm and the elasticity of demand of the competitive fringe.

This approach is interesting in that it looks explicitly at the source of monopsony power. Supply inelasticity may be seen to be important element in determining the overall impact of buyer power. However, it also has problems. As noted by Jacobson and Dorman (1992; see also Jacobson and Dorman, 1991) elasticities of supply are difficult to measure in practice, and hence, whilst it may, in principle be suitable, this measure is less likely to be practical than is BCR. Added to this, the measure is only suitable within monopsony-type models; specifically, where there is perfect competition on the supply side of the market. In markets where this does not obtain (e.g. with monopoly or oligopoly supply), supply is not independent of demand and the model does not easily extend. This is a significant practical limitation. Nevertheless, some markets relevant to the industry in hand are essentially competitive (in supply), for example the market for fresh produce. Therefore, particularly when BCR is very high, and despite the practical difficulties, it is likely to be worthwhile to attempt a calculation of this measure, or at least to survey the literature for estimates. This will enable some prioritisation of cases.

3. Performance Measures

A third approach is to measure buyer power by output or performance measures such as profitability or the price-cost margin. An obvious measure of buyer power in a monopsony-type model is the margin between the price the monopsonist is willing to pay (at the margin) and the price he does pay; or simpler still, the size of the discount on the competitive price. And, more generally, a direct measure of buyer power would be the size of the discount gained by the buyer (or buying group) and/or the value of any special terms it obtained from suppliers (net of any cost savings made in selling to a larger group). However such information is difficult to obtain, or, at least, would require considerable effort and expense to gather. Therefore the measure is not well suited to a preliminary investigation established to examine the *a priori* possibility of further investigation being required.

Less demanding would be details of the price-cost margins of the buying firms. However, price-cost margins reflect a number of different things and are not indicators of buying power alone. The problem of the foregone alternative is particularly severe here. Supermarket multiples may for example exert buying power in order to lower prices and increase price-cost margins, but price reductions might simply reflect reduced cost savings in handling or be due to buying in bulk rather than reflecting (additional) buying power. In this sense, high margins may not be undesirable in the eyes of Society generally since the benefits could be obtained in a market with competitive supply. Alternatively, supermarket multiples might exert buying power and achieve lower prices but also exert power at the retail stage, enabling them to increase their margins by more than implied by buyer power alone. Or high price-cost margins could be achieved by lowering costs at all stages of operation of the firm, rather than them arising from the buying power of the firm.

Two problems are evident in these brief examples. One is that price-cost margins of downstream firms depend on all stages of their operations and not just on buyer power in the upstream market. Second, price-cost margins themselves reflect two factors, prices *and* costs, and, at least on an *a priori* basis, one should not leap to the conclusion that they imply buyer (or seller) market power. Having said this, high price-cost margins *could* be indicative of such power. They should not in any sense be determinative of potential problems, but they may be a useful indicator of cases to investigate further.

4.3 Market Definition

Clearly, the definition of the market whether it is broad or narrow - is an important issue in the assessment of market power. There are two key dimensions which require consideration here: the geographic extent of the market and the substitutability between products providing similar services. Potentially there are considerable differences between the appropriate definitions on the selling and the buying sides. For many goods, competition on the selling side may for practical purposes be limited, with consumers facing a limited number of stores within easy travelling distance in a given geographic area (so the relevant market is sub-regional) and with segmentation by retail service. In contrast on the buying side, the geographic market could be national or international, but because of the specific nature of supply for particular brands or items, the product dimension might turn out to be quite narrow. Moreover, individual suppliers may be economically dependent on particular distributors (especially where long-term supply contracts are a common market feature).

As a background, and general guide, we may take the Commission's Notice on Market Definition. Market definition on the *sellers*' side concerning the extent of the market depends on the question: "...whether [given a particular definition] the parties' customers would switch to readily available substitutes or to suppliers located elsewhere in response to a hypothetical small permanent relative price increase to the products and areas being considered...." (Commission Notice of 9/12/97) in such numbers as to make the price increase unprofitable. If so, the market definition must be broadened. This broadening (by product and/or area) continues until the question can be answered in the negative.

To take an example within which to consider the *geographical* extent of the market, we may consider electrical goods retailing. The market would be a sub-region if when all the electrical retailers in that area raise their prices by 5-10%, insufficient customers search elsewhere (chose alternative shopping venues) to make the increase unprofitable. But if large numbers did buy elsewhere, the market would have to be broadened to, say, a region, or even a country. However, the matter also depends on practice and time-scale. To take the more directly relevant example of UK supermarkets, if it is common practice for nationwide pricing to be adopted by most chains then consumers in fact do not have the opportunity to purchase elsewhere at different prices and the observation that prices and other aspects of format are aligned across a country indicates that the retailers do not believe separate markets are easily or fruitfully identified. Sometimes, data may be brought fairly directly to bear - the case of car price differentials between the UK and Continental Europe comes to mind. In this case, the market is clearly at most the UK (more probably a part of it), since various factors mean only small numbers of British customers search in continental Europe despite what appear to be significant price differences. In the case of food retailing, we take the pragmatic view that the countries of the EU are significantly different from one another in terms of consumer tastes, shopping habits and major players that the most appropriate definition of the retail market is national as opposed to international This is a relatively broad conception of the market and for some purposes, or in some countries, it would be thought too broad - one can imagine a gap in the chain of substitutes between areas of France or Italy, for example. However in practice, data at a finer level of disaggregation than national are not at all easy to obtain, so that a pragmatic definition would need to be at national level, geographically speaking. Of course this may mean that for some purposes, the true market concentration is understated by the data.

There is also the question of the product side of the definition. Again the test is whether customers would switch to substitutes in sufficient numbers if price rose 5-10% over a sustained period. The operational issues in the particular case we examine here are whether to include discount stores and whether to include convenience stores. Given the developments in the relationship between discount stores and existing supermarket chains in some countries (e.g. Germany) and given the presence in some other countries (e.g. the UK) of a clear recognition of the importance of low price ranges to a significant group of consumers, we take the view that discount stores should be included in the definition. Their essential appeal is low prices and significant numbers of consumers seem willing to trade off price against range. On the other hand, convenience stores satisfy a rather different market. Arguably, this is the less sensitive market for "top-up" products, as opposed to a weekly shop. Perhaps, therefore, it might not be appropriate to include them in the definition of the market in all cases.

There is an important caveat to the Commission's test. The price concerned might not be the market price "...where the prevailing price has been determined in the absence of sufficient competition"(para 19). This caveat is important to avoid a logical contradiction, often known as the "cellophane fallacy". By definition a profit maximising monopolist does not produce on the inelastic portion of a demand curve. Thus, from a monopoly price, it is not the case that increasing the price will be profitable. Yet a monopolist is the only firm in the market, so the market cannot be broader. Clearly, a less than monopoly price must constitute the appropriate benchmark from which to carry out the hypothetical test. Indeed, we would argue that the most appropriate price from which to carry out the test would be an essentially competitive price. Again, this may mean that a pragmatic approach to definition serves best.

Let us turn now to modifying the definition to tackle the question of market definition on the*buyer's* side. Consider the following proposal (of our own devising) which moves the question from purchasers to suppliers: The question is whether [given a particular product and geographical market definition] the parties' suppliers, faced by a 5-10% permanent cut in the price they receive, would refuse to supply to the buyer(s) in such numbers that the price cut proposed would reduce the parties' range of goods sold to such an extent that the price cut was unprofitable.

This impact on profit would be likely to be felt because there would be insufficient throughput of goods of that type into the store(s) (in the case of the party being a retail buyer) in question, because there was then insufficient choice of goods for customers to be attracted to the store. Thus, of course, the definition ultimately relates to the end consumer, and the typical or general consumer's practices, since the demand by a buyer is derived from that of the final consumer. If the question was answered in the affirmative, the range of buyers (geographically or by type) would then be expanded to broaden the defined market until the answer is negative.

To take an example, from which to fix the product side, suppose an Italian clothing chain, specialising in designer clothing, seeks to impose a price cut on its suppliers coming from within a given geographical market: would sufficient of them refuse to supply so that the chain then has very much less to offer the customer, so that significantly fewer people buy? Is the fall-off in sales sufficient to make the attempt to impose the price cut on suppliers unprofitable? If not, that chain constitutes a market on the buyers' side. (Again, this definition is consistent with what the UK's Office of Fair Trading calls the "hypothetical monopolist" test in its guidelines on the Competition Act 1998 which brings a structure like Articles 85 and 86 into UK law.) But if so, expand the definition to encompass more chains of a similar nature. Would the attempt now be unprofitable? Continue expanding on the buyers' side until the answer is no. We may imagine that if all clothing stores of a particular type within a specified geographical area acted in the same way, producers would buckle under the stores' demands, but they may well be unlikely to do so when faced by a small chain acting unilaterally.

On the geographical side, the price cut described above might be imposed on local regional suppliers, national suppliers, or international suppliers. Again we could ask the question, given a set of products, at what geographical level it would be necessary to impose the hypothetical price cut in order to reduce the range significantly enough to render the cut unprofitable. For most products, including groceries, the impact of a price cut imposed by a "hypothetical monopolist" upon suppliers from a particular region would be unlikely to have an impact.[19] The more likely levels of geographical market on the buyer side are national or international.

Again, custom and practice are of some importance. In the food producing industry (on the manufacturing side), major producers are often multinational. However negotiations are commonly carried out by retailers with national subsidiaries, and so the appropriate level at which to consider the geographic market in food retailing is national.[20]

On the product side, the market is certainly broader than food itself. A retailer which did not carry a range of household goods (detergents and other cleaning goods, paper products such as toilet tissue etc.) along with alcoholic as well as soft drinks, would be considered to have a poor "offer" to consumers. The extent to which the definition needs to encompass fresh produce (fruit and vegetables, bread, uncooked meat etc.) may differ from country to country.

The "cellophane fallacy" caveat explored above is important also in this context: if current buying price has already been pared to the bone, a further cut would be infeasible- a supplier may be prepared to liquidate rather than cut supply price further. Hence, the impact of existing market power on the prevailing buying price must be recognised when engaging in the thought experiment- a competitive price is the best point from which to start the experiment.

Procedurally of course, the Commission would need to establish the relevant market definition along the lines spelled out, *before* proceeding to examine buyer market power as in 4.2 above. However, to summarise on our working pragmatic definition of the food retail market for the purposes of this study, we take the market on both buyers and sellers side to be at the country level, geographically.[21] On the

19. Though for some products supply is local, e.g. locally grown vegetables.

20. This may not remain so. Instead, it may be that, increasingly, selling (and buying) will take place at the EU level.

21. Though, we recognise that in practice the sellers' side may take on a localised nature if nationally-operating

sellers' side, the product market includes conventional super/ hyper- markets and discounters. On the buying side, the product market includes household goods and drinks in addition to foods as such.

4.4 Assessing the impact of buyer power in specific cases

Against this definitional background and the propositions of the previous chapter, we next turn to some suggestions for evolving a methodology which might be employed to assess empirically the impact of buyer power in a particular case. It must be said at the outset however, that the existing academic literature contains remarkably few empirical studies which have attempted to assess the impact of buyer power on prices, profits or any other measures of firm behaviour or "performance". In that sense, we tread more or less virgin territory.

Step 1: preliminaries

As always, the assessment should start with rigorous definition of the appropriate market. This will be followed by a summary of the size distribution of the major players (in this case, of course, buyers) in that market.

Step 2: concentration

The *potential* for market dominance may then be deduced by estimating buyer concentration measures. There should be flexibility in identifying *how many* of the leading players to include in the concentration measure. In general, it is too simplistic to consider only the share of the largest firm, but, equally, summary statistics, such as the 5 firm concentration ratio, or Herfindahl/Entropy indices will often gloss over important size differentials *within* the leading group. As is clear from Table 7.6 below, there are important differences between member states in the nature of the size distribution within the top 5: sometimes, the market can be characterised as a single dominant buyer, but more usually, a natural statistical break suggests that the number of significant players will be between 2 and 4. Similar remarks apply to measuring the concentration of food manufacturers.

Step 3: behaviour

Whatever the measure of structure, the potential for dominance is not the same as dominance itself. To go any further, we need next to introduce information on behavioural and performance variables. As a general proposition, we believe that it is unlikely that behavioural indicators will provide conclusive evidence. Even assuming access to detailed information on buyer-seller contracts, how are we to deduce

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chains choose to adopt local pricing (which the flexibility of EPOS systems makes feasible) or competition is predominantly between regional and/or local operators.

without reasonable doubt the relative bargaining strengths of the two parties in drawing up the contract? In general, therefore, we believe that outcomes are likely to provide the more conclusive evidence.

Step 4: analysis of performance outcomes

Given the well-known ambiguities of data on profitability (e.g. differing accounting conventions, disaggregating consolidated accounts, etc.), the assessment will focus inevitably on margins.[22] The retail/wholesale[23] mark up is the obvious starting point. However, it will be essential to control for factors which are product-specific, insofar as they influence the marginal cost of retailing the product (for example, frequency of purchase, perishability, volume-value ratios.) The word "control" can only be defined rigorously once the scope of the empirical analysis has been set. Hypothetically, consider the market for instant coffee. An analysis of whether there was "high" buyer power in this particular market might be conducted econometrically using panel data across countries, time and products. The objective might be to assess whether retail mark-ups were especially high in this market (perhaps in a particular member state) relative to mark-ups earned elsewhere (in other product and/or geographic markets). If so, whilst the main focus of the analysis will be on the causal relationship running from structure to margins, it would be essential to include other explanatory variables reflecting the product characteristics just mentioned.

Assuming specificational issues such as this have received careful attention, we believe that analysis of margins offers the best prospect for making an accurate assessment of the impact of buyer power. In principle, the aggregate mark-up of retail price over the sum of production and retail cost (M1) can be decomposed into the supplier's (manufacturer's) mark-up (M2) and the retailer's mark-up (M3).[24] Joint (systems) analysis of these three margins (and their changes over time) should provide evidence on whether buyer power has an impact which is at the expense of (i) the manufacturer only, (ii) the final consumer only, or (iii) both. A particular factor of relevance would be if the retail margin had been growing as the supplier margin was shrinking.

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22. The problem with price data (whether retail or wholesale) on their own is that trends may be influenced considerably by external factors such as the general economic environment which makes identifying causal mechanisms and associations with market power extremely difficult.

23. "Wholesale" should be interpreted here as the factory gate price.

24. The practical problems will involve allocating costs to specific products when these are shared with other products. For instance, the retail gross margin on product i (GM_i) may be straightforward to calculate as the retail selling price (p_i) less the unit purchase price (w_i) all divided by the retail price (i.e. $GM_i = (p_i - w_i)/p_i$). But the retail net margin for the good (NM_i) will also need to take account of the retail costs for selling the product (r_i), i.e. $NM_i = (p_i - w_i - r_i)/p_i$, though with common display/shelving/store facilities, etc., the allocation of costs to a particular product line will inevitably be somewhat arbitrary.

CHAPTER 5 - COMPETITION POLICY AND BUYER POWER

The debate over the design of appropriate competition and anti-trust policy towards buyer power has developed considerably in recent times as the problem has taken on greater significance in light of the increased concentration of retail markets. Much of the literature has focused on US policy, and in particular criticisms of the Robinson-Patman Act - see Borgesani, de la Cruz and Berry (1997) for a thorough review of the relevant US policy and law. However, policy and law in the EU has also been the subject of recent debate - see for example Vogel (1998), Ratliff (1998) and, for a comprehensive review, OECD (1998). This section briefly reviews the issues in the European context.

The European Commission's established position on buyer power is perhaps best set out in the Conference papers of the "European Competition Forum, 1995".[25] The discussion in this Forum suggested that various competition authorities consider buyer power to be a real issue, something which is often exploited in an unacceptable manner, but not a practice which is easy to tackle under traditional notions of anti-trust and competition law. The issue is also viewed as more one for national than EC enforcement, given the marked disparity in market concentration and retail structures in different countries and the present reality that most buying activity is at most on a national scale (rather than on a cross-national or pan-European level).

However, specific national legislation exists which is designed to combat the abuse of buying power based on "economic dependency" notably in French[26] and German[27] law.[28] Thus, for instance, French law prohibits the abusive exploitation, by an undertaking or a group of undertakings, of the state of economic dependence of a customer or supplier which has no equivalent alternative. Such abuse can occur where there is a refusal to supply, tied sales, discriminatory conditions of sale or the breaking off of established business relations on the sole ground that the other party refuses to submit to unjustified conditions of business.

The kind of unacceptable practices considered range from the general extraction of non-cost justified rebates to entry fees, listing fees, shelf rental payments and other changes which are forced by the buyer after the original contract had been signed and agreed (i.e. mainly forms of post-contractual opportunistic behaviour).

In practice, the power of the retailer in buying comes from the sheer range and diversity of the products it stocks. Even for a supplier that may have considerable market share (bringing it close to being classified as dominant on normal Article 86 principles) may not be in a position to resist a key retailer's demands. For

25. "Proceedings of the European Competition Forum", edited by Ehlermann and Laudati (1997), Chapters 7-9.
26. Article 8(2) of the 1986 Ordonnance.
27. Section 22 and 26(3) of the 'German Competition Act.
28. Related laws exist in Portugal, Spain and Greece.

the supplier, the retailer may represent a significant proportion of its overall sales (say 15%), but for the retailer that 15% may represent say only 1% or 2% of turnover, and thus the real power may lie with the purchaser and not the supplier. The purchaser wants the leading brands in its outlets but would not suffer that much, if it had to switch. It could also delist the supplier's brands and put in its own brands. In some cases, it may be possible for the supplier to shift its supplies to other outlets in the event that it loses the customer, but often that is not true, which means that the supplier is, in practice, very much in the hands of the purchaser. Moreover, even losing one key retailer may mean that the supplier loses critical economies of scale, raising its average costs and placing it a competitive disadvantage with other rival suppliers.

The various provisions in national law which exist focus on the idea, that a party infringes competition law if it abuses a situation of economic dependence. However, what the discussion in the Forum showed is that these provisions had been hardly used since they were introduced. In large part this has been due to a reluctance on the part of suppliers to complain (for fear of reprisals). But, even if a case is taken up it may well fail because of the requirements of showing (i) dependence, (ii) abuse and (iii) an effect on the market (which is notoriously difficult to show).

The overall conclusion is that the relevant provisions are not successful at present, (though they may have some limited deterrent effect) and that abusive buyer power may be something that could be tackled better as a concept of unfair competition than as one of anti-trust. However, it should be evident that unfair competition is usually associated with intellectual property rights and in this context it would indicate that the issue is really over the division of economic surplus (profits) rather any detrimental impact on total economic welfare (which is the essence of concerns in competition policy).

Interestingly the French Ordonnance has since been strengthened in this direction by the Act of 1 July 1996.[29] This prohibits as involving the abuse of a situation of economic dependence:

(a) listing fee practices imposed by distributors on producers without any actual, proportionate quid pro quo; (Article 36(3))

(b) the seeking of advantages under the threat of a sudden breaking-off of commercial relations; (Article 36(4))

29. Similarly, Germany and Portugal have also recently strengthened their abuse of economic dependence provisions. Germany has introduced "presumptions" of dependence in order to simplify proof of independence and its competition law has been amended to include a prohibition of loss-leading. Portugal has added a series of per se prohibitions against "abusive bargaining practices" which can be enforced without a complaint being filed.

(c) the abusive breaking-off without notice of established commercial relations; (Article 36(5)).[30]

The proceedings also discuss the use of EC Competition law in these situations.[31] It is argued that it is possible to intervene on the basis of Article 85 if the buyer power in question is created through horizontal agreements. However, there may be problems showing an infringement. For example, the agreements are often not between competitors since the groups in question are established on different territories (i.e. not direct competitors when selling). Moreover, since the purchasing power of the group has to be weighed against concentration on the supply side, it may be viewed as falling outside Article 85(1). In terms of using Article 86, the key issue is defining whether there is dominance on the part of the buyer. In this regard, the existence of "entry" or "listing fees" might be viewed as the compulsory remuneration of the supply listing service.

The extent to which "economic dependency" as a concept is appropriate in the design of competition policy remains contentious. In so far as dependency may result in adverse welfare effects, say because short term gains (e.g. from retailer cost reductions) are outweighed by long-term detriment to efficiency (e.g. due to raised costs and/or reduced quality as a consequence of underinvestment by suppliers) then it is of direct concern to competition policy. Otherwise, it may be better tackled under unfair competition laws - e.g. when it is simply a matter of distribution of economic rents. But apart from economic dependency there is still real concern that buyer power may distort both supplier and retailer competition, i.e. along standard horizontal market power concerns. In the United Kingdom, for example, there has traditionally been a view held by competition authorities that the power of the large supermarket chains has a positive effect since it brings down prices, and the benefit is generally passed on to the customer insofar as there is strong competition at the distributor level, but this position is currently under review, given increased concern that retailers may not be passing on benefits to consumers and retailer buyer power is in fact reinforcing their seller power (and vice versa).

The overall conclusion is that, apart from standard horizontal concerns where buyer power goes hand in hand with seller power, these are issues which are not easily dealt with in EC Competition law. There have been examples of wording applicable to buyer power and some cases[32] but for the moment these are issues which are more likely to be dealt with at a national level.

30. See, 1996 EC Commission Competition Report, p.320-1; Lamy Droit Economique 1998, p.501.
31. In particular, see pages 210-215.
32. For instance, *Filtrona Tabacalera* (1989 EC Commission Competition Report at point 61).

Nevertheless, beyond the issue of buyer power *per se* and its impact on supplier viability and other problems arising through economic dependency relationships, EC competition law has special bearing on other aspects, notably vertical restraints. Of course, in practice, key manifestations of buyer power arise through retailers placing contractual obligations on suppliers which go beyond the simple specification of price and quantity to be transacted - for example, exclusive supply obligations, slotting allowances, listing fees, and retroactive discounts. Such buyer-induced vertical restraints, as with all other classes, can have both pro- and anti-competitive effects (see Dobson and Waterson (1996), Dobson *et al.* (1998) and OECD (1998) for a discussion).

The EC policy treatment of vertical restraints has recently been the subject of much debate and reappraisal, with the release of the EC Green Paper in January 1997, and new proposals have subsequently been forthcoming (though a number of key revisions have yet to be finalised). New standard block exemption rules will apply across all sectors so that vertical restraints associated with retailers will receive the same treatment as with, say, restraints induced by producers. Buyer-induced restraints like exclusive supply obligations will generally treated as being neither blanket-prohibited nor, at the other extreme, freely permitted, but instead subject to market share rules - such that below a critical threshold (yet to be determined, but possibly around the 30% mark) a firm may receive an exemption in regard to Article 85(1), but above this level the practice could be investigated and, if found to be against the public interest, then prohibited.

In addition, the new block exemptions rules have a particular bearing on retailer alliances - viewing them essentially in terms of a vertical arrangement rather than simply a cooperative horizontal one. The suggestion is that associations of independent retailers could be permitted to benefit from block exemption regulations, provided that the independent retailers are small and medium-sized enterprises, the market share of the association remains below a certain threshold (20%) and that there are no territorial sales restrictions or other "horizontal aspects" which violate Article 85 (like price fixing).

This approach clearly has both an economic and social aspect in potentially benefiting smaller businesses by allowing them to compete more effectively with large, integrated retail groups. Moreover, this approach is somewhat similar to national law in some member states - notably Sweden, Denmark and Finland - which provide similar chain cooperation clearances. For instance, the so-called "ICA" block exemption in Sweden (named after the major grocery chain of that name) provides a general prohibition in Article 6 of the Swedish Competition Act for retail businesses which cooperate in chains, provided that their market share is not more than 20% of the relevant market. Practices exempted are those involving restrictions in cooperation on purchasing, common marketing, common setting of prices in common marketing, assistance with calculations, the reservation of rights to sell goods commonly purchased, and cooperation on business establishment, financial and administrative tasks and business/personnel development.

In the case of Denmark, certain agreements regarding chain cooperation are excluded from the prohibition in Article 6 of the Danish Competition Act provided the chain has less 25% market share and the arrangements do not infringe a defined "black list" of practices. Amongst other things, participants in a chain cooperation can be obliged to buy the assortment which the chain cooperation commonly markets, to buy a minimum quantity of the commonly bought products and follow ordering, invoicing and payment procedures, to market the chain and commonly bought products according to agreed patterns, not to participate in or have economic involvement with other competing chain operations, and to obtain approval from the other participants on the location of new business premises. However, the exemption does not apply if the participating businesses are prevented from (i) buying and marketing other products or services than those in the chain cooperation agreement, (ii) marketing their own businesses, and (iii) lowering their prices directly or indirectly.

In Finland, general exemptions exist for a retail chain's price cooperation for national, regional and local special offer campaigns in the consumer goods field, provided that a certain market share is not exceeded, sought by the Association of Finnish Retailers. Thus, for instance, the Finnish Office of Free Competition issued a one year exemption for local campaigns by marketing rings in the Kesko K-Group, provided that the market shares of those concerned did not exceed 20%.

Such exemptions in individual national member states, as well as the proposed change to EC law and policy, permit a greater coordination of business practices by formally independent businesses. This may permit members to benefit from scale and scope advantages and place them on a more equal competitive footing with large integrated rival retail groups, and thus promote a degree of retail diversity, particularly if it helps stem the decline of small independent businesses. Though, clearly on the buying side, the effect will be to raise buyer concentration which may exacerbate any economic dependency problems facing suppliers (particularly as the high threshold levels may permit such chains to have significant buyer power in their own right), yet it could conceivably benefit suppliers if it promotes more effective retail competition and provides an effective alternative means for producers reaching consumers (i.e. weakens the tight gate-keeper position of leading retailer groups).

PART II STATISTICAL ANALYSIS

Preamble

This part of the report includes most of the formal statistical analysis. It provides a bridge between the theoretical discussion of part I, and the case studies of part III. Thus, one purpose is to quantify some of the concepts just defined (e.g. buyer and seller concentration) for the EU retail food sector - both for individual member states and for the EU in aggregate. In addition, it sets the backcloth, or perspective, for the more in-depth case study analysis of four specific countries, and three specific products, described in the following chapters.

It includes two chapters. The first, chapter 6, draws on existing statistical sources to build up a series of specially constructed tables. These are designed to provide a summary of what is, in fact, a very disparate, often inconsistent, literature. In that sense, it is our interpretation of what is the "received picture" of the key structural dimensions of the sector. Chapter 7 has a more ambitious objective. It constructs a new database - the EU Retail Food Market Share Matrix - which is designed to yield an integrated, and internally consistent, statistical mapping of the structure of the sector at both the aggregate EU and national levels, and for the leading firms therein. We believe that this provides additional insights on some elements of structure, such as aggregate EU concentration and cross-border production, whilst improving the quality of information on others, e.g. measures of concentration at the national level. It also provides background information of relevance to our selection of case studies and the analysis (in the Appendices) of merger activity and cross-border alliances.

CHAPTER 6 – AN OVERVIEW OF MARKET STRUTURE BASED UPON EXISTING SOURCES

The overview is structured around 12 tables. Its objective is to draw together an opening picture of some of the salient features of structure. In effect, it is the result of a trawl of existing studies; in that sense it is not original. However, the existing literature is extremely disparate in coverage, and variable in the quality of its estimates. In providing our own overview, therefore, we have exercised considerable judgement in selecting and reporting only those estimates which we judge to be reliable and not internally inconsistent. We have also attempted to provide a synthesis which is wider in scope than any existing survey of which we are aware. Nevertheless, various gaps are apparent, and some elements of structure clearly require a more systematic documentation. The next chapter will attempt to fill in some of those gaps.

6.1 Market size and the size of retail outlets (Tables 6.1-6.3)

There is a rich academic literature within industrial organisation which explores the relation between size of market, the number of selling outlets and the size of those outlets[33]: this information can provide important insights into the nature of the underlying competitive process. In this particular context, there are two important dimensions.

- Over time, we know that there has been a continued decline in the number of retail food outlets in most, if not all, member states (e.g. Tordjman, 1994). This is apparently confirmed here by comparing columns 3 and 5 in Table 6.2. However, the two sources from which they are derived are clearly incompatible, and this provides a salutary example of how care must be taken in constructing internally consistent databases.[34] Across member states, there is obviously considerable variation. Table 6.1 reports the evidence at the aggregate level of all retailing, whilst Table 6.2 is confined to food retailing in particular.

33. Two recent (seminal) examples are Sutton (1991) and Bresnahan and Reiss (1991)

34. Even acknowledging that there has been a genuine contraction in the number of outlets between these years, the difference between these two sources in the total number of food outlets in the EU as a whole (400 thousand, as opposed to nearly 900 thousand) is incredible. Also, the different rankings for Germany between the two sources is disconcerting. This is a classic example of data inconsistencies and questions of reliability. Existing sources report wildly differing estimates of both the numbers of retail food outlets and the aggregate turnover of retailers in each member state. This derives from (i) familiar difficulties in defining small scale establishments, (ii) ambiguities in measuring turnover from food retailing, as opposed to the turnover of shops selling (amongst other things) food. In general, the data appear to be more reliable at the aggregate retail level.

Table 6.1: Size of the market across the member states

	per capita GNP ($000) 1995	population 1995 (mn)	Number of retail outlets (000)	inhabitants per outlet	Retail sales (Ecu bn)	Retail sales per outlet (Ecu 000)
Germany	27.5	81.9	415.3	196	373	898
France	25.0	58.1	343.4	169	292	850
UK	18.7	58.6	289.9	202	233	803
Italy	19.0	57.3	627.2	91	311	496
Spain	13.6	39.3	440.2	89	89	202
Netherlands	24.0	15.4	123.3	125	61	494
Belgium/Lux	25.7	10.6	110	92	33	300
Greece	8.2	10.4	170.7	61	25	147
Portugal	9.7	9.9	130.4	76	26	200
Sweden	23.8	8.8	52.8	167	29	547
Austria	26.9	8.1	37.7	214	31	822
Denmark	29.9	5.2	40.9	128	28	684
Finland	20.6	5.1	31.7	162	22	694
Ireland	14.7	3.6	35.9	101	12	334
EU15 Total		372.3	3236.5	115	1565	549

Sources: for GNP and population, World Bank, "World Atlas 1997"; for number of outlets and their sales, Corporate Intelligence on Retailing, as reported in "The European Retail Handbook 1998", for 'the latest available year'

Table 6.2: Numbers of Retail Food Outlets across the member states

	population 1995 (mn)	number of food outlets 1996/7 (000)*	inhabitants per outlet 1996/7	number of food outlets 1992/3 (000)**	inhabitants per outlet 1992/3
Germany	81.9	73.6	1111	44	1883
France	58.1	34.8	1667	87	670
UK	58.6	33.9	1667	60	975
Italy	57.3	114.6	500	296	193
Spain	39.3	79	476	177	223
Netherlands	15.4	6	2500	21	748
Belgium/Lux	10.6	13	769	37	289
Greece	10.4	17.2	588	54	194
Portugal	9.9	27.3	344	53	188
Sweden	8.8	6.2	1428	14	609
Austria	8.1	7.2	1111	7	1157
Denmark	5.2	3.2	1667	12	446
Finland	5.1	4.1	1250	7	743
Ireland	3.6	9.5	370	9	383
EU15 Total	372.3	429.4	867	876	425

*Sources: * La Distribution Alimentaire, ACNielson, 1998; ** "Retailing in the European Economic Area", EUROSTAT, 1996*

- In general, (and as might be expected), the larger member states tend to have more retail outlets. However, the number does not rise proportionately with population size, and this means that, when judged by the number of inhabitants served by each outlet, Germany, UK and France have the highest rankings, and Portugal, Greece and Ireland the lowest.

Given that a larger inhabitant per outlet ratio will translate, ceteris paribus, into higher turnover per outlet, there are obvious implications of this for the differential ability of retailers from the different member states to achieve scale economies. Quite obviously, this suggests that full exploitation of scale economies in the smaller member states may only be possible for a limited number of firms, giving rise to the possibility that there will be natural oligopolies. Moreover, some members currently record an "inhabitants per outlet" rating which is relatively low, given the size of the national market. This is especially true for Italy and (to a slightly lesser extent) Spain. (The reverse is true for Austria and, to a lesser extent, Netherlands and the Scandinavian countries.) This is sometimes ascribed historically to cultural north-south factors, but, whatever the reason, there might be the *a priori* expectation that future consolidation of outlet size will be greatest in Italy and Spain.

To add a wider perspective, Table 6.3 compares the EU as a whole with Japan and the USA. Judged on this evidence, EU15 has "too many" retail outlets compared to the USA, given their comparative sizes. However, "too many" is an ambiguous term, and this comparison probably only carries much meaning if one believes that the current level of integration within the states of the USA provides a useful indicator of what is to come with ongoing European integration. Japanese outlets, on the other hand, serve far fewer inhabitants than their European counterparts - as might be expected given the smaller population, although there is far less difference when judged by average turnover.

Table 6.3: Comparison of the EU retail sector with Japan and the USA

	population (mn)	number of enterprises (000)	population per enterprise	turnover (mn ecu)	turnover per enterprise (000 ecu)
EU15	372.3	2553	146	1261	494
USA	263.1	1530	171	1350	883
Japan	125.2	1519	82	682	449

Sources: Derived using "Panorama of EU Industry, 1997", p.21-15, Table 5.

6.2 Consumer Demand (Table 6.4)

There is a number of reasons why the nature of the competitive process should be sensitive to the demand growth environment. These range from the obvious (e.g. the well-known empirical regularity that new entry is more common in growing markets) to the more theoretically subtle (e.g. the possibility that collusive outcomes are more/less likely in periods of boom/recession.)

Whilst it should be acknowledged that "food" is an heterogeneous grouping which will include many specialist product lines of a "luxury" nature (i.e. income-elastic), there is little doubt that, in aggregate, it will have an income elasticity which is well below unity. What this means is that long-run demand is unlikely to exhibit dramatic growth (or cyclicality).

Given, moreover, the absence of much growth at all in the aggregate European macro-economy, the results shown in table 6.4 unsurprising.

Table 6.4: Growth in demand by member state

	% growth in total retail sales volume, 1990-94	value of food sales 1996 (1990=100)
Austria	n.a.	113.4
Belgium/Luxembourg	6.9	130.7
Denmark	6.4	123.8
Finland	n.a.	95.2
France	5.8	113.4
Germany	6.5	111.4**
Greece	-10.8	147.2***
Ireland	12.0	130.1
Italy	1.0*	139.9
Netherlands	7.9	117.4
Portugal	n.a.	180.3
Spain	n.a.	132.5
Sweden	n.a.	109.1
UK	8.6	140.0

* 1992-4; ** base=1991; *** value in 1994

Sources: Total retail sales, corrected for inflation, are derived from data in Table 2, p.21-14 of "Panorama of EU Industry 1997", EUROSTAT

Value of food sales are extracted from the individual country tables in "The European Retail Handbook", 1998. The definition of "food" varies considerably between countries. It invariably includes drink and tobacco, and often other products. These figures are for values, and are not corrected for differential inflation.

- Retail sales in aggregate grew only very sluggishly in real terms during the first part of the 1990s (column 1 of table 6.4). Amongst the member states shown, only Ireland achieved double figure growth between 1990 and 1994 (equivalent to an average annual growth rate of 2.9%), and annual average rates of between 1.5% and 2% were the norm.

- Reliable comparable estimates of real growth in retail food sales are elusive - the figures in column 2 of the table are uncorrected for price inflation - but, judged in nominal terms, it appears that the average annual growth rate, 1990-96, was only between 2% and 5% in most cases. Allowing for inflation, this implies that real growth must have been extremely sluggish.

Against this aggregate backcloth, it is clear that individual firms can only have achieved significant growth of turnover in real terms by increasing domestic market share, or from excursions into other member states, or by diversification within and beyond food retailing.

6.3 National Seller Concentration (Table 6.5)

In spite of the ready availability in the existing literature of market share and concentration estimates for most of the member states, it is by no means clear that previous calculations have been made on a like-for-like basis. Again, there is a variety of reasons why international comparisons are hazardous[35]. With this qualification, Table 6.5 presents the most recent available comparison across member states in CR5 - the 5 firm concentration ratio (showing the share of total food retail sales accounted for by the 5 largest firms), combined with estimates of how concentration has changed within each member state in recent years. The latter are probably the more reliable because similar accounting conventions are more likely to have been used when comparing a given country at two points in time than when comparing different countries at the same point in time.

- Concentration has risen significantly in most member states in recent years. On the evidence of this table, this trend has been pervasive, although it appears that the largest rises have tended to occur in member states in which concentration was initially more moderate.

To some extent, the latter finding is inevitable, given that CR5 is bounded from above. More substantively, however, it may reveal convergence across the member states.

35. These include the fact that some estimates do not correct firms' turnovers for non-food sales, some include buying groups as single entities, and different conventions are used in counting the turnover of very small firms (which affects the denominator in this summary index.)

- Whether or not there has been a tendency to convergence, significant differences between member states still remain. Currently, concentration is relatively highest in the small northern member states, and lowest in the southern states. Germany, UK and France lie somewhere between the two extremes.

Table 6.5: Five firm concentration ratios for food retailing

	Current Level*	**Change in recent years****		**Source**
		% points	period	
Austria	**79**	+14	1990-96	"Regal" 1997
Belgium/Luxembourg	**57**	+1	1988-92	AIM
Denmark	*(78)*			"Food Business"
Finland	**96**	+3	1990-96	Nielson, Finland, 1997
France	**67.2**	+7	1988-92	AIM
Germany	**75.2**	+10	1988-92	AIM
Greece	*(59)*			The Retail Pocket Book 1998
Ireland	**50**			
Italy	**30**			
Netherlands	**79**	0	1988-92	
Portugal	**52**			
Spain	**38**	+11	1988-92	AIM
Sweden	**87**	+24	1985-96	Supermarket Svenska Detaljhandel, 1997, for Food and Daily Goods
UK	**67**	+7	1988-92	AIM

*Sources: * The current level is for the latest available year, as reported in "La Distribution Alimentaire, 1998" (except for Denmark and Greece, for which the source is as shown in the final column). The sources for "changes in recent years" are various, and as shown. They are not necessarily directly comparable with the current levels.*
Note: These estimates are drawn exclusively from previous studies. See section 7.4 and Table 7.4 for our own estimates, based on the market share matrix.

Two additional points are noteworthy. First, the estimate for Germany needs to be treated with extreme caution. Other contemporary estimates place German CR5 at much lower levels (the difference depending on whether buying groups are treated as single entities.) Second, and more substantively, the traditional expectation from Industrial Organisation was that concentration will tend to be lower, *ceteris paribus*, in larger markets (which are able to support more efficient-scaled firms). On this expectation, concentration should be lowest in Germany, France and the UK. The fact that this is not so implies that this is a market in which sunk costs may be endogenous to the oligopoly game (whereby, increases in market size encourage firms to escalate their sunk costs such as marketing.) As such, the larger size of the market does not necessarily support more small-sized firms because they must be that much larger to compete with the market leaders.

This table, in particular, should be treated as provisional, pending the derivation of our own estimates in the next chapter, in which we are careful to distinguish buyer and seller concentration, and to employ consistent criteria of measurement.

6.4 The changing face of retail outlets (Tables 6.6 - 6.9)

Both from casual empiricism and previous studies, it is clear that the face of food retailing has undergone a major shift in recent decades. Due to the spread of, first, supermarkets and then hypermarkets, the demise of the traditional counter-service family-run store has been dramatic and probably irreversible.

Table 6.6: Grocery Turnover by Store Type

	hypermarkets		supermarkets		others*
	1996	*change since 1980*	1996	*change since 1990*	1996
Austria	12	*+3*	52	*+11*	36
Belgium/Luxembourg	16	-	70	*+5*	14
Denmark	17	*n.a.*	59	*+8*	24
Finland	22	*n.a.*	51	*-1*	27
France	51	*+16*	44	-	5
Germany	24	*+8*	52	*+7*	24
Greece	5	*+5*	51	*n.a.*	44
Ireland	12	*n.a.*	41	*n.a.*	47
Italy	13	*+13*	39	*n.a.*	48
Netherlands	5	*+3*	82	*+7*	13
Portugal	42	*+42*	28	*+10*	30
Spain	34	*+22*	25	*+5*	31
Sweden	13	*n.a.*	64	*+4*	23
UK	45	*+29*	42	*+2*	13

These figures are for percentages of national aggregate turnover accounted for by each type of outlet
** superettes & clerk service*
Source: ACNielson, Retail Pocket Book, 1998; La Distribution Alimentaire, 1998.
Definitions: Hypermarkets an 2,500 + sq.m.; Supermarkets an 400-2,499 sq.m.; others (including superettes and clerk service) an <400 sq.m. These definitions, whilst typical, are not universally adopted by all data sources. The above cited sources appear to have used these definitions.

- The diffusion of hypermarkets (columns 2 and 3 of table 6.6) is obviously well under way, but incomplete, in all member states.

According to these figures, it is most advanced in the UK and France (in line with their relatively high concentration levels). In most other countries, their is relative uniformity, with the hypermarket market share lying in the region 10-20% - with the exception of the two Iberian countries (both of which, interestingly, have been significantly penetrated by French retailers.) In nearly all countries, however, the increase in their market share since 1980 has been significant.

- The rise of the supermarket, on the other hand, appears to have peaked, with, typically, less dramatic growth in their share during the 1990s.

Obviously, this is part due to the rise of the hypermarket and part to their already high share at the turn of the decade. Nevertheless, there remains considerable scope for growth in both forms in some member states - notably Italy.

- The other major selling development has been in the rapid growth of discount stores

(This is a term which evidently intersects the hypermarket/supermarket nomenclature in most data sources.[36]) As can be seen from Table 6.7, discount stores increased their market share in all member states between 1991 and 1996 - typically by between 5% and 7%, although strangely (in the light of the previous point) by 10% in Italy. This may suggest the emergence of a dual industry in that country, the reasons for which deserve further attention. In the next chapter, we identify the role of specific firms (for example, Aldi and Lidl) in this development.

Table 6.7: Growth in numbers of discount stores

	1996		1991		growth in share
	% of national turnover	no. of stores	% of national turnover	no. of stores	(% points)
Austria	17	568	14	530	3
Belgium/Luxembourg	25	762	18	587	7
Denmark	20	739	15	544	5
Finland	12	820	10	760	2
France	7	1940	1	436	6
Germany	30	12130	24	8290	6
Greece	n.a.	n.a.	n.a.	n.a.	n.a.
Ireland	n.a.	n.a.	n.a.	n.a.	n.a.
Italy	10	2360	..	60	10
Netherlands	13	607	10	482	3
Portugal	9	314	2	30	7
Spain	9	2315	5	1180	4
Sweden	11	305	6	166	5
UK	11	1440	6	1129	5

Source: The Retail Pocket Book 1998, ACNielson

36. There appears to be no formal definition of what constitutes a distant store. Nevertheless, different sources appear to use the term consistently.

In general terms, franchising is an organisational structure which can be used to gain a leading market position without necessarily incurring the same magnitude of sunk costs as would full-fledged ownership. At this stage in our research, we have little to add on this issue beyond the data reproduced in Table 6.8 (which is not confined to food retailing).

Table 6.8: Franchising across the member states

	number of franchisors		**number of franchisees**	
	1993	**1994**	**1993**	**1994**
Austria	80	170	2500	2700
Belgium/Luxembourg	90	135	3200	2495
Denmark	42	42	500	500
Finland	..	..	..	..
France	500	500	30000	30000
Germany	370	420	15500	18000
Greece	..	..	..	..
Ireland	20	..	..	..
Italy	318	361	16100	17500
Netherlands	331	340	12640	12120
Portugal	55	70	..	..
Spain	117	250	14500	20000
Sweden	200	200	900	900
UK	373	396	18100	24900
EU Total	2496	2884	113940	129115

Source: table 14, p.18, "Retailing in the European Economic Area, 1996", EUROSTAT

With the growth of the hypermarket, in particular, new opportunities for scale economies and innovation have emerged. Perhaps most significant of all, is the growing use of electronic scanning at the check out.

- The diffusion of scanning has been rapid in recent years. In all member states for which data are available, its usage at least doubled between 1991 and 1994 (Table 6.9). Assuming a further acceleration post-1994, it must by now, have become a significant feature in the operations of many of Europe's leading retailers.

Not only does this technology permit a variety of internal economies, but also it provides the retailer with a rich source of detailed information about, for example, the elasticities of demand for specific brands. Undoubtedly, this has sharpened the retailer's capabilities - both in competing with its rivals and in bargaining with its suppliers, the food manufacturers.

Table 6.9: Diffusion of scanning (number of scanning stores)
(measured in hundreds)

	1994	1991	1987	1981
Austria	47			
Belgium/Luxembourg	35	0.1		
Denmark	27	0.1		
Finland	32			
France	200	66	16	
Germany	149	73	10	0.2
Greece				
Ireland	3	1	0.1	
Italy	68	37	5	0.1
Netherlands	30	11	4	
Portugal	44	3		
Spain	115	50	2	
Sweden	60			
UK	180	60	8	0.1
EU Total	990			

Source: Panorama of EU Industry, 1997, table 11, p21-19

6.5 Increased upstream control by the retailers (Tables 6.10 - 6.12)

A number of the features already described have fairly obvious implications for the buying (as well as the selling) power of retailers, but this section considers three additional features.

- <u>The retailers "private (own) labels" account for a significant and increasing proportion of total turnover.</u>

The data reproduced in table 6.10 are taken from different sources which, once more, seem incompatible across a run of years. However, we have been able to locate two comparable pairs of years for most countries, together with an up-to-date picture for 1997 for the countries in which penetration seems most pronounced. This is sufficient to draw the following conclusions, which are best treated in an ordinal, as opposed to cardinal, manner. First, private label penetration is highest amongst a cluster of countries which includes the UK, France, Germany and the Benelux countries. Amongst these, it is most pronounced in the UK, least pronounced in Germany with the other three countries somewhere in between[37]. Evidence for the other member states is rather more patchy. However, such as it is, it suggests that private labels are less pronounced in the southern and Nordic states. Second, all of the evidence shows increasing penetration in all countries over time. From the table, it is clear that this was

37. It is worth noting that most studies of private label record penetration rates even higher in Switzerland than in the UK. Of course, Switzerland is excluded from all comparisons in this project.

particularly rapid during the 1980s for the four countries shown. Further advances were also made during the first half of the 1990s in the UK, Belgium, Germany and Spain, but not in France or the Netherlands. The most recent data, for 1997, are unfortunately, not directly comparable with those for the earlier years. For this reason, one can not say for certain, whether the growth in private labels during the 1980s was sustained throughout the 1990s; perhaps there are some suggestive signs of a slow down.

Table 6.10 Private Label Penetration (Value Shares) by Member State (%)

	1997	**1995***	**1992***	**1990****	**1980****	**By leading retailers (1993/4)**
UK	42.3	29	25	31	22	Sainsbury 55; Tesco 46; Safeway 38; Asda 32.
Belgium/Lux	24.9	22	16			
Netherlands	19.1	16	16			
France	18.2	16	16	20	11	Monoprix 28; Casino 25; Intermarche 23; Carrefour 22; Auchan 19; Leclerc 10
Denmark		13				
Germany	12.6	11	6	24	15	Aldi 90; Metro 33; Tengelmann 18.
Spain		10	8	9	2	Eroski 24; Pryca 20; Alcampo 15
Portugal		9				
Austria		9				
Finland		8	8			
Sweden		8	8			
Italy		6	4			
Greece		3				

*Notes: These estimates have been taken from a variety of sources. While the inter-country comparisons within each year (i.e. down each column) are comparable, only the years marked with identical * are comparable with each other. Thus, 1980** and 1990** are comparable (Nielson/PLMA/Mintel from "The Grocer" 8.5.93); 1992* and 1995* are comparable (AC Nielson, "Private Label European Share and Price Trends, 1992-95".) The 1997 estimates are reported here as the most recent (AC Nielson, reported in "Food Business News", July 1998).*

- Another crucial, and very particular, feature of the retailing industry, as opposed to most others, is the prevalence of 'buying groups'.

In some cases, these are consortia of (often small) independent retailers who combine for the purposes of enhancing their joint purchasing power. In other cases, the groups appear to be more closely linked through quasi-joint ownership. On a substantive level, the existence of these groups means that there is an important distinction to be made between seller concentration in the retail market and buyer concentration with respect to the manufacturers. On a statistical level, many of the existing data sources, unfortunately, treat these groups in different ways, sometimes combining the sales of constituent firms, but sometimes not. For this reason, we shall not report the results from previous studies here, leaving an assessment of their impact to the next chapter.

- Partly because of the strength of leading retailers and the existence of buying groups, independent wholesalers appear to have a relatively minor role in the food chain

As an illustration, Table 6.11 reproduces a listing of the 20 largest European "grocery wholesalers. The striking feature of this Table is its heterogeneous nature. Note, for example, the leading role of the wholesaling activity of the French cigarette manufacturer (SEITA), the leading position of Nestle (a manufacturer), the relatively low ranking of UK wholesalers (in spite of the size of UK retailing). This is all suggestive of the fact that wholesaling generally lacks the very large independent operators which are commonly found in other forms of retailing on the one hand, and manufacturing on the other hand.

Table 6.11: EU's top 20 grocery wholesalers

	Country of origin	Sales (bn ecus)
Nestle	Switzerland	38.2
Food Ingredients Specialities	Switzerland	38.1
Rewe	Germany	14.6
Sandoz Nutrition	Switzerland	10.7
Casino Guichard Perrachon	France	9.5
Coop Valais	Switzerland	7.3
Spar Handels	Germany	6.9
Edeka	Germany	6.3
Faellesforenigen for Danmarks	Denmark	3.0
Booker Belmont	UK	2.9
SEITA	France	2.4
Nurdin & Peacock	UK	2.0
Merkur	Switzerland	2.0
Ramsvita	Switzerland	2.0
Tengelmann	Germany	1.8
Hofer & Curti	Switzerland	1.7
Systeme U Centre Regional Ouest	France	1.6
Schuitema	Netherlands	1.4
Skandinavisk Holding	Denmark	1.3
Fyffes	Ireland	1.1

Source: Panorama of EU Industry, 1997, p.21-8, table 6. All figures relate to 1994, except Edeka (1993).

Turning to the food manufacturing sector, the EU is dominated by some of the world's leading multinational firms (see the next chapter). Nevertheless, it is sometimes argued that even these firms are losing bargaining muscle vis-a-vis the leading retailers with the latter's expansion in recent years. As testament to this, AIM (1995) for example, shows that the sales turnover of the EU's 10 leading retailers far exceeds the FMCG turnover of the EU's 10 leading manufacturers. Although this is a striking statistic, it is misleading in at least two respects. First, necessarily, the turnover of a given retailer (A) buying exclusively from a given manufacturer (B) must always be the greater simply because of the retail mark up - no matter how small. Second, even the most diversified food manufacturer does not supply the full range of food products carried by the retailer, and a more germane comparison of relative size should be conducted at a far less aggregated level than "total food sales". Such a disaggregated analysis will form part of the analysis in Part III.

In anticipation, however, Table 6.12 reproduces a list of the world's leading 25 Food and Drink Manufacturing firms and investigates their presence within the EU using the "1993 EU market share matrix for manufacturing" (Davies, Rondi and Sembenelli, 1998). That matrix records the market shares of the 5 leading producers in, *inter alia*, each of the 15 "3-digit" food, drink and tobacco industries within EU manufacturing.

- Over half of the world's largest manufacturers have a leading presence in at least one manufacturing industry in the EU[38]. Even more strikingly, four firms in particular - Unilever, Nestle, Philip Morris and Danone (BSN) - re-appear frequently as the leaders in many individual product markets.

Clearly, any evaluation of the bargaining power of the two sides to the retailer-manufacturer relationship will need to recognise this considerable concentration on the manufacturing side as well.

38. In fact, the proportion may be even however because the base list of the world's leading manufacturers seems to involve some double counting, e.g. Nabisco appears along with Nestle.

Table 6.12: The World's Leading Food & Drink Manufacturers in EU Manufacturing

	World food sales ($US bn)	Total sales in EU food manufacturing (bn ecus)	Markets in which firm is one of the 5 leaders (NACE 3 digit)
Nestle	38.8	13.1	412,413,414,417,421,423,428
Philip Morris	33.4	11.3	413,417,421,423,429
Unilever	26.7	14.6	411,412,414,415,421
ConAgra	24.8		
Pepsico	19.1		
Cargill	18.7	2.4	411
Coca-Cola	18.0	1.8	428
Danone	14.2	8.9	427,428,423,413,417 419
Archer Daniels	13.3		
Mars	13	3.1	421,422
Grand Metropolitan	12.7	2.4	413,424
IBP	12.7		
Kinn	11.6		
CPC International	9.8	1.6	418,423
Anheuser-Busch	9.6		
Sara Lee	9.4	1.3	423
ABF	9.2		416,418,419,420
Heinz	9.1	1.5	423
Asahi Breweries	9.1		
Eridania Beghin-Say	9.1		
Nabisco	8.3		
Novartis	8.1		
Cadbury-Schweppes	7.7	3.0	428
Campbell Soup	7.7		
Guinness	7.6	2.2	424,427

Sources: The list of the world's leading manufacturers is taken from "The Retail Pocket Book, 1998", Nielson. Their operations in the EU food manufacturing industries is taken from the "EU manufacturing Market Share Matrix, 1993", UEA/CERIS. It should be noted that the absence of an entry in the third column does not necessarily mean that the firm concerned does not produce in the EU - it merely reflects the fact that the matrix only includes estimates for firms who are within the top 5 in at least one three digit industry.

6.6 Classifying the Member States

It is self-apparent, even from this brief overview, that significant differences exist between the individual member states. One objective of this project is to examine how far these differences are being eroded and whether there is a discernible process of convergence. Notwithstanding possible convergence however, we can categorise the member states into one of four broad groups:

- UK, Germany and France tend to have the largest firms and stores, and concentration is high in spite of relatively large market size. A number of the leading French and German firms are increasingly multinational.

- Amongst the smaller northern member states - Sweden, Finland, Denmark and the Netherlands - concentration is again high (sometimes very high) and advanced retailing methods have achieved high penetration. On the other hand, they tend to be dominated by local indigenous firms who, whilst large relative to the market, are quite small in absolute terms.

The other two groups are rather more fluid and less well-defined.

- Austria, Belgium (and perhaps Ireland) are small countries, strongly influenced by adjacent larger neighbours. Undoubtedly, these are less insular markets than those of the previous group, and Austria, in particular has a strong German presence.

- In the southern member states - Italy, Portugal, Spain and Greece - traditional retailing structures are much more evident, and concentration is discernibly lower. However, generalisations for this group, in particular, may be dangerous. Certainly for the first three countries, as various of the above tables reveal, change has been particularly rapid in very recent years (e.g. the fast diffusion of hypermarkets), probably partly the result of multinational expansion by leading firms from the first group. Moreover, Italy is an enigma. Not only is it obviously out of line with the three other large member states, but also there is (admittedly poorly documented) suggestions of a significant north-south heterogeneity within that country.

Quite obviously, whilst these groupings may be presentationally useful for some purposes, crude generalisations should be avoided.

CHAPTER 7

THE EU RETAIL FOOD MARKET SHARE MATRIX

7.1 Introduction

This chapter builds on the overview of the previous chapter - which was based mainly on data and tabulations more or less already in the public domain - by constructing a "market share matrix for aggregate EU food retailing" for 1993 and 1996. The objective of this matrix[39] is to provide an integrated and harmonised database which contains most of the key information on the structure of the market and leading firms, but without being unmanageably large. Therefore, it focuses only on the main players. This keeps the matrix reasonably compact and easy to manipulate. (It would be easy to update as new data become available.) However, because of the concentrated nature of the market, this compactness is not at the expense of coverage - as will be seen, although the matrix includes only about 50 firms, they account for half of the entire turnover of food and daily goods retailing in the EU.

Section 7.2 presents the EU retail market share matrix for 1996, and its counterpart for 1993. This provides an opening picture of the main features of structure and recent changes. The following sections each pursue the individual elements of structure in more detail. Section 7.3 examines aggregate concentration at the EU level, and section 7.4 compares the concentration of sellers in each member state. Section 7.5 turns to the increasing extent of cross-border ("multinational") activity. Section 7.6 examines buyer concentration, by adjusting the estimates of seller concentration to allow for buying groups at the national level, and cross-border alliances at the aggregate EU level. Section 7.7 focuses more explicitly on the individual firms: it identifies the most prominent multinationals and discounters and constructs a league table of the leading firms by typical size of outlet. Section 7.8 switches attention on to the food manufacturing industries - presenting concentration ratios at both the EU level and for individual member states.

7.2. The EU retail food market share matrix

7.2.1 The underlying concept

As already mentioned, this stage of the statistical work is based on the newly constructed database which we refer to as the Market Share Matrix for Food Retailing in the EU. This draws on a concept first used in previous work on the structure of Manufacturing in the EU (Davies *et al*, 1996). Its purpose is to provide a consistent mapping of some of the main features of the structure of this sector - both for the EU

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39. This matrix draws upon the methods and experience gained from constructing similar matrices for the manufacturing sector of the EU for the years 1987 (Davies, Lyons et al, 1996) and 1993 (Davies, Rondi and Sembenelli, 1998).

defined as a single entity, and for individual member states. In particular, it should include sufficient information to provide estimates of concentration of markets and the structure of the leading firms. However, emphasis is placed on confining data collection to manageable proportions, and, therefore, the database should be as compact and manageable as possible.

A basic requirement is that the matrix should include all of the major players on the EU stage. Thus, we start by identifying a set of leading firms, where a firm is defined as a leader if it satisfies one, or both, of two criteria:

- it is amongst the 5 leaders (largest firms) in at least one of the member states, and/or
- it is amongst the EU's largest 20 food retailers when judged by its aggregate EU food turnover.

In a fairly obvious sense then, a sample satisfying these criteria should include all firms with at least some significant degree of retail selling power at the EU or national level.

7.2.2 Constructing the matrix

In order to make comparisons standardised, wherever possible, we have used a single source - the European Retail Handbook (CIR, 1998) - for our data on size. Company size is measured by the turnover of outlets devoted primarily to selling food, drink and tobacco. However, these outlets typically also sell other products (especially superstores, hypermarkets), and this can sometimes lead to unavoidable overestimates. On the other hand, we do not include the sales of these firms through non-food outlets such as DIY shops. Moreover, all estimates are confined to the firms' operations within EU15.

Special attention has been paid to deriving comparable and consistent estimates of thesize of the market (i.e. each member state's total retail food sales.) This is rarely discussed in much detail in most previous studies of market shares in the food retailing literature, and researchers often fail to document their sources. However, by deconstructing previous estimates, it appears that many are seriously flawed by a failure to compare like with like: sometimes, they define the market, in effect, as merely the sum of the turnovers of just multiple grocers; sometimes, adjustments for non-food sales are made for some countries, but not for others. One manifestation of this is that different researchers have produced wildly different estimates of concentration for the same country (see Table 7.5 below for examples).

In constructing our own estimates of total market size, we have tried to be as encompassing as possible - including an allowance for the turnovers of specialists and traditional outlets, as well as those of the multiple grocers. We have used, as a starting point, the various time series magnitudes reported in the European Retail Handbook for "Total Food, Drink and Tobacco Sales", most of which have been derived from official primary sources. However, these have also been scrutinised by comparing with macro aggregates (GDP, GDP per head and aggregate consumption) in order to ensure comparability, for example, on marginal and average propensities to consume retail food. For some countries (e.g. Benelux and Germany), this has caused us to revise upwards the published estimates of total market size. For this reason, our estimates of total market size are somewhat larger than those implicit in most previous studies by consultancy firms; correspondingly, our estimates of concentration tend to be somewhat lower.

One other major difference from some previous studies is the exclusion, at this stage, of retail buying groups. More precisely, we do not assume that a buying group is a single seller (but see below for adjustments when turning to buyer concentration.)

7.2.3 The Matrix for 1996

Table 7.1 reports the basic dimensions of the matrix for 1996. This is the most recent year for which comprehensive and consistent information is available across all firms and member states. (However, this does mean that some of our estimates are slightly out-of-date, especially in those member states in which there have been important mergers in the last two years.)

Table 7.1 The 1996 EU Retail Market Share Matrix
(a) Broad Dimensions

		number	sales (ECUs bn)	share of retail food (%)
Countries		14		
Firms		56	379.5	49.7
Entries		113		
	Leading	70	334.2	43.7
	Non-leading	43	45.4	5.9
Total EU Market Size			763.9	

The matrix covers the 15 member states in EU15 (but with Belgium and Luxembourg consolidated into a single entity). There are 56 firms on the matrix. Of these, 52 qualify by virtue of being one of the five leaders in at least one member state. In principle, 70 firms (5*14) could qualify under this criterion; however, nine firms occupy a leading position in more than one member state: Metro (6), Aldi (5), Promodes (3), Auchan (3), Carrefour (2), Rewe (2), Tengelmann (2), Tesco (2), and Ahold (2).

These 55 firms include 17 of the 20 largest EU food retailers. The three other firms, Lidl & Schwarz, Casino and Spar Handels, have also been included under the second criterion - by virtue of their absolute size, they are amongst the EU's 20 largest food retailers even although they are not in the top 5 in any particular member state.

In 1996, the aggregate turnover of these firms in food retailing in the EU amounted to 380 billion ecus - almost exactly half of the total turnover of food retailing in EU15. Of this, 334 billion ecus was accounted for by their "leading" (i.e. top 5) operations; this amounts to 43.7% of total EU food retailing, and this is therefore the (weighted) average 5 firm concentration ratio in individual member states.

Table 7.1(b) shows the matrix in full. Reading down each column provides a picture of the upper tail of the size distribution for each member state; reading across each row reveals the pattern of each firm's multinational activities (where applicable).

Table 7.1(b) The 1996 EU Retail Market Share Matrix in full

			Turnover (bn ecus) in member state:														
			A	**BL**	**D**	**FIN**	**FRA**	**GER**	**GRE**	**IRE**	**IT**	**N**	**P**	**SP**	**SW**	**UK**	**TOTAL**
	Firms:	origin															
1	Rewe	GER	3.5				0.1	21						0		0.5	25.3
2	Metro	GER	0.9	0	0.3		2	16	0.3		1.5	1.2	0.7	0.7			24
3	Aldi	GER	1.5	1.2	0.5		1	17				1.1				0.8	23.6
4	Promodes	FRA					16		0.2		1.3		0.3	5.1			23.4
5	Edeka	GER	0		0.2			20									20.6
6	Carrefour	FRA					16				0.5		0.3	3.7			20.4
7	Intermarche	FRA		0.2			19						0	0.1			19.7
8	Auchan	FRA		0			15				0.4		1	2.7			19.4
9	Tesco	UK								1						16	17.2
10	Leclerc	FRA					16						0.1	0.1			15.9
11	Tengelmann	GER	0.7					13			0.7	0.6		0.1			15
12	Sainsbury	UK														12	12.5
13	Lidl & Schwarz	GER		0			1.2	9.6			0.5		0	0.3		0.3	12
14	Casino	FRA					10										10.3
15	Spar Handels	GER						9									9.01
16	ASDA	UK														8.5	8.49
17	Safeway	UK														8.1	8.14
18	Ahold	N										6.6	1.4				7.95
19	Coop Italie	IT									6.7						6.71
20	ICA	SW													6.5		6.55
21	GIB group	BL		4.6													4.62
22	FDB Coop	D			4.6												4.57
23	Eroski	SP												3.3			3.3
24	Somerfield	UK														4	3.95
25	Spar Osterreich	A	2.5								1.1						3.57
26	Delhaize le Lion	BL		2.9			0.3		0.3								3.56
27	Dansk Supermk	D			2.7			0.4								0.4	3.43
28	Kesko	FIN				3.3											3.34
29	La Rinascente	IT									3.2						3.2
30	De Boer Unigro	N		0.3								1.9		0.5			2.83
31	KF Konsum	SW													2.8		2.75

Table 7.1(b) continued

			Turnover (bn ecus) in member state:														
			A	**BL**	**D**	**FIN**	**FRA**	**GER**	**GRE**	**IRE**	**IT**	**N**	**P**	**SP**	**SW**	**UK**	**TOTAL**
32	D-Gruppen	SW													2.7		2.71
33	SOK	FIN				2.7											2.66
34	GS(Benetton)	IT									2.6						2.58
35	Vendex	N		0.4								2.1					2.45
36	Systembolaget	SW													2.4		2.35
37	Hipercor	SP												2.3			2.30
37	Tuko	FIN				2.3											2.3
39	Esselunga	IT									1.7						1.74
40	Sonae (Promodes 22.5%)	P											1.7				1.69
41	Louis Delhaize	BL		1.6													1.61
42	ADEG	A	1.6														1.59
43	Colruyt	BL		1.5													1.52
44	Alko	FIN				1.4											1.42
45	Axel Johnson	SW													1.1		1.12
46	Dunnes	IRE								1.1				0			1.09
47	Dagrofa	D			1												1.01
48	Musgrave	IRE								1							0.97
49	Marinopoulos	GRE							0.8								0.83
50	Tradeka	FIN				0.8											0.82
51	Elomas	GRE							0.5								0.51
52	Centralkob	D			0.5												0.49
53	Veropoulos	GRE							0.5								0.48
54	Sklavenitis	GRE							0.4								0.44
55	BWG	IRE								0.4							0.41
56	Superquinn	IRE								0.4							0.41
Total matrix firms			11	13	9.8	11	98	107	3.1	3.9	20	14	5.5	19	15	51	380
National market turnover			17	19	16	12	163	194	9.2	6	133	26	9	52	20	88	764
Top 5			10	12	9.3	11	83	88	2.6	3.9	16	13	5	17	15	49	334
C5 (%)			59	62	59	89	51	45	28	64	12	50	56	32	78	56	43.7

As can be seen, firms from Germany, France and the UK occupy all of the 17 top rankings. This reflects partly the size of the market in these three large countries, but it is also a manifestation of significant cross-border operations of some of these firms.

It should be stressed that the table is confined only to each firm's EU food retailing turnover. In some cases, this is significantly smaller than the firm's aggregate world turnover. This is for two reasons: (i) some firms have important non-food retailing activity within the EU (diversification), e.g. Sainsbury in DIY and Benetton in textiles; (ii) some have multinational food activities in the rest of the world, e.g. Ahold in the USA, and some of the German firms in Eastern Europe.

7.2.4 The Matrix for 1993

All firms on the 1996 matrix have been tracked back to 1993, and the matrix has been re-constructed for that year by also taking into account any significant entry/exit between the two years. From the summary statistics (Table 7.2(a)), it can be seen that five more firms qualified for inclusion in 1993. The most notable exitors 1993-96 were Docks de France, Karl Wlaschek, Makro, and Power (ABF), each of which was acquired, and Konsum Osterreich, which collapsed.

Table 7.2 The 1993 EU Retail Market Share Matrix
(a) Broad Dimensions

		Number	sales (ECUs bn)	share of retail food (%)
Countries		15		
Firms		61	315.1	46.3
Entries		103		
	Leading	70	276.9	40.7
	Non-leading	33	38.2	5.6
Total EU Market Size			681.2	

Although there were more firms on the 1993 matrix, they accounted for fewer non-zero cells and a proportionately smaller aggregate turnover. As will be seen, this implies that both concentration and multinational activity have increased between these two years.

Table 7.2(b) The 1993 EU Retail Market Share Matrix in full

			Turnover (bn ecus) in member state:													
			A	BL	D	FIN	FRA	GER	GRE	IRE	IT	N	P	SP	SW	UK	TOTAL
1	Edeka	Ger			0.49			20.5									20.9
2	Metro	Ger	1.02		0.16		1.84	16.5	0.1		1.24						20.8
3	Promodes	Fra					13.6	1.34	0.1		0.34			3.38			18.8
4	Leclerc	Fra					17.9							0			17.9
5	Aldi	Ger	1.06	0.97	0.39		0.21	13.9				0.9				0.23	17.6
6	Intermarche	Fra					17				0.1		0	0			17.1
7	Carrefour	Fra					12.3				0.1		0.24	2.97		0.2	15.8
8	Rewe	Ger						14.3									14.3
9	Tengelmann	Ger	0.51					10.2			0.55	0.46					11.7
10	Sainsbury	UK														11.7	11.7
11	Tesco	UK					0.49									10.9	11.4
12	Auchan	Fra					8.4				0.1			1.57			10.1
13	Casino	Fra					8.73										8.73
14	Safeway/Argyll	UK														7.28	7.28
15	Lidl & Schwarz	Ger					0.22	6.58			0			0			6.87
16	ICA	SW													6.73		6.73
17	Dock de France	Fra					6.25							0.38			6.63
18	Ahold	NL										6.12	0.5				6.62
19	Spar Handels	Ger						6.37									6.37
20	ASDA	UK														6.24	6.24
21	Coop Italie	IT									5.94						5.94
22	GIB group	BL		4.48													4.48
23	Somerfield/Isosceles	UK														3.77	3.77

Table 7.2(b) continued

			Turnover (bn ecus) in member state:														
			A	BL	D	FIN	FRA	GER	GRE	IRE	IT	N	P	SP	SW	UK	TOTAL
24	FDB Coop	D			3.7												3.7
25	Kesko	F				3.29											3.29
26	Standa	IT									2.89						2.89
27	Karl Wlaschek	A	2.49								0.1						2.59
28	KF Konsum(Coop)	SW													2.53		2.53
29	Systembolaget	SW													2.5		2.5
30	D-Gruppen	SW													2.5		2.5
31	Delhaize "le Lion"	BL		2.32					0.18								2.49
32	Spar Osterreich	A	1.91								0.29						2.21
33	SOK	F				2.13											2.13
34	Vendex	NL		0.18								1.83					2.01
35	La Rinascente	IT									2						2
36	Unigro	NL		0.45								1.25		0.28			1.98
37	Dansk Supermkt	D			1.8												1.8
38	Alko	F				1.74											1.74
39	GS	IT									1.61						1.61
40	Louis Delhaize	BL		1.56													1.56
41	Konsum Osterreich	A	1.53														1.53
42	Tuko	F				1.48											1.48
43	Makro	NL										1.19	0.26				1.45
44	ADEG	A	1.41														1.41
45	Esselunga	IT									1.39						1.39
46	Axel Johnson	SW													1.11		1.11
47	Colruyf	BL		1.1													1.1
48	Power	IRE								1.06							1.06
49	El Corte Ingles	SP												1.03			1.03
50	Sonae (Promodes 22.5%)	P											1.01				1.01
51	Dagrofa	D			0.98												0.98
52	Dunnes	IRE								0.93							0.93
53	Musgrave	IRE								0.86							0.86
54	Pao de Acucar	P											0.74				0.74
55	Tradeka	F				0.54											0.54
56	Marinopoulos	Gre							0.35								0.35
57	Superquinn	IRE								0.25							0.25
58	BWG	IRE								0.19							0.19
59	Sklavenitis	Gre							0.19								0.19
60	Veropoulos	Gre							0.12								0.12
61	Centralkob	D			0.11												0.11
	Total all matrix firms		9.9	11.1	7.6	9.2	87.0	89.7	1.0	3.3	16.6	11.8	2.8	9.7	15.4	40.3	315.1
	National market turnover		15.5	17.3	13.6	9.8	146	167	8.2	5.3	127	21.5	7.5	43.2	19.4	79.3	681.2
	Top 5		8.4	10.4	7.4	9.2	69.6	75.4	0.9	3.3	13.8	11.3	2.7	9.3	15.4	39.9	276.9
	C5 (%)		54.2	60.2	54.2	93.5	47.5	45.1	10.9	2.0	10.9	52.5	36.5	21.6	79.3	50.2	40.7

7.3 Aggregate Concentration at the EU level

Perhaps the most striking "headline" from the matrix is that about 50 firms account for almost exactly half of the entire turnover of the EU Food retail sector. This is a rough, "first-blush", indication of the extent of concentration at the level of the EU, taken as a single entity.

(5)

However, it is only a crude measure which needs some refinement. In particular, we should remember that not all of the matrix firms are particularly large - especially in the lower tail, there are a number of quite small firms which qualify as leaders in the smaller member states. Therefore, it is more meaningful to concentrate only on the upper part of the matrix, remembering that, by construction, it includes the 20 largest food retailers[40].

As shown in Table 7.3, the top 10 firms account for 27.4% of total EU retail food turnover, and the next 10 for a further 12.6%. Thus, the top 20 account for 40% of total EU retail food activity. Superficially at least, this would appear to indicate a very high level of concentration in a sector which is by its nature geographically dispersed, and traditionally fragmented.

Table 7.3 Aggregate Concentration

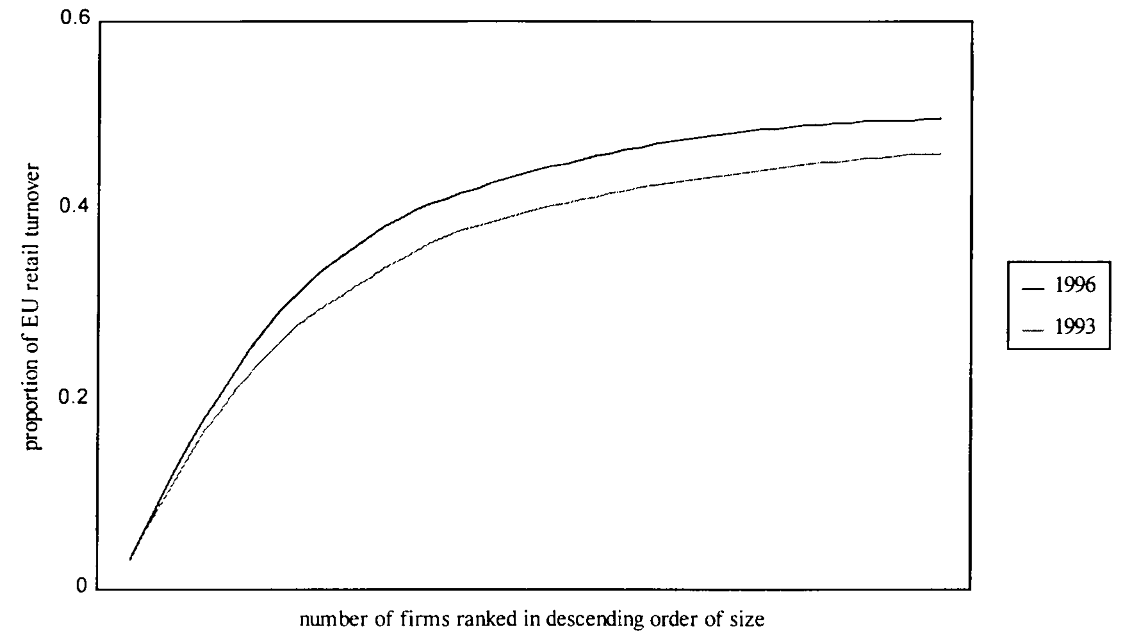
Cumulative Distribution of Aggregate Size (%)		
Share of firms ranked:	**1996**	**1993**
1- 10	27.4	24.5
11-20	12.6	11.3
21-30	4.9	5.0
31-40	3.0	2.9
41-50	1.4	1.8
top 50	49.3	45.5

However, in the absence of obvious comparators, "high" has a somewhat empty ring to it - in what sense is 40% high? And compared to what? First, it is certainly high relative to the share of the top 20 firms in EU manufacturing: according to Davies et al (1998), the top 20 in that sector accounted for only 14.5% of sales in 1993. Second, and on the other hand, it does not appear to be as high as reported concentration in the US retail food sector. According to estimates attributed to the Harvard Business School, and reported in *Food Business News*, July 1998, the top 10 in the US account for 37% of total US retail food turnover (i.e. about 10% points more than our figure for the EU.)

In truth, however, neither of these comparisons is particularly illuminating. After all, manufacturing is much larger, and a more heterogeneous sector than retail food, and it is hardly surprising that it records lower concentration. Similarly, a comparison with the US retail food sector might also be misleading: first, we are not confident that the above quoted US estimate is based on a measure of total market size (the denominator) which is as broad-based as the one we have used for the EU. Second, there is perhaps no reason for expecting the EU to be similar to the US, at least at this stage in European integration.

40. In fact, the matrix probably also includes most of the top 30 firms - the only probable top 30 firms not on the matrix are Cora, Comptoirs Modernes, and KwikSave.

Figure 7.1 Cumulative Aggregate Concentration Curves



Ultimately, the most important comparison is inter-temporal - how is aggregate EU retail food concentration changing over time? Unfortunately, here, we are confined to just a comparison of our own estimates for 1993 and 1996. Nevertheless, even over this relatively short three year period, there appears to have been a significant increase in EU concentration. As shown in the table, there was an increase of 4.2% points in the share of the top 20 between 1993 and 1996. Moreover, the table and figure 1, which show the cumulative concentration curves for the two years, reveal that the increased share of matrix firms is almost entirely attributable to the top 20. Indeed, the next 30 firms actually suffered a joint loss of 0.4% points between the two years. This is due, presumably, in part to the rapid growth of the very largest firms, but also in part to the exit of some important medium-large firms, as described in the previous section.

7.4. Concentration within individual member states

Tables 7.4 to 7.6 turn the focus on to concentration within the individual member states. Table 7.4 confirms that the above increase in concentration at the EU level is mirrored by typically increasing concentration in the individual member state- by about 3% points on average between 1993 and 1996.

It also confirms important differences between member states. Broadly speaking, the ranking of member states is as described in the previous chapter. The highest 5 Firm concentration ratios are to be found in Finland and Sweden, and the lowest in the southern countries - Greece, Spain, Italy. The UK, France and Germany lie within the middle of the range. Perhaps most interestingly, there appear to have been significant increases in concentration in Portugal, Spain, Austria, Greece and the UK. Moreover, since these estimates refer to 1996, they will not reflect the effects of continued merger activity post-1996 in Spain, Portugal and the Netherlands in particular. In those countries, concentration is probably now higher than shown in the table.

Table 7.4: Five Firm National Concentration Ratios (%)

	1996	1993
Austria	59	54
Belgium/Lux	62	60
Denmark	59	54
Finland	89	94
France	51	48
Germany	45	45
Greece	28	11
Ireland	64	62
Italy	12	11
Netherlands	50	52
Portugal	56	36
Spain	32	22
Sweden	78	79
UK	56	50

Table 7. 5 Comparisons of C5 from different sources

	Our estimates 1996	LDA 1997	PBUK 1996	EH 1996	AIM 1992	HBS	OXIRM	Average of other estimates
Austria	58.6	79	67.9	72.9				73.3
Bel/Lux	61.6	57	56.9	77.4	53	60		60.9
Denmark	59.5		48			78		63.0
Finland	89.1	96	95.4	97.5				96.3
France	50.6	67.2	60.1		49	65		60.3
Germany	45.4	75.2	41.5	73.5	37			56.8
Greece	28.0		58.7					58.7
Ireland	64.2	50	50.4					50.2
Italy	11.8	30	35			21	58.5	36.1
Netherlands	50.4	79	76.7	71.7	59			71.6
Portugal	55.7	52	52.9				55	53.3
Spain	32.1	38	34.6		23		47.7	35.8
Sweden	77.9	87	70.5	93.5				83.7
UK	56.2	67	65.2		60	63		63.8
Average	52.9							61.7

Other Sources: LDA La Distribution alimentaire
AIM AIM
PBUK UK Pocketbook
EH European Handbook
OXIRM referred to in "Food Retailing in Southern European Countries", European Regional Review, 1998 (date of estimate not reported in source)
HBS Harvard Business School (date of estimate not reported in source)

As a reference point, Table 7.5 digresses briefly by comparing our estimates with those from previous studies. As can be seen, our estimates are typically lower - by about 10% points on average[41].

Tables 7.6 and 7.7 have a more substantive role. They delve behind the simple C5 summary statistics. Table 7.6 identifies the magnitudes of size inequalities *amongst* the top 5 firms within each country.

Table 7.6 A Typology of market structures based on market shares amongst the top 5

	C5	MS1	MS2	MS3	MS4	MS5	
Austria	58.6	20.5	14.5	9.3	9.0	5.2	duopoly
Belgium/Lux	61.6	24.0	15.2	8.3	7.9	6.1	dominant firm
Denmark	59.5	29.2	17.3	6.4	3.4	3.1	Dominant firm
Finland	89.1	28.3	22.5	19.4	12.0	7.0	triopoly
France	50.6	11.9	10.1	9.7	9.6	9.4	symmetric oligopoly
Germany	45.4	10.9	10.5	8.9	8.4	6.7	Symmetric oligopoly
Greece	28.0	9.0	5.6	5.2	4.8	3.4	Unconcentrated
Ireland	64.2	17.9	16.6	16.2	6.7	6.7	triopoly
Italy	11.8	5.1	2.4	1.9	1.3	1.1	unconcentrated
Netherlands	50.4	25.7	8.0	7.6	4.7	4.4	dominant firm
Portugal	55.7	18.7	14.9	11.1	7.6	3.4	triopoly
Spain	32.1	10.0	8.6	7.1	5.0	1.4	Unconcentrated
Sweden	77.9	33.0	13.8	13.7	11.8	5.6	Dominant firm
UK	56.2	18.5	14.2	9.7	9.3	4.5	duopoly
Average	52.9	18.8	12.5	9.6	7.3	4.9	

Definitions: *(based on identifying the "natural breaks" within the top 5)*

Dominant Firm	MS1>20% and MS1>1.5*MS2
Duopoly	MS2>12.5% and MS2>1.5*MS3 but not dominant firm
Triopoly	MS3> 10% and MS3> 1.5*MS4, but not dominant firm or duopoly
Symmetric oligopoly	None of the above; each firm is "sizeable" (MS>8%), and at least 67% the size of its immediate, higher ranked, neighbour
Unconcentrated	No firm has MS>10%, and CR5<33%

41. This appears to be for two reasons. First, as mentioned earlier, many previous estimates have been based on measures of market size which are too low, and this means concentration will have been over-estimated. Second, some previous estimates have included buying groups as single entities, and this obviously increases the share of the top 5 "firms". For example, this is presumably the reason why one source cites C5 for Italy as high as 58.5%. The other major feature of this table is the surprisingly wide variance in estimates amongst previous estimates for the same country. For example, C5 in Italy varies between 21% and 59%, in Germany between 37% and 74%, and so on. This underlines the need for a set of estimates which have been constructed on an internally consistent basis. Hopefully our estimates have achieved that objective.

Table 7.7 Major mergers & acquisitions since 1992

Country	year	Acquiring firm		Acquired firm	
		Name	Status	Name	Status
AUSTRIA	1996	Rewe (GER)	MNE entry	Billa (from Karl Wlaschek)	#1
	1998	Rewe (GER)	#1	J.Meinl	#6
	1998	Edeka (GER)	MNE entry	Adeg	#3
BELGIUM	1995	Promodes (F)	MNE entry	Mestdagh (25% stake)	top 10
DENMARK	1997	FDB	#1	NKL/KF	
		(JOINT VENTURE WITH SWEDISH &NORWEGIAN FIRMS)			
FINLAND	1996	Kesko	#1	Tuko (not allowed by EC)	#3
FRANCE	1992	Tesco (UK)	MNE entry	Catteau	top 20
	1994	Delhaize le lion (BL)	MNE entry	PG	top 20
	1996	Auchan	#5	Docks de France	#6
	1997	Promodes	#3	Casino (contested, did not occur)	top 10
	1997	Carrefour	#2	Cora (increased holding)	#7
	1997	Casino	#6	Leader Price	top 20
	1997	Promodes	#3	Catteau (ex Tesco)	top 20
	1997	Comptoirs Modernes	#8	PG (ex Delhaize le lion)	top 20
	1997	Casino	#6	Franprix	top 20
	1998	Carrefour	#2	Comptoirs Modernes	#8
GERMANY	1992	Metro	#4	ASKO	#6
	1997	ITM/Intermarche (F)	MNE entry	Spar Handels	#6
	1997	Spar Handels	#6	Pro Verbraucher	top 30
	1998	Metro	#4	Alkauf	top 10
	1998	Walmart (US)	MNE entry	Wertkauf	top 20
	1998	Metro	#4	Kriegbaum	top 20
	1998	Spar Handels	#6	Pfannkuch	top 30
GREECE	1992	Delhaize le Lion (BL)	MNE entry	Alfa Beta	top 10
	1995	Promodes (F)	MNE entry	Marinopoulos (20% hldg)	#1
IRELAND	1997	Tesco (UK)	MNE entry	Power (acq from ABF)	#2

Table 7.7 continued

Country	year	Acquiring firm		Acquired firm	
ITALY	1993	Carrefour (F)	MNE entry	Gran Sole	top 20
	1995	La Rinascente	#3	CEDIS	top 20
	1996	Promodes (F)	MNE entry	Garosci (joint venture)	top 10
	1997	Promodes (F)	MNE entry	GS (acquired a holding)	#5
	1997	Auchan/Leroy (F)	MNE entry	La Rinascente (JV)	#3
	1998	Tengelmann (GER)	MNE entry	Gruppo PAM	top 10
	1998	La Rinascente -Auchan	#I	Colmark	n.a.
NETHERLANDS	1992	Ahold	#1	Schuitema	#10
	1997	Metro (GER)	MNE entry	Makro-SHV	#10
	1997	De Boer	#4	Unigro (merger)	#4
	1998	Vendex-de Boer-Unigro	#3	KBB	#10
	1998	Vendex	#3	Bijenkorf	n.a.
	1998	Vendex	#3	De Boer - Unigro	#4
PORTUGAL	1992	Ahold (NL)	MNE entry	Jeronimo Martins (49%)	#2
	1997	Promodes (F)	#1	Lojas de Desconto	top 10
	1997	Pao (Auchan) (F)	#3	Minipreco	top 10
SPAIN	1997	Promodes (F)	#1	Simago	top 20
	1998	Gidae	#4	merger: Eroski, (#4), Unide (#8) Syp	
	1998	Alcampo	#5	Sabeco	top 10
UK	1993	Rewe (GER)	MNE entry	Budgens	top 20
	1998	Somerfield	#6	Kwik Save	#5

Key to Firm Status
Acquiring firm: this shows the firm's ranking by market share in the country concerned, or that it used the acquisition as the mode of multinational (MNE) entry.
Acquired firm: this shows the firm's ranking by market share in the country at the time of acquisition; "top 10" ("top 20") indicates within the top 10 (or 20) at the time of acquisition.

Using the typology defined in the notes to the table, certain stylised facts emerge:

- in four of the smaller northern member states - Belgium, Denmark, Netherlands and Sweden - the leading firm is "dominant", in the sense that it accounts for one quarter of the market (or more), and is faced with only much smaller rivals.
- in three of the southern member states - Italy, Spain and Greece - not only is concentration relatively low, but also even the largest firm has a limited market share (10% or less). These appear to be unconcentrated markets by any criterion, although recent merger activity suggests that the picture is currently changing in Spain.

In the remaining seven countries, concentration is higher and involves two or more roughly equally sized firms:

- Germany and France both display structures in which all top 5 firms have sizeable, and roughly comparable, market shares.
- In the UK, also, four firms have market shares in the region of 10% or more, although, in this case, two - Tesco and Sainsburys - are significantly larger than the other two.
- In each of Austria, Finland, Ireland and Portugal, there are two or three firms significantly larger than the other leaders. Loosely speaking, they can be characterised as duopolies or triopolies.

Although speculative, the make-up of the groups just identified is, arguably, more revealing than the concentration ratios in identifying the nature of the underlying size of market- concentration relationship - and in predicting where change is most likely in the future. Broadly speaking, two speculative hypotheses might be put forward.

H1: There is a long-run equilibrium relationship, in which the size of national market will determine the number of significant players. In smaller member states, the market may only be able to sustain one or two major firms, whilst, in the larger countries, it may be as many as four or five firms.

H2: This equilibrium may be near to current reality in some countries: Germany, France, the UK, Austria, Benelux, Sweden and Denmark. In others, however, it remains to be achieved: Greece, Italy, Spain, Finland, Ireland and Portugal.

This is, of course, highly speculative, but there are certainly signs of intensive recent merger activity in most of the second set of countries listed under H2. If the hypothesis is correct, concentration should increase in all countries but Finland; and, we might expect, perhaps, three leaders to break away from the pack in Italy and Spain. In each of Ireland, Portugal and Finland, however, it may be that in the long-run, only one or two major players will survive.

If such restructuring is to occur, mergers and acquisitions will clearly play a major role. Table 7.6 lists the main mergers and acquisitions of recent years, arranged by member state and annotated by the status of the acquiring and acquired firms. Two, more or less general, trends are apparent across the member states. First, there has been significant cross-border (multinational) entry. Whilst, of itself, this does not necessarily increase concentration in the member state concerned in the short-run, the longer-run ramifications and subsequent developments may well increase concentration. For example, the acquisition by Rewe of Billa from Karl Wlaschek in Austria merely changed the ownership of one of the market leaders initially. Subsequently, however, there are signs of further German entry into Austria, leading to continued consolidation and concentration. The second general trend is that the acquiring firms shown tend to have a market ranking within the top 5, whilst the acquired firms tend to have come from the middle part of the country size distribution (i.e. often outside the top 5, but within the top 10 or top 20.) This mirrors the development noted above, at the level of the EU as a whole, for the very largest firms to expand at the expense of their medium-sized rivals.

Turning to differences between the member states, the table points to major activity in some of the smaller and/or southern states in which we have already suggested major restructuring is likely (e.g. Portugal, Italy, Spain, Netherlands). In addition, however, there have been major waves of mergers in the last few years in both France and Germany, but not the UK. In the UK, rumours and tentative merger proposals among the leading firms have been a common feature in recent years, but so far little has materialised beyond the recent merger of Somerfield and KwikSave (ranked respectively 5 and 6 by turnover in the UK).

Finally, Table 7.8 places these data in a chronological perspective, from which it appears that significant merger activity has intensified in the mid to late 1990s.

Table 7.8 Annual time series of major M&A activity

year	no.
1992	5
1993	2
1994	1
1995	3
1996	4
1997	17
1998 (so far)	16
Total	48

7.5. Cross-border operations

One of the most attractive features of the market share matrix is that it provides a very clear integrated picture of the flows of cross-border activities by Europe's leading firms[42]. In the three parts to Table 7.9, the firm level data in the full matrix have been consolidated into country aggregates. For example, reading across the row for Germany, we have a picture of the activity of the German market leaders across the other member states, as well as in Germany itself. Reading down the column for Germany,

42. In accounting terms, cross border activity is the third part of a relationship which links concentration at the EU level to concentration within individual member states.

the numbers refer to (the much smaller) operations of firms from other countries in Germany. Conceptually, this is analogous to a matrix of intra-EU FDI flows, both inward and outward, between member states.

Table 7.9 Cross-border operations, by member state: (a) 1996

	Firms' turnover (bn ecus) in:														
country of origin	**A**	**BL**	**D**	**FIN**	**FRA**	**GER**	**GRE**	**IRE**	**IT**	**NETH**	**P**	**SP**	**SW**	**UK**	**Total**
Austria	4.1								1.1						5.2
Bel/Lux		10.7			0.3		0.3								11.3
Denmark			8.8			0.4								0.4	9.5
Finland				10.6											10.6
France		0.2			92.9		0.2		2.2		1.7	11.8			109.0
Germany	6.7	1.3	1.0		4.3	106.8	0.3		2.7	2.9	0.7	1.2		1.6	129.5
Greece							2.3								2.3
Ireland								2.9							2.9
Italy									14.2						14.2
Netherlands		0.7								10.6	1.4	0.5			13.2
Portugal											1.7				1.7
Spain												4.5			4.5
Sweden													15.5		15.5
UK								1.0						49.3	50.3
Total	10.8	12.9	9.8	10.6	97.5	107.2	3.1	3.9	20.2	13.5	5.5	18.0	15.5	51.2	379.5

Table 7.9 Cross-border operations, by member state (b) 1993

	Firms' turnover (bn ecus) in:														
country of origin	**A**	**BL**	**D**	**FIN**	**FRA**	**GER**	**GRE**	**IRE**	**IT**	**NETH**	**P**	**SP**	**SW**	**UK**	**Total**
Austria	7.3								0.4						7.7
Belgium		9.5					0.2								9.6
Denmark			6.6												6.6
Finland				9.2											9.2
France					84.2	1.3	0.1		0.6		0.3	8.3		0.2	95.1
Germany	2.6	1.0	1.0		2.3	88.3	0.1		1.8	1.4				0.2	98.8
Greece							0.7								0.7
Ireland								3.3							3.3
Italy									13.8						13.8
Netherlands		0.6								10.4	0.8	0.3			12.07
Portugal											1.8				1.8
Spain												1.0			1.0
Sweden													15.4		15.4
UK					0.5									39.9	40.4
Total	9.9	11.1	7.6	9.2	87.0	89.7	1.0	3.3	16.6	11.8	2.8	9.7	15.4	40.3	315.2

Table 7.9 Cross-border operations, (c) by member state

	1996				1993		
	dom	in	out		dom	in	out
Austria	4.1	6.7	1.1		7.3	2.6	0.4
Belgium	10.7	2.2	0.6		9.5	1.6	0.2
Denmark	8.76	1.0	0.7		6.6	1.0	
Finland	10.6				9.2		
France	92.9	4.6	16.1		84.2	2.8	10.9
Germany	107	0.2	22.5		88.3	1.4	10.5
Greece	2.3	0.8			0.7	0.3	
Ireland	2.9	1.0			3.3		
Italy	14.2	6.0			13.8	2.8	
Netherlands	10.6	2.9	2.6		10.4	1.4	1.7
Portugal	1.7	3.8			1.8	1.0	
Spain	4.5	13.5			1.0	8.6	
Sweden	15.5				15.4		
UK	49.3	1.9	1.0		39.9	0.4	0.5
Total	335.1	44.5	44.5		291.3	23.9	23.9

KEY: "dom" (for domestic) indicates the turnover in member state i of firms originating from member state i; "in" indicates turnover in i of firms from other member states; "out" indicates turnover of firms originating from i in other member states.

As can be seen from part (a), the majority of outward activity in 1996 originated from Germany and France, with smaller magnitudes attributable to the Benelux countries, Austria and Denmark (only one firm in each of the last two countries is involved.) In terms of the received theory of multinational firms, this activity by firms from the smaller member states can be explained by a desire to break free from the constraints on growth implied by a limited home market. However, much more important is the explanation of why German and French (but not UK) firms have been so active in cross-border activity. Again, this may be due, in part, to constraints on domestic growth - remembering that in these two countries, there are at least 5 strong market leaders vying for market share. In addition, however, this cross -border expansion may be motivated by a desire to exploit firm-specific assets, including new selling modes and structures (for example, discounting). Turning to the distribution across the host countries (inward), it is clear that the major recipients are the southern and smaller member states. Significantly, Sweden and Finland stand alone, with no linkages, outwards or inwards, to the rest of the matrix.

Part (b) of the table replicates for 1993. This reveals how quickly the non-diagonal elements of the matrix have changed in just three years. Part (c) of the table merely summarises, by comparing the outward and inward aggregates for each country. Perhaps the key statistics here are to be found in the final row. In 1996, 44.5 bn ecus of the turnover of matrix firms was accounted for by their operations outside their home member states. This amounts to 11.7% of the matrix total, and compares with only 7.5% in 1993. In this sense, cross-border activity has increased in proportionate terms by over 50%.

7.6 Impact of buying groups - buyer concentration versus seller concentration

Thus far, we have been concerned with retailer seller concentration and, as such, it is appropriate not to conceive of the buying group as a single entity. However, when measuring buyer power (vis-a-vis the food manufacturers), it is, arguably, appropriate to group together all firms buying through a single purchasing arm.

Table 7.10 Five firm concentration ratios, adjusted for buying groups, 1996

	Excl BG	Incl BG	Buying groups in top 5
Austria	58.6	58.6	
Belgium/Lux	61.6	84.6	BLOC, VAC
Denmark	59.5	76.6	SuperVib
Finland	89.1	89.1	
France	50.6	78.2	Cometca, LeClerc, ITM, Centrale Casino, Eurocham
Germany	45.4	50.0	Markant
Greece	28.0	28.0	
Ireland	64.2	64.2	
Italy	11.8	26.2	ADI, Euromadis, Intermedia, Supercentrale
Netherlands	50.4	69.6	SuperUnie, KBB, Radar
Portugal	55.7	62.4	Uniarme, Elos
Spain	32.1	49.3	Euromadi, IFA
Sweden	77.9	77.9	
UK	56.2	56.2	
Average	52.9	62.2	

Assuming all identified buying groups can be treated in this way, Table 7.10 revises the previous estimates of seller concentration, by including any buying group whose firms have a joint market share which places them in the top 5[43]. As can be seen, such adjustments must be made for 8 of the member states, and, in each case, the effect is to significantly increase, sometimes drastically as for France, the value of C5. The average across member states now increases by 10% points to over 60%, and only Greece and Italy lie significantly below 50%.

43. Of course, C5 is also adjusted by subtracting the share of any firms displaced from the top 5, or who belong to the buying group now included.

Moving beyond buying groups which operate within individual member states. Table 7.11 turns to cross-border alliances. This shows the constituent members of each alliance and their aggregate turnover. Nearly all of the firms on the matrix belong to one or another of these alliances. The largest appears to be AMS, whose members have a combined turnover of 65 bn ecus, which is about 8.5% of the total EU market. The joint turnover of the 8 alliances listed amounts to over 250 bn ecus, i.e. roughly one third of the total EU market.

Table 7.11 Cross-border alliances

Alliance	Members:	Combined turnover (bn ecus)
AMS		**64.93**
Ahold	Hakon Gruppen	
Safeway	Jeronimo Martins	
ICA	Mercadona	
Kesko	Rinascente	
Edeka	Superquinn	
Allkauf	Casino	
EMD		**53.71**
Musgrave	Selex	
Syntrade	Euromadi	
DAGAB-UNIL	Uniarme	
Supervib	UNIL	
Markant	ZEV Markant	
Nisa Today's	Leclerc	
nb. most EMD members are national buying groups		
DEURO		**44.37**
Makro	Metro	
Carrefour	plus NAF International	
NAF INT		**20.31**
Coop Italia	NKL	
Coop Schleswig-Holstein	FDB	
KF Gruppen	CWS UK	
S-Group	Tradeka	
EUROGROUP		**27.75**
Coop Schweiz	Vendex-De Boer Unigro	
Markant	Rewe-Billa	
SED		**17.78**
Esselunga	Sainsbury	
Delhaize Le Lion		
BIGS		**14.43**
Hellaspar	Bernag Ovag	
BWG/Spar	Dagrofa	
Tukospar	Spar Landmark	
Spar	Unidis (DeBoer Unigro)	
Despar		
EUROPARTNERS		**11.21**
Superunie	Cora-Loius Delhaize	
Somerfield		
Note: turnovers are estimated for EU member states only		

7.7. Firm-specific analysis

Tables 7.12 to 7.14 document three aspects of the structure of individual firms. The 18 firms listed in Table 7.12 account for virtually all the cross-border activities depicted earlier in Table 7.9. The two indices shown each indicate the relative importance to the firm of its operations outside its own member state. For example, 32% of Metro's turnover emanates from its non-German food operations; and the E value (an entropy index) indicates how widely dispersed the turnover is across different locations[44]. Unsurprisingly, given earlier tables, the list is dominated by firms from Germany, France and the Benelux countries:

Table 7.12 The Leading Multinational Firms

		% outside home MS	E index	Also operates in:
Metro	Ger	32.1	3.51	France, Italy, Netherlands, Austria, Spain, Portugal, Greece, Denmark, Belgium
De Boer Unigro	NL	31.4	2.30	Spain, Belgium
Spar Osterreich	A	30.0	1.84	Italy
Promodes	Fra	29.8	2.30	Spain, Portugal, Italy, Greece
Aldi	Ger	26.3	2.81	Austria, Belgium, Denmark, France, Netherlands,UK
Carrefour	Fra	22.2	1.93	Spain, Italy, Portugal
Dansk Supermkt	D	21.2	1.94	Germany, UK
Auchan	Fra	20.8	2.00	Spain, Portugal, Italy, Belfium/Luxembourg
Lidl & Schwarz	Ger	19.7	2.15	France, Italy, Spain, UK, Belgium, Portugal
Delhaize le Lion	BL	17.9	1.81	France, Greece
Ahold	NL	17.0	1.58	Portugal
Rewe	Ger	16.4	1.70	Austria, UK, France, Spain
Vendex	NL	16.1	1.55	Belgium
Tengelmann	Ger	13.6	1.76	Italy, Netherlands, Austria, Spain
Tesco	UK	5.8	1.25	Ireland
Intermarche	Fra	1.8	1.11	Belgium, Spain, Portugal
Dunnes	IRE	1.7	1.09	Spain
Leclerc	Fra	1.3	1.08	Spain, Portugal
Edeka	Ger	1.1	1.06	Denmark, Austria

Notes: "% outside home MS" indicates the percentage of the firm's turnover accounted for by operations outside its home member state.
The E index is an entropy index of multinationality, expressed in number equivalent form. The lower limit of 1 is scored by a firm operating excxlusively in its home member state. Higher values indicate greater dispersion across member states. For example, Metro's operations are equivalent to a firm operating in equal proportions in 3.5 different member states.

44. It should be noted, therefore, that the firms are not ranked in order of the *absolute* magnitudes of their foreign activity: this is why, say, Spar Osterreich and Dansk Supermarkt feature so high in the list - they are relatively small firms, but with a large proportion of their turnover outside their home bases.

Similarly, the make-up of the list of leading discounters, shown in Table 7.13, come as little surprise. It is dominated by four of the largest German firms, followed by Promodes. Together, these five firms operate about 15,000 discount outlets, which is roughly 60% of the total within the EU. Each of these firms is significantly multinational in its discounting operations. In terms of the conventional theory of multinational firms, their specific asset appears to be expertise in the discounting selling mode.

Table 7.13 The Leading Discounters

	Number of outlets in member state:														
Member states:	**A**	**BL**	**D**	**FIN**	**FRA**	**GER**	**GRE**	**IRE**	**IT**	**N**	**P**	**SP**	**SW**	**UK**	**Total**
Firms:															
Aldi	197	280	177		320	2775				327				176	4252
Lidl & chwarz		45			585	2017			195		19	130		132	3123
Tengelmann	some					2660			120	some		40			2820+
Rewe	some				60	2393			70			30			2553+
Promodes					28				some		125	1727			1880+
Dansk Supermkt			237			126								106	469
Carrefour					346										346
Casino					241										241
Vendex		52								160					212
FDB Coop			211												211
SOK				210											210
Intermarche					207										207
Tuko				145											145
Louis Delhaize		144													144
Auchan											124				124
Coop Italie									100						100
Marinopoulos							100								100
ICA													81		81
KF Konsum													57		57
Delhaize le Lion		51													51
Tesco								18							18
La Rinascente									7						7
GS(Benetton)									some						0+
Metro						some									0+
other firms	371	190	114	465	153	2159	n.a.	n.a.	1868	120	46	388	167	926	6645
total number of discount stores	568	762	739	820	1940	12130	n.a.	n.a.	2360	607	314	2315	305	1440	24300
% of turnover accounted for	17	25	20	12	7	30	n.a.	n.a.	10	13	9	9	11	11	

Turning to the typical size of outlet operated by firms, Table 7.14 provides the one instance in which UK firms dominate the rankings. Judged on these data, the UK market leaders tend to operate shops which are as much as 8 times larger than the average for all firms on the matrix. This indicator is admittedly very crude, and may be biased if there are important inter-country differences in the way that number of outlets are measured. On the face of it, however, this ranking is clearly correlated with the proportionate reliance on hypermarkets, as opposed to other forms of retail outlet. Most of the firms shown in this table are hypermarket-intensive.

Table 7.14 The firms with the largest scale outlets

Average turnover per outlet (mn ecus)	
ASDA	39.9
Sainsbury	33.0
Leclerc	30.7
Tesco	26.7
Superquinn	25.3
Carrefour	24.7
Sonae (promodes 22.5%)	23.8
Esselunga	20.4
Dunnes	18.9
Safeway	16.6
Auchan	15.9
Metro	15.4
Sklavenitis	14.3
Colruyt	10.9
Marinopoulos	8.3
Intermarche	8.2
Delhaize le Lion	8.1
GIB group	7.0
La Rinascente	6.9
Somerfield	6.6
Axel Johnson	6.3
Eroski	6.2
Systembolaget	6.2
GS(Benetton)	6.1
Aldi	5.5
Dansk Supermkt	5.5
Coop Italie	5.3
Alko	5.1
Promodes	4.7
SOK	4.6
Ahold	4.1
Average for all matrix firms	4.1

7.8 The structure of food manufacturing

Finally, Table 7.15 records some summary statistics on the industries manufacturing food and other daily goods. These data are derived from the EU manufacturing market share matrix (Davies *et al*, 1998), EUROSTAT trade data, and national production censuses. It complements Table 6.12 of the previous chapter, which identified some of the leading multinational manufacturing firms involved.

Table 7.15 The Structure of EU Manufacturing: Food and Other Daily Good "3-digit" industries

	Five firm concentration ratios														
		EU		France		UK		Belgium		Germany		Intra-EU Trade		Intra-EU Trade	
	NACE	93	87	92	85	92	86	91	86	93	87	93	87	93	87
PHARMACEUTICALS	257	20	22	12	11	44	38	47	51	25	26	14	12	3.4	2.9
SOAP & DETERGENTS	258	43	34	25	27	59	46	55	52	50	33	16	11	5.4	4.3
DOM & OFF CHEMICALS	259	52	62	75	66	58	48	62	85	65	66	49	48	1.9	1.8
OILS & FATS	411	39	29	53	64	53	73	84	85	50	53	12	13	4.1	2.8
MEAT PRODUCTS	412	5.6	6.5	7.4	6.3	20	20	11	10	28	24	19	20	2	1.9
DAIRY PRODUCTS	413	18	15	14	15	59	59	28	33	24	17	17	15	3.4	2.7
FRUIT & VEG PRODUCTS	414	15	16	20	26	47	33	39	43	31	28	27	29	2.9	2.6
FISH PRODUCTS	415	22	17	30	20	49	63	75	73	58	48	21	19	1.7	1.2
GRAIN MILLING	416	17	22	23	24	62	69	39	33	36	35	5.1	8.5	1	1
PASTA	417	30	24	79	79	n.a.	n.a.	87	89	70	76	12	7.2	1.6	1.3
STARCH	418	61	40	96	95	n.a.	n.a.	98	100	n.a.	n.a.	16	14	4.8	1.3
BREAD & BISCUITS	419	20	23	7.1	8.4	47	55	22	25	15	10	8.3	6.9	1.7	1.3
SUGAR	420	40	31	56	67	100	100	89	74	86	65	8.1	5.2	1.3	1.3
CONFECTIONERY	421	47	39	33	43	70	61	41	40	38	31	18	15	4.1	3.4
ANIMAL FOODS	422	13	15	20	15	54	50	37	40	36	38	9.3	6.2	1.6	1.3
OTHER FOODS	423	22	21	42	25	30	29	39	45	42	39	14	12	3.9	2.9
DISTILLING	424	32	37	29	33	63	64	47	56	40	39	20	15	2.8	1.7
WINE & CIDER	426	18	18	21	27	91	92	96	98	62	58	14	14	2	1.3
BEER	427	25	26	71	55	50	50	59	46	18	14	5.4	3.9	2.5	1.7
SOFT DRINKS	428	36	30	47	46	63	37	58	57	24	21	5.3	4.3	2.5	2.4
TOBACCO	429	49	55	100	100	100	99	94	92	89	89	7.7	6	1.5	1.1
Average of above		29.7	27.7	40.9	40.5	58.8	57.1	57.4	58.2	44.4	41.5	15.2	13.6	2.7	2.0
Average for all manufacturing		25.7	24.8									23.2	21.0	2.3	1.8

Notes: "Intra-EU trade" denotes the ratio of intra-EU trade to apparent consumption (expressed as a percentage), "MNE" denotes the average Entropy index of multinationality amongst the 5 EU market leaders in the industry concerned; the lower value is 1, where none of the top 5 firms is multinational - higher values indicate greater dispersion of output across the member states. Source: Davies et al (1998).

The main features of these data are as follows:

- At the EU level, the 5 firm concentration ratio in the typical 3 digit food manufacturing industry is about 30%. This compares to C5 of 15% from the EU Retail matrix. In some sectors, e.g. Tobacco, Chocolate and Household Chemicals, it exceeds 40%. Broadly speaking, manufacturing concentration tends to be higher where the products are typically advertising intensive with pronounced brand loyalty.
- Concentration has tended to increase, 1987-93, by about 2% points on average. This rate of increase, and the absolute levels, are both larger than the averages for all manufacturing industries over this period.

(6)

- Typically, intra-EU trade flows are relatively small in these industries: about 15% of apparent EU consumption is accounted for by imports from elsewhere in the EU - significantly lower than the average (23%) for all manufactured goods.
- On the other hand, multinational production within the EU is relatively higher than for manufacturing as a whole, and it increased quite dramatically between 1987 and 1993.
- Comprehensive consistent data on concentration in the individual member states is less readily available. The estimates for the four countries shown indicate typical C5 values in the region of 40-60%, with the UK and Belgium tending to have more concentrated industries than France and Germany.

Obviously, there are important inter-industry differences. Nevertheless, the stylised picture is one in which concentration at the EU level tends to be higher on the manufacturing side than in retailing. On the other hand, levels seem roughly comparable at the national level. Trade flows tend to be small, and most of the large firms are multinational, serving national markets through local production.

PART III – CASE STUDIES

This part of the report presents detailed case studies designed to examine the experience of different countries and specific products at a disaggregated level. In particular, it focuses on market structure in the different countries and its relationship to buying power and the possible existence of anti-competitive effects.

There are four country studies covering France, Germany, Spain and the UK with detailed information on three specific products: washing powders and detergents, coffee and butter and margarine. The countries were selected in part because we had access to local researchers who were able to provide us with country-specific information on the food retail distribution sector, but, more importantly, because they represent a good cross-section of the different experience of countries in the EU. Thus, the UK has relatively high concentration in food retailing, and has the largest share of own brand sales; Germany is distinguished by its discount chains, which appear to have induced fierce competition at the retail stage; in France, there has been considerable growth in hypermarket groups which have also sought to expand into other countries in the EU; and, in Spain, concentration is lower, although, more recently, has been increasing at a rapid rate.

Although there are differences between the countries, it is important to note that there are strong similarities too. In all countries concentration in food retailing has been increasing, and is likely to increase further in the years ahead. In many markets, this has led to bilateral oligopoly situations arising where retailer chains and major European producers individually engage in bilateral negotiations over prices, fees paid, product positioning and so on. Nevertheless, a commonly expressed concern of suppliers is that retailer chains have "excessive" buying power which allows them to "squeeze" low prices out of dependent suppliers and obtain unjustified fees and rebates and dictate other contractual terms such as exclusive supply obligations.

The structure of this part is as follows. Chapters 8-11 consider the details of market structure and conduct in each of the four countries in turn (taken alphabetically). The intention is to allow us to consider the similarities and differences between countries and products. None of the chapters has a concluding section since chapter 12 summarises the evidence using the framework developed in chapter 3 as a means of organising our findings.

The studies were contructed using information collected by local researchers in each of the countries under investigation. These researchers were asked to provide reports on buyer power in the food retail distribution sector using a set of guidelines which covered both general issues and specific products. The types of issue addressed included the structure of food retailing, buying practices, the effect of own brands, and wholesaling and distribution in each of the countries concerned.[45]

The research uses, in part, published information in each of the countries (e.g. company reports, trade journals, published papers, and so on). In addition, a number of firms and other organisations were interviewed in order to obtain further insight into the key factors involved. Fuller details of this exercise are given in Appendix A.4. In brief, the local researchers were asked to identify the major firms and other organisations involved in each country and then to select a sample of these for interview (of course, allowing for possible non-response).[46] Three questionnaires (one each for food retailers, buying groups and producers) were used as a basis for conducting the interviews (or in some cases, completed questionnaires were returned). Interviews were conducted by telephone (the most frequent type) or face-to-face, and, in a few cases, a completed questionnaire or other written material was returned.

In all, 118 organisations were contacted and 47 interviews were obtained or (questionnaires were returned), 40% response rate. Inspection of Table A.4.1 in Appendix A.4 shows that we had 15 responses in Germany, 11 in France, 10 in the UK and 8 in Spain. Overall, interviews/responses took place with 9 retailer chains, 24 producers, 3 buying groups and 11 other organisations (Table A.4.1). While there are some gaps in the table by categories/countries, information and interviews were obtained from a broad cross-section of the relevant firms/organisations involved and provided additional useful information in the case studies reported below.

45. We would like to thank the country contributors for their work in producing the country-based reports: Marie-Laure Allain (Crest-Lei) and Claire Chambolle (CEME) for France, Christoph Schenk (Humboldt University, Berlin) for Germany, and Juan Manez Castillejo (University of Warwick) for Spain and the UK.

46. In fact, as noted in the appendix, most of the leading firms were contacted in this exercise.

CHAPTER 8 – FOOD RETAILING IN FRANCE

8. Market Structure Characteristics and Evolution

France has a dense retail network of both traditional and modern stores, even if traditional food retailing is declining. Since 1970, the food retailing market share of supermarkets and hypermarkets in France has doubled, to the detriment of small independent stores. More than 60% of French consumers' food purchases are made in supermarkets or hypermarkets, as shown in the following table:

Table 8.1 Market share by type of outlet

Type of Outlet	1970	1980	1997
Hypermarkets (>2,500m^2)	3.6	14.3	33.0
Supermarkets(between 400 and 2,500 m^2)	9.0	16.8	28.3
Other big stores	20.7	13.7	1.5
Small stores, including specialists	66.7	55.2	37.2

Source: INSEE 1988

In 1998, according to INSEE, 36% of French households shop in two different stores, 29% only shop in one store, 16% shop in three stores, and 15% never go to a supermarket at all. Consumers choose their main store principally according to practical criteria (67% of consumers choose one of the closest stores). Price is the main criterion for only 16% of households, choice for 11% and quality for 5%. But when two stores are equidistant from their household, they choose the cheapest: hypermarkets and supermarkets chains in France are involved in a very intense price competition. Delivering the lowest price is the aim of most of these chains.

Food retailing is quite highly concentrated in France as it is in the UK. In 1996, the five leading chains shared 51% of sales, (compared to 56% in the UK). In 1997, Intermarché acquired the German retailer Spar. It thus became the leading French retailer, with a turnover of about FFr. 200 billion. But Carrefour's turnover is growing faster, and the recent acquisition of Comptoirs Modernes (about FFr. 32 billions sales in 1997) may lead to the recovery of its leading position.

Table 8.2 shows total sales in France in FFr billion of the leading hypermarket and supermarket chains in 1996 and 1997. Intermarché is the largest group here with sales of FFr. 142 billion although Carrefour, if one includes sales of Cora and Leclerc, is close behind. Table 8.3 shows total sales (i.e. not only in France) of the main groups where Carrefour if one includes Comptoirs Modernes and Cora is the leading group, and Intermarché is in second place. These two chains are by far the largest if one includes all sales. Foreign sales are important for Carrefour, Promodès and Auchan amongst others.

Table 8.2 - Grocery sales in France (FFr. billions), 1996-1997

Groups	1996	1997
Intermarché (TTC)[1]	139.6	141.7
Carrefour	92.2	96.2
Leclerc (TTC)	136.0	140.0
Auchan	n.a.	79.0
Promodès	66.5	67.5
Casino	58.3	67.0
Système U (TTC)	43.0	50.6
Cora (41% owned by Carrefour)	34.0	34.0
Comptoirs Modernes	28.2	30.5

Source: COB, 1998
1 TTC means taxes included.

Table 8.3 - Total grocery sales for each group (FFr. billions), 1992-1997

Groups	1992	1993	1994	1995	1996	1997
Intermarché	113.6	n.a.	109.0	116.0	139.6	195.0
Carrefour	117.1	124.5	136.3	144.6	154.9	169.3
Leclerc	113.8	n.a.	112.5	117.0	136.0	140.0
Auchan	85.1	n.a.	60.6	64.3	120.0	130.0
Promodès[1]	84.2	90.2	94.7	100.6	103.5	110.0
Casino	61.6	63.1	63.0	64.1	66.8	74.5
Docks de France[2]	32.0	n.a.	43.5	46.7	-	-
Système U	40.0	n.a.	n.a.	n.a.	43.0	50.5
Cora	n.a.	n.a.	n.a.	n.a.	39.0[3]	46.0
Comptoirs Modernes	22.6	23.6	25.7	27.0	30.2	32.1

Source: COB, 1998
1 Promodès turnover is about FFr. 170 billion in 1997 when including franchisees sales.
2 Taken over by Auchan in 1996
3 FFr. 45 billion when including the Belgian group Louis Delhaize, 41% owned by Cora and managed by Cora.

Hypermarkets dominate the French retailing system (Table 8.4): they are responsible for 47 % of general food retailing (except specialised food stores, such as bakers or butchers shops). Supermarkets account for 37 % of sales, discounters 4 % and general grocery stores 12%. Food sales account for about 55% of hypermarkets turnover, and 80 % of supermarkets turnover.

Table 8.4 - Evolution of the number of hypermarkets for each group[1]

Group	1988	1992	1996
Leclerc	155	298	373
Carrefour	68	109	117
Géant (Casino)	24	49	108
Mammouth (Paridoc)	76	86	92
Continent (Promodès)	34	65	84
Cora	46	49	54
Auchan	39	49	52
Hyper U	-	18	33
Hyper Champion	-	-	12
Total number of hypermarkets	725	950	1060

Source: Linéaires, 1998
1 These statistics do not take account of the average sales area of each store: in 1996, Carrefour owned less hypermarkets than Leclerc, but the two groups had the same total sales area.

Table 8.5 - Evolution of the number of supermarkets for each group

Group	1988	1992	1996
Intermarché	1,114	1,613	1,646
Champion	232	467	536
Super U	250	498	513
Casino	n.a.	259	380
Stoc	199	326	369
Atac	n.a.	205	326
Monoprix	126	n.a.	198
Prisunic	207	187	181
Match	n.a.	156	164
Leclerc	335	227	136
Total number of supermarkets	6,070	7,412	7,670

Source: Linéaires, 1998

The French retailing industry has become increasingly concentrated in the last ten years. According to Nielsen, in 1997, the five main retailers shared 67.2% of the food market, whereas they shared only 55.7% in 1992. Our own estimates (from Chapter 7) show lower levels of concentration but still a notable increase from 47% to 51% (Table 8.6). Clearly, even in 1993-6 at these lower levels[47], concentration is significant and increasing. Within this, however, Leclerc appears to have lost market share whilst for Auchan it has increased.

47. As noted in Chapter 7, our estimates of concentration exclude non-food and related items from the data, and include all food retailing including fast moving consumer goods (fmcg's). This accordingly leads to lower estimates of five firm concentration than those usually found in the literature.

Table 8.6 - Market shares, 1993 and 1997

Group	1993 %	1996 %
Intermarché	11.6	11.9
Promodès	9.3	10.1
Leclerc	12.2	9.7
Carrefour	8.4	9.7
Auchan	5.7	9.4
Casino	6.0	6.3
C_5	47.5	50.8

Source: Chapter 7

A number of significant mergers have been successful, and this has facilitated the growth in market shares of the firms involved. For instance, Auchan became the fifth national group in 1996 thanks to its acquisition of Docks de France. The first important merger in recent years happened in 1991 when Carrefour acquired Euromarché (Euromarché's turnover was about FFr. 27 bn.) for FFr. 5.5 bn. In 1992, Casino took over Rallye (whose turnover was about FFr. 20 bn.). Promodès intended to increase its size in 1998 by announcing a take-over bid for Casino, but the Board of Casino refused the offer and Promodès failed in its attempt. Finally, the recent acquisition of Comptoirs Modernes by Carrefour (who already owned part of the firm) in 1998 allowed this hypermarket-specialised group to diversify its retailing network into supermarkets, and to recover a leading position. Independent groups have also sought to increase their size: Leclerc and Système U concluded a co-operation agreement on the 29th June 1998. Both groups retain their own names, but they intend to negotiate their supplies together. If they were to merge, they would be the largest retailing group in France.

Other factors have also fostered the increasing concentration, among them the progressive saturation of the French market and the mediocre growth of household consumption, which has restrained the growing retailing chains' turnover.

During the last ten years, numerous small retailing groups have disappeared: either being acquired by larger groups or going into liquidation. Among the 50 main supermarket chains in 1986, 21 no longer existed by 1996 and it is estimated that ten others could disappear soon. This evolution is even more remarkable for hypermarkets: 30 different hypermarket names existed in 1986, with only ten remaining by 1998.

Finally, it is worth noting the recent development of deep discounters in France. The first deep discount stores were opened in 1988 by the German groups Lidl and Aldi. They still are not very developed, partly because of the discount pricing of the main groups, but their turnover is increasing. In 1996, hard discount stores (mainly supermarkets) accounted for 7.5 % of the food sales in French self-service stores. In 1991, hard discount stores provided only 1.3 % of food sales. The leading hard-discount chains are German: Lidl is the market leader, but the French groups responded a few years ago by creating their own hard discount subsidiaries. For example, Carrefour created Ed which is now the second largest hard discounter in France. Casino bought 70% of Baud-Franprix and owns now the fourth largest hard-discount chain with its 265 Leader Price outlets.

Consumers seem to have benefited from the development of mass distribution, and more particularly from the strong price competition it induced. In the 1980's the government considered the development of mass distribution as an instrument to fight against inflation. On the other hand, consumers sometimes complain about the decreasing number of small independent stores, and they accuse the big retailing chains of squeezing out small shopkeepers. This was an argument for the Galland law (see below). But on the whole, the first effect seems to override the second, and consumers have benefited from the development of mass retailers where there have been significant efficiency improvements.

The leading French retailing chains agree that the wave of great mergers and take-overs will go on over the coming years, especially among French groups. Even the independent groups have started a rapprochement, as shown by the co-operation agreement signed by Leclerc and Système U in 1998. Moreover, the Conseil de la Concurrence (the Competition authority) does not seem disposed to prevent new mergers, as shown, for example, in its 1997 report.

Introduced in 1996, the Raffarin law[48] regulates the opening of new stores with a sales area over 300 m^2. Each project has to be accepted by regional commissions and these commissions are also able to prevent the extensions of current premises. Furthermore, in 1996, the government decided to stop all extensions during a six month period. In 1997, 25% of new stores were rejected by the commissions, and since 1996 the number of supermarkets opening has decreased significantly (less than 200 per year since 1996, while there were more than 300 per year between 1986 and 1995).

The retail network in France is quite dense and is nearly saturated. Because of this the leading retailing groups (especially Intermarché and Carrefour) increasingly focus on expansion abroad, and they scarcely attempt to open new outlets in France. In 1996, only 24 hypermarkets were opened, among which 19 were in fact upgrades from supermarkets to hypermarkets. About 70% of the supermarkets that opened in 1996 were deep discount stores, mostly belonging to foreign groups. The recent development of those

48. Loi du 5 Juillet 1996 relative au développement et à la promotion du commerce et de l'artisanat.

kinds of outlets, whose names were previously unknown, shows that there are few barriers to entry for retailers providing new kinds of services, like deep discount. But there certainly are more significant barriers to entry in classical food retailing in France, as it would be very difficult for an unknown retailer to succeed in opening a hypermarket in France.

Besides the Raffarin law, the 1996 Galland law[49] has had an important impact on the relationships between manufacturers and retailers in France. This law has clearly two purposes. First, the government wanted to reduce the imbalance between suppliers and retailers by limiting retail chains buying power. The second aim was to protect small shopkeepers from the hard competition of great retail chains. The Galland law brought six main changes in French regulation:

- invoicing rules have been changed, such that refunds now have to appear on bills and cannot be negotiated at the end of the year. Furthermore, commercial services offered by retailers (e.g. end-of-aisle displays or promotional activities) have to be put on a special bill rather than being negotiated *ad hoc*.
- selling at a loss is now completely forbidden, and the threshold is now defined by the price charged on the bill (with the new invoicing rules) plus transportation costs and taxes. Retailers can no longer set retail prices below wholesale prices for loss leaders and recover a profit by charging the producers for services or asking for a refund.
- "excessively low prices" are forbidden. This rule completes the ban on selling at a loss, and is aimed primarily at own brands. "Excessively low prices" are not defined exactly in the law, but the intention is to include low prices compared to costs of production and distribution.
- refusal to supply is now permitted.
- listing fees without any real benefits (i.e. services provided by the retailer) are not permitted. Furthermore, retailers asking for a listing fee have now to commit on a minimum amount of purchase, which has to be in proportion to the fee. (The law does not mention which proportion should be used).
- finally, a retailer who wishes to stop purchasing a particular product has to give prior written notice to the producer and vice versa.

At present the law has had mixed effects. In part, this is due to the ambiguity of the wording, as, for example, in the case of listing fees. In addition, the right of producers to refuse to supply certain retail outlets can be seen as anti- rather than pro- competitive. This provision, in support of producers, allows them to choose their own retailing network and, for example, will allow producers of household appliances not to supply discount stores. This provision, however, does not affect food retailing.

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49. Loi N. 96-588 du 01 07 1996 sur la loyauté et l'équilibre des relations commerciales.

The law has had an impact on retail prices: according to Nielsen, the prices of well known brands sold by hypermarkets increased by more than 4% during the first half-year of 1997. This effect was softened a few months later, and after an adaptation period, prices decreased slightly. Also the number of products sold at a loss seems to have decreased dramatically. The Galland law has had an effect on the development of own brands (further details are given in section 8.4). Moreover, the prohibition on selling at a loss has enhanced the pressure exerted by retailers on producers to reduce their prices.

8.2 Retailer Buying Power

The recent wave of mergers in French retailing appears before increased retailer buying power, even if producers are quite concentrated in some markets. Carrefour or Intermarché for instance, with a turnover of about FFr. 200 bn., appears to have a stronger position, say, than the leading French food producer, Danone, with its FFr. 88 bn. turnover. Moreover, large retail chains' market valuation is increasing rapidly: in March 1997, Carrefour's market capitalisation was more than twice as high as Danone's. Between 1995 and 1997, the market capitalisation of the three main listed retail chains (Carrefour, Promodès and Casino) increased by more than the CAC 40 (Table 8.7). This, of course, partly reflects take-over activity, particularly by Carrefour.

Table 8.7 - Changes in market capitalisation, 1995-1997

CAC 40	Carrefour	Promodès	Casino
+ 62%	+179%	+144%	+90%

Source: Linéaires, 1998

A recent study by INSEE of the food market shows that consumers generally have stronger preferences for stores than for brands: when their preferred brand is not available in their usual food store, 56% of consumers buy a substitute brand, 24% wait until their next visit and only 20% go to another store to find their preferred brand. These preferences were reversed at the end of the 1970's, when the new development of advertising on TV strengthened brand power. Buying power has incontestably increased during the last twenty years, and since the beginning of the 1990's it has progressively been concentrated amongst a few groups.

The main retail chains account for a significant part of many producers' sales. For example, Table 8.8 shows the share of Intermarché in the sales of some food brands in 1991. These proportions indicate that producers (especially small producers), depend heavily on Intermarché for their sales, and this means that they could be at a bargaining disadvantage in selling to this chain. While this may not always be the case, especially where large producers are concerned, it indicates the buying power that large retail groups potentially have.

Table 8.8 - Intermarché's buying market share for several food brands, 1991

Belin (biscuits)	15 %	Poulain (chocolate)	20 %
Maxwell (coffee)	18 %	Panzani (pasta)	18 %
Vittel (water)	16 %	Lesieur (oils and fats)	18 %

Source: Trade sources

The evolution of retailing in France was influenced by the growing importance of buying groups like Leclerc, Intermarché and Système U: between 1988 and 1996, the part of the hypermarkets owned by these groups grew from 20 % to 40 %. These groups are essentially independent stores who use the Leclerc or Intermarché name. From their point of view there is, of course, 'brand' recognition and the benefits of belonging to a buying group. Historically, independent groups promoted intense price competition between retailers: independent firms aim at high turnovers rather than at high profitability, and their pricing policy is often very aggressive.

Retailers tend to regard price and quality as the main factors they consider in dealing with their suppliers but whilst price is negotiable, quality often is not. The decline of Euromarché which led to its being acquired by Carrefour in 1991 appears mostly due to its attempt to adopt a strategy of raising its margins. Obtaining the lowest prices for consumers is clearly an important factor in France. Retailers' shelves now contain low price items besides known brands and these own label goods, produced often by small producers, account now for 7% of total food sales. Retailers developed these low price goods, in particular, to fight against the development of deep discounters.

Bulk buying undoubtedly generates reduced costs, but discounts obtained by the major retail chains appears to result largely from their buying power. For instance, Danone's operating income decreased from 10% to 8.8% between 1992 and 1995, whereas Carrefour's gross profit increased from 16.8% to 18.5% during the same period and this may indicate (albeit in fairly crude terms) the shifting of power between producers and retail groups (source: trade press). GEA estimates retailer average gross margins for different products as follows:

Table 8.9 - Retailer average gross margins by product category, 1994

Fresh products	Grocery	Drinks	Frozen items	Average (food)
15 %	16 %	15 %	17 %	14.5 %

Source: GEA

Our interviews suggest that retailers refuse to purchase leading brands fairly infrequently, but they might threaten to do so when they negotiate with producers. Small producers face more difficulties in dealing with big retail chains: whereas retailers claim to develop "partnerships" with small firms. But these small producers do not seem completely satisfied, as a recent study by ETHIC[50] shows. Small producers had to identify the two main factors of dysfunction in their relationships with retailers. Table 8.10 shows the results. Clearly, the suggestion that negotiators change too frequently, selected in over 60% of responses, suggests that the relationships between producers and retailers are not likely to be that close.

Table 8.10 - Small producer problems with large retailers

The negotiators change too frequently	60.2 %
The terms of agreements are not respected	43.3 %
The agreements are constantly modified	37.8 %
There are too many negotiators	28.9 %
Retailing structures are not clear	26.4 %

Source: ETHIC, 1998

Recent cases of refusal to purchase in the mineral water market indicate that retailers sometimes prefer to lose turnover by delisting major brands. Such action is useful in illustrating that a threat is credible, even if it induces losses in the short run. The Competition Authority in France has considered several cases of refusal to purchase recently, in several different markets.

Small suppliers are usually unable to impose conditions on major retail chains. Retailing conditions are of course discussed, but discussions are usually linked to services provided and charged for by retailers. Large producers seem to be able to resist pressure from the major chains, as observed by the Conseil de la Concurrence in its 1994 report on the washing powders market (see below).

8.3 Buying Groups

There are different kinds of buying groups in France. First, integrated buying groups (owned by one firm) are the oldest. In most cases, smaller groups have joined these integrated buying groups. For instance Cap, the Promodès food buying group, has independent affiliated firms, like Prisunic, which was part of Pinault-Printemps and was bought out by Monoprix in October 1997. Smaller buying groups sometimes join larger ones: thus Francap which combines independent wholesalers working for small stores (its turnover is about FFr. 18 bn.) joined Casino's buying group three years ago.

50. ETHIC is a research group which looks at the relationships between small firms and retailers and was

Secondly, some buying groups are owned by several firms, like Francap or Paridoc. Finally there are independent buying groups, like Leclerc, Système U or Intermarché, who often have their own national and regional supplying system. Usually, producers have to negotiate first with the national buying group that lists their products without quantity pre-commitment. Then they also have to negotiate at a regional level and finally perhaps with each store. This process seems more complicated for producers than direct negotiation with a national buying group.

In the mid 1980's, some "super-buying groups" were created, sometimes uniting very different distributors with diverging goals. Thus buying groups like Alci, Difra or Socadip appeared but most of them collapsed soon after because of the diversity of their members. Sometimes such buying groups joined a hypermarket chain and several small independent retailers whose supply needs were completely different. Moreover, the concentration wave in French food retailing appears instrumental in the decline of some super-buying groups. When Carrefour, which had its own buying group, bought Euromarché in 1991, Socadip could not survive the 30 billion francs loss due to Euromarché's departure. Now most of the buying groups are composed of a dominant large retailer joined by small satellite retailers (Table 8.11).

Large buying groups typically refuse members with too low a turnover. However, it is possible for small retailers to join small buying groups which can join larger ones. Thus, Francap members, for example, are now affiliated to Casino's buying group.

At present, retail buying groups at the European level exist but these appear to have had limited success as far as retail buying is concerned in France. An example is Leclerc which joined the EMD (European Marketing Distribution) group in 1997. The main reason for the lack of impact so far appears to be the divergence of interests of the members of these groups. This recalls the lack of co-ordination in the "super-buying groups". At present, European-based buying groups appear mainly to be operating in low-price-items often sold by discounters.

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created by the Federation of Trade and Retailing in France.

Table 8.11 - Main buying groups and their members, 1996

Buying Group	Market share in food retailing
Cometca	**17.9**
Carrefour + Ed	*13.1*
Comptoirs Modernes	*3.0*
Métro France	*1.8*
Leclerc (GALEC)	**15.3**
Intermarché	**15.1**
Paridoc	**14.1**
Groupe Auchan	*12.4*
Coop. Atlantique	*0.6*
Guyenne & Gascogne, PG, Chareton, Schiever	*1.1*
CAP	**12.7**
Promodès	*11.0*
Prisunic	*0.7*
Hyparlo, Provencia	*1.0*
Casino	**12.3**
Groupe Casino	*7.5*
Monoprix	*2.1*
Coop. de Normandie	*0.5*
Francap Alimentaire	*1.2*
Système U	**1.2**
Locéda	**5.7**
Groupe Cora	*4.3*
Catteau -Tesco France	*0.6*
Coop d'Alsace	*0.4*
La Moderne, Migros	*0.4*

Source: Nielsen/Linéaires, 1996

8.4 Own Brands

Whilst not having developed as far as in the UK, own brands are of growing importance in France. This is, in part, due to the retailers' ability to extract lower purchase prices from suppliers of own brands which enables them to set higher margins. In addition, with the passing of the Galland law, retailers have a stronger incentive to sell own brands as provisions in the law have strengthened the hand of branded good producers. According to an inquiry conducted by INSEE in April 1998, 72% of the customers who regularly frequent supermarkets or hypermarkets buy own brands. Also, 13% ignore own brands entirely even though own brands are already in most stores. However, consumers still often confuse own brands and low price products. Over the past few years, retailers have been seeking to increase own brand quality, and they now try to create innovative products under their own names to enhance their reputation. As a result, own brands have increased the competition between producers for shelf space in supermarkets. Table 8.12 gives own brand market shares for the main retailers in 1996.

Table 8.12 - Own brand shares (food only) for leading retailers, 1996

Names	Own brands market share	Number of items
Franprix	28.0	n.a.
Casino	24.8	1800
Intermarché	24.7	2500
Géant	20.0	1800
Carrefour	18.9	1642
Monoprix	18.7	1800
Système U	18.5	985
Continent	17.8	1440
Stoc	16.2	650
Auchan	15.7	1500
Match	15.4	1100
Champion	15.1	1240
Leclerc	14.8	500
Cora	12.2	1224
Prisunic	11.7	550

Source: Secodip-linéaires, 1997

Table 8.13 illustrates the development of own brand market shares in supermarkets and hypermarkets:

Table 8.13 - National brands, Own brand and low price items shares for supermarkets and hypermarkets

	1991	1994	1995	1996
National Brands	80.6	75.0	75.3	76.0
Own Brands	14.7	17.1	17.4	17.1
Low price items	4.7	7.9	7.3	6.9

Source: LSA, 1998

Own brands growth is a major trend in the recent evolution of distribution. In 1995, own brands provided on average 20% of sales (25% of shelf space) compared to only 10% ten years before and the development goes on. Leclerc, for instance, which was initially opposed to own brand development (less than 7% of sales before 1997 were own brand), changed its strategy in 1997 and its goal is now to double its own brands turnover. Retailers try to reinforce the association between their name and their own products.

Table 8.14 gives own brands market shares for the main retailers in 1993.

Table 8.14 - Own brand shares for leading retailers, 1993

Retailer	Own Brands Market Shares
Monoprix	28%
Casino	25%
Intermarché	23%
Carrefour	22%
Auchan	19%
Leclerc	10%

Source: GIRA, 1993-1994

As noted above, retailers set higher margins on own brands than on other brands even if retail prices are lower. According to ICC 95, the mark up rate fixed by retailers is estimated on average at 23% of the turnover for own brands, 15% for low price products and 14.5% for national brands. Moreover, shelf space profitability is higher: if the gross mark-up per square meter of shelf space index is 100 then own brands profitability is 123, low price items profitability is 63 and national brands profitability is 103.

8.5 Internationalisation

Internationalisation has been an important feature of French hypermarket and supermarket chains. There are two main reasons why such internationalisation exists. First, the French food retail market is fairly saturated, and, in particular with the Raffarin law recently introduced, future hypermarket or supermarket growth within France is more difficult. Second, international subsidiaries tend to be more profitable than domestic ones, particularly in countries in southern (or eastern) Europe where large store development lags behind. In fact, French companies began moving into other countries in the early 1970's and this process has continued ever since.

Table 8.15 shows foreign turnover by leading retail groups in 1997. Much of the expansion has been undertaken by Carrefour (which also acquired Comptoirs Modernes in 1997 and has a 41% stake in Cora), Promodès and Auchan. Carrefour, for example, opened its first hypermarket 'Pryca' in Spain in 1973 (in Barcelona) and now has 56 'Pryca' stores. Promodès moved into Spain in 1976 and now has 52 hypermarkets 'Continente', 1,830 discount stores 'Dia' and 33 cash and carrys 'Puntocash'. Non-integrated groups such as Leclerc have been slower to start International development although Leclerc now has 11 stores abroad. Intermarché recently bought 75% of Spar, the fifth largest German distribution group.

Table 8.15 - Foreign turnover of leading French retail groups, 1997

Groups	Foreign turnover (FFr bn.)	% of Total Turnover
Carrefour	62.7	40.5%
Promodès	37.0	35.7%
Auchan	23.5	19.5%
Cora	11.0	24.0%
Casino	8.5	11.5%
Comptoirs Modernes	2.0	7.0%

Source: Linéaires, trade estimates

Greece and Italy offer real growth prospects to the extent that a strict legislative system has delayed retail trade evolution for a long time. East European countries, which represent 70 million consumers, offer new outlets for the largest French groups. In particular, Poland is an emerging market with an underdeveloped market structure and growing consumers' buying power. Casino, Auchan and also some non-integrated groups have already begun to settle in Poland. As this trend continues, companies such as Carrefour and Promodès will look increasingly to buying supplies on an European (or even global) level, and this will heighten the buying power of such groups.

8.6 Products

8.6.1 Washing Powders and Detergents

The market for washing products in France represents 60% of the detergents' market. It is quite strongly segmented, as each brand exists in several formats (standard powder, liquid, concentrated, and recently tablets) and in various container sizes. This segmentation is a central issue in the negotiations between producers and retailers: producers develop innovations to bring about market growth, and they create a number of new reference points, whereas retailers face increasing difficulties in handling this product proliferation and the ensuing complexity of the range of products. More particularly, the launching of compact powders initially suited both producers and retailers because of the potential growth it offered and because of the decrease of logistic costs it was supposed to bring. Yet it did not seem to suit consumers, since nearly 50% of them now still buy standard powder, as shown in Table 8.16. The number of reference points listed by retailers has thus increased: there are about 130 reference points in the average hypermarket, and about 85 in the average supermarket.

Table 8.16 - Market segmentation in washing powders

Market segment	1991	1997
Standard	47 %	49.3 %
Liquid	20 %	13.8 %
Concentrated liquid		9.9 %
Concentrated	24 %	16.9 %
Special	9 %	10.1 %

Source: LSA, 1998

The market for washing powders is dominated by four international groups, which compete at a European and a world-wide level. The market is very concentrated, since these four companies produce 94% of sales while the rest is now almost completely composed of own brands.

Table 8.17 - Market shares of leading producers of washing powders

Producers	Main Brands	Market shares: 1988	1990	1995	1996	1997
Procter & Gamble	Ariel, Vizir, Bonux	34.5 %	35.5 %	36.7 %	38.2 %	37.6 %
Lever	Skip, Omo, Persil	28 %	27 %	23.3 %	22.5 %	22.9 %
Henkel	Le Chat, Super Croix	20 %	18.5 %	21.4 %	20.6 %	21.3 %
Colgate Palmolive	Dash, Axion, Gama	11.5 %	11 %	12.3 %	12.8 %	12.2 %
Own brands[1]		6 %	8 %	6.3 %	5.9 %	6 %

Source: LSA, 1998

[1] For 1988 and 1990, "others" and "own brands".

Market shares have been quite stable for the last ten years with P&G the market leader with 38% of sales in 1997, followed by Lever (23%), Henkel (21%) and Colgate Palmolive (12%) (Table 8.17). Own brands' market share increased at the end of the eighties, but since then they have not increased, and their market share has even decreased slightly. Also at the end of the nineties, small independent brands have disappeared from the shelves. The main reason for this appears to have been the high level of advertising of branded goods, and the strong brand allegiance that this creates. In addition, the major producers produce brands for each segment of the market (Table 8.18) and this makes it difficult for new firms/products to find a niche in which to make a profit. Also recently introduced washing tablets are well-protected by patents, and this makes it difficult for other firms (e.g. producing own brands) to produce their own versions of this product.

Table 8.18 - Leading brands by market segment

	Up-market	Medium	Down-market
Procter & Gamble	Ariel	Vizir	Bonux
Lever	Skip	Omo	Persil
Henkel	Le Chat	Super Croix	
Colgate-Palmolive	Dash	Axion	Gama

Source: LSA, 1998

Negotiations between producers and retailers in this market focus on a number of factors such as rebates, listing fees, services to be provided by retailers, slotting allowances and so on. Given the limited number of groups on both sides of the market, terms and conditions are normally established by secret bilateral negotiation which can also lead to discriminatory financial conditions between retailers. The market has also been apparently affected by delisting of products, and, in some cases, refusal to supply.

In 1994, the Conseil de la Concurrence carried out an investigation[51] into the market for washing powders in France. This inquiry revealed the existence of a number of anti-competitive practices in the washing powders market between 1989 and 1992, mainly concerning the relationship between manufacturers and retailers.

Amongst other things, the Conseil found:

- a number of more or less hidden rebates and fees paid by producers to hypermarket or supermarket groups. These payments were part of confidential agreements (i.e. not written into official prices) but were often included in "commercial co-operation budgets", "advertising budgets" and so on. The Conseil identified eight separate types of payment, and criticised the producers for special payments made to Intermarché, GALEC (the buying group for Leclerc) and Système U, along with criticising the retailers for undertaking these arrangements.
- several cases of delisting had occurred. For example, in 1989, Sachap (the regional buying group for Leclerc) refused to purchase Lever's brands, in protest against Intermarché's low prices, which, according to Scachap, revealed discriminatory conditions. Lever's brands were boycotted for four months, until Lever paid a special fee.
- producers often try to impose conditions too and sometimes use practices like resale price maintenance or refusal to deal. For instance, Henkel was criticised for having imposed a minimum retail price on its main retailers. Moreover, these minimum prices were found to be discriminatory. At the same

51. Decision N. 94-D-60, 13th December 1994.

time, Procter & Gamble proposed recommended prices and was not criticised. Also, the four main producers refused to supply some products to Intermarché in 1989 and 1990 in protest against the retailer selling at a loss.

- finally, there was some evidence that branded washing powders were sold at a loss. Competition on branded washing powders is very intense at the retail level, and margins are typically very thin and, in some cases, negative. In 1994, for example, Lever accused Intermarché of selling its brands at a loss: Intermarché published a promotion catalogue which announced a retail price for Lever's brands that undercut the wholesale price by 2.5%.

We spoke to several leading producers in this market. They argued that buying power was a very important problem in France. Yet it appears that the brand leaders have very strong brands and this strengthens their bargaining power with retailers. Refusal to purchase is now very rare and it seems unlikely that own brands will increase market share markedly from the level so far attained. On the other hand, one major concern of retailers is to limit the increasing number of reference points, and to avoid the over-segmentation of the market. They are trying to obtain the removal of some products from manufacturers. This could be a central point in forthcoming negotiations.

8.6.2 Coffee

The coffee market has two main sub-markets: roast and ground coffee and instant coffee. In France, instant coffee constitutes 20% of total coffee consumption in volume compared to nearly 90% (in sales value) in the UK. In the roast and ground coffee market there are three main segments: Arabica, Mixed coffee and Decaffeinated coffee, but a finer market segmentation would also distinguish different quality levels.

The following table shows the evolution of the share of the average consumers budgets allocated to the consumption of coffee (and other beverages). After a fall at the beginning of the nineties, the share of the consumers' budget allocated to the consumption of coffee (and other beverages) has increased again recently, and its level in 1996 is slightly more than in 1990. However, tea and other beverage consumption has increased in this period, and in fact, coffee consumption declined slightly in 1996 (and 1997).

Table 8.19 - Coffee (and other beverages) in the average consumer budget

Years	1990	1992	1993	1994	1995	1996
Budget Coefficient for Coffee, Tea, Herb Tea	0.323	0.272	0.265	0.290	0.340	0.346

Source:Insee 1995, 1996.

One of the main reasons for this is the rise of the world price of Arabica (+ 50%) and of Robusta (+ 40%) in 1997. This increase has affected prices in supermarkets by 25% to 40%. Distributors reflect the increase in these costs in coffee national brands although to some extent they smooth out price increases for own brands and low price coffee.

Table 8.20 shows the sales of roast and instant coffee in France for 1998.

Table 8.20 - Sales of coffee in France, 1998

Product	Roast coffee	Instant Coffee
Turnover in FFr. millions	7,581	2,517

Source: Eurostaf, 1998

The two main producers of roast coffee in France are the Kraft Jacobs-Suchard which has a market share of 44%, and Douwe Egberts' with a market share of about 16% (Table 8.21). Italian groups like Lavazza or Segafredo and the French group Legal S.A follow. Own brand market shares are growing with sales of 17% in 1997. The market for instant coffee which is, of course, much smaller is dominated by Nestlé with Nescafé having nearly 70% of the market. The second producer on the French market is Maxwell, a General Foods subsidiary, whose market share is about 15%. Own brands provide 6.2% of the market and other brands 8.8%.

Table 8.21 - Leading brand market shares, 1996 and 1997

Brands	**Market shares in volume (1996)**	**Market shares in volume (1997)**
Maison du Café (Douwe Egberts)	14.9%	16.5%
Carte Noire (K-J-S)	17.0%	16.5%
Jacques Vabre (K-J-S)	14.2%	13.8%
Grand Mère (K-J-S)[1]	13.2%	13.2%
Lavazza	7.0%	6.2%
Segafredo	5.8%	5.4%
Legal	5.6%	4.5%
Malongo	3.0%	3.1%
Own Brands and First Price Products	15.9%	17.3%
Other Brands	3.3%	3.4%

Source: LSA Février, 1998
1 KJS=Kraft-Jacobs-Suchard

The major producers of coffee are subject to pressure from the major retailing chains to reduce prices for this product. In particular, when the coffee price increases (as for instance occurred during the summer of 1994 and at the end of 1996), retailers may try to impose a delay on producers before they can pass the increase on in wholesale prices. This delay enables retailers to lay in stocks, and when producers raise their prices retailers need to purchase less coffee. That can account for why retail prices do not always reflect changes in the underlying coffee price. As the coffee price is very volatile, producers, tend to bear the larger part of costs induced by market volatility.

In this market, retail prices usually reflect wholesale prices, as retailers typically charge a very small mark-up for the major coffee brands, because coffee has traditionally been considered a loss leader or very low-margin item. Nevertheless, since the Galland law forbids sales at a loss, retailers are no longer able to have negative margins. As with other products (and other countries) retailers charge higher margins on own brand products.

Coffee is similar to other products in that retail grocery chains often ask coffee producers to pay for special services. These services are, for instance, communication services (regional advertisements) or rents for end-of-aisle displays, that tend to increase the demand for a brand. This allows retailers to obtain rebates, the amount of which producers estimate at between 15% and 30% of sales. Buying groups can also require up-front fees from the producers.

Refusal to purchase appears rare in this market, but sometimes a retailer may stop listing one brand which for a secondary producer can induce serious losses.

It is expected in the next few years that concentration in the roast coffee market will increase, although own brands will also probably increase their market share. As in other markets this will put pressure on secondary producers. In this case, however, the low technology involved and the availability of sales to restaurants and cafés (accounting for 30% of total consumption) mean that a sizeable number of secondary producers are likely to survive. In the Instant sector, Nestlé is likely to continue to dominate the market.

8.6.3 Butter and Margarine

The butter and non-butter spreads market is divided into three segments in France: butter, margarine and low fat products (typically with less than a 60% fat content). Sales of butter (the largest segment) were Ffr. 6.0 billion in 1997 (Table 8.22) compared to margarine (Ffr. 1.4 billion) and low fats (Ffr. 0.8

billion). Consumption of margarine is much lower in France than the European average, with 3.5 kg/hab/year in 1997 compared to 6kg/hab/year.

Table 8.22 - Total turnovers of butter and margarine, 1997

Products	Butter	Margarine	Low fat products
Turnover Ffr. m.	6028	1385	836

Source: EUROSTAF, 1998

In the butter sector, the market is very atomistic and own brands and low price products represent more than two thirds of the market volume. The four first brands, Président, Elle & Vire, Paysan Breton and Bridel represent only thirty one per cent of the market (Table 8.23). On the other hand, margarine is dominated by Unilever which controls Astra and supplies nearly half of the margarine market. In this sub-market, own brands and first price products represent about one third of the whole market. Vamo is the main company that produces first price products and own brands for supermarkets. To capture consumers, margarine producers adopt two kinds of strategy. The first one concerns the design of products: margarine is sold in small tubs instead of packs. The second strategy consists of a very high segmentation of the market with nearly fifteen brands and only a few producers.

Table 8.23 - Market shares in butter, margarine and low fat products, 1998

Groups	**Butter**	**Margarine**	**Low fat products**
Astra Calvé	*Total: 0%*	*Total: 47%* (Fruit d'or, Plantafin, Equilibre, Effi, Astra, ...)	*Total: 39%* Fruit d'or (8.4%) Effi (10.5%) Plantafin (20.1%)
Besnier	*Total: 18.1%* Bfpridel (4.4%) Président (13.5%)	*Total: 0%*	*Total: 9.5%* Bridélight (5.6%) Bridélice (3.2%) Président (0.7%)
Cema		Primevère (1.3%)	
CLE	Elles § Vire (6.7%)		
Laïta	Paysan Breton (6.3%)		
Vedial	*Total: 0%*	*Total: 19%* (Prima, St Hubert 41, Le Fleurier,Mr Tournesol, Tournolive...)	*Total: 34.8%* Prima (3.3%) St Hubert 41 (18.7%) Le Fleurier (12.8%)
Own brands	26.9%	19.4%	7%
Others	42.2%	13.3%	9.7%

Source: Iri-Secodip, April, 19th 1998 and RIA 1998.

In the low fat content sector the leading group Astra Calvé has a 39% market share in 1998 followed by Védial 35%.

The market for butter is particularly interesting in this case. Given the atomistic nature of supply, the retailers are in a strong position to squeeze as much profit as possible out of the small suppliers. Retailers may obtain fees for listing products, for making certain types of shelf space available, for end of aisle displays and so on. Moreover, distributors may treat butter as a loss leader and often set zero margins on branded butter products, whilst realising positive margins on own brand products. From the point of view of the consumer, therefore, butter is sold at a very advantageous price. But other, smaller retailers may suffer as a consequence of this, and producers themselves may be forced to toe the line or lose their sales. There is a case, therefore, for arguing that retailer buying power could be detrimental in this respect: i.e. it tends to increase the pressure on small retailers' ability to survive, and similarly for small producers.

On the other hand, it could be argued that in terms of economic efficiency, small producers should only be allowed to make normal profits and that pressure by retailers ensures this is so. But this ignores the fact that by a change of policy, a retailer could effectively put a supplier out of business, and this is clearly a major threat as far as the supplier is concerned. This raises the issue of economic dependency, and the extent to which retailer power might be a concern for competition authorities.

CHAPTER 9 – GERMAN FOOD RETAILING

9.1 Market Structure Characteristics and Evolution

Germany has a somewhat different market structure in food retailing to the other countries we consider. While the German market has developed in similar ways to other countries as far as the reduction in the number of smaller stores and the growth of hypermarkets is concerned, and supermarkets initially gained an increasing market share, recent trends have shown a slight decrease in supermarket share and significant growth by discounters. In particular, since 1992, German discounters have grown to become the leading type of food outlet with nearly 22% of retail food sales in 1997 (Table 9.1). Supermarkets (with less than 1,500 m^2 of floor space) are now in second place with 20.5%.

Table 9.1 - Market share (in turnover) by type of outlet, 1992-1997

Type of Outlet	1992	1994	1996	1997
Discounters	17.6	19.9	21.7	21.8
Hypermarkets (>1,500 m^2)	16.6	17.5	17.9	18.7
Supermarkets (400-1,500 m^2)	21.8	21.4	20.7	20.5
Other big stores	14.1	12.5	11.3	10.9
Small stores, including specialists	29.9	28.7	28.4	28.1

Source: Euromonitor, 1998

A similar picture is shown in terms of the number of outlets. Here, discounters have increased their outlets by 46% in 1992-97 and hypermarkets by 18%. On the other hand, supermarkets have experienced a slight decline, and other big food stores have declined by 18% (Table 9.2).

Table 9.2 - Number of food outlets by type, 1992-1997

Type of Outlet	1992	1994	1996	1997
Discounters	8,388	10,073	11,580	12,220
Hypermarkets (>1,500 m^2)	1,854	2,023	2,097	2,191
Supermarkets (400-1,500 m^2)	9,735	9,831	9,610	9,596
Other big stores	48,010	43,250	40,800	39,600

Source: Euromonitor, 1998

Germany has experienced low economic growth since reunification and this has led to relatively low growth rates in food prices in nominal terms and falling prices in real terms. In nominal terms, food prices increased by less than 1% (on average) in the years 1992-7. If we allow for inflation, however, they declined by over 10% in the same period. Against this backdrop, and, in part, reflecting it in the growth of discounters, price competition in food retailing has been very intense in the 1990's.

In terms of seller concentration, German food retailing is less concentrated than the UK or France but more concentrated than Spain. Table 9.3 shows the major food retailing groups in Germany and their estimated market shares in 1996. The market is dominated by two groups (Rewe and Edeka/AVA) with market shares of more than 10 per cent. They are followed by Aldi (9%), Rewe (8.4%) and Tengelmann (6.7%). Metro is a company group whilst Edeka and Rewe are co-operatively organised and have some characteristics of a buying group (see below). Aldi is a discounter. There is also one major buying group, the Swiss-based Markant group which also has a market share of more than 10 per cent. This group acts as a buying group for mostly small independent firms, but also includes some larger players such as Lidl.

Table 9.3 - Market shares, 1993 and 1996

Group	1993 %	1996 %
Rewe-Group	8.6	10.9
Edeka/AVA-Group	12.2	10.5
Aldi-Group	8.3	9.0
Metro-Group	9.9	8.4
Tengelmann-Group	6.1	6.7
Karstadt	6.0	6.2
Lidl and Schwarz	3.9	5.0
Spar-Group	3.8	4.6
	45.1	45.5
Buying group		
Markant-Group	11.0	11.3
C_5[1]	50.0	50.0

Source: Authors' estimates (see Chapter 7)
[1]Concentration ratio calculated omitting Tengelmann.

There is also a number of other groups of significant size in German food retailing. Aldi, Tengelmann, Karstadt, and Lidl and Schwarz all have market shares of 5 per cent or more. Of these, Aldi, and Lidl and Schwarz are major discount chains who typically carry a limited range of products which they sell at very low prices. The other groups are more standard retail chains.

Table 9.4 shows estimates of market concentration by sales in 1985-94[52]. As in other European countries, market concentration has increased dramatically in Germany with the five firm concentration ratio almost doubling over the period shown. Second tier firms are also a key feature in Germany with the second largest five firms accounting for an extra 19 percentage points of concentration in 1994. In an important

52. These estimates are not directly comparable with those in Table 9.3 but are included here to show the changes in concentration that have taken place.

sense, this group of firms provides a strong "countervailing" presence, increasing competition for the leading firms. This contrasts with the UK, for example, where second tier firms are much smaller than in Germany.

Table 9.4 - Market concentration by sales, 1985-1994

	Concentration %		
Group	**1985**	**1990**	**1994**
Top 5	31	45	59
Top 10	46	62	78
Others	54	38	22
Total	100	100	100

Source: Schmidt (Wirtschaft und Wettbewerb), 1997

The rise in concentration in the years 1985-94 is mainly associated with an increase in merger activity. Prior to 1986 there were significant obstacles to mergers in this industry but these were over-turned in a court ruling in 1986. As a result there was a boom in mergers, especially in 1986-87. Merger activity has continued into the 1990s although in some cases (e.g. Aldi) firms have developed through internal growth. Most recently (in 1998), some large mergers took place with Metro buying Allkauf and Kriegbaum, Intermarché buying Spar and Wal-Mart buying Wertkauf and the larger Spar outlets (>5,000m^2).

Every two years, the Monopolies Commission is required to report on competition and concentration in different industries in Germany (e.g. in food retailing). In its 1996/7 report, it noted that whilst mergers continued to take place, resulting in a reduction in the number of medium-sized firms, there was no overall detrimental effect on competition. In addition, the growth of discounters, in particular, has kept competition strong.

Finally, the Government has recently changed its Act on Restraints on Competition (Gesetz gegen Wettbewerbsbeschrankungen) in May 1998 (to take effect on 1st January 1999). The changes are similar in some respects to those in the 1996 Galland Law in France in that they seek to shift the balance between large multiple retailers and producers. Specifically, the new law forbids retailers from setting prices permanently below purchase prices (at the request of suppliers who felt that this tended to affect the consumer's perception of product quality). Second, it allows for the possibility that firms can take action in the courts against the abuse of a dominant position without having to wait for the Cartel Office to take action. Third, it allows suppliers who wish to complain about the abuse of purchasing power by a retail chain to remain anonymous during the Cartel Office investigations (although not before the Court). And finally, the law also allows exemptions for retail buying groups with shares of less than 10-15% from the normal cartel laws; intended to enable smaller food retailers to compete with the larger retail chains.

9.2 Competition in Food Retailing

Although concentration in German food does not seem that out of line with other large member states, arguably the market appears to be much more competitive than elsewhere. This provides a salutary warning that concentration data can only provide a first indicator of possible market power and that more detailed analysis is required before strong conclusions can be drawn. In the German case, the growth of discounters has been a major factor in the competitiveness of the retail market.

In terms of the analysis of chapter 3, the leading multiple chains have buying power (question 1 of Table 3.1), they have it against both powerful and relatively powerless suppliers (question 2) but they do not appear to have significant selling power (at least in some areas: see below) (question 3). This contrasts with the three other countries that we consider. From our analysis, this suggests that while retailers can obtain significant discounts from suppliers, they also tend to *pass them on to consumers*. According to Schmidt (1997), discounters operate on very small margins of only 1-2% compared to typical margins of 6-8% in Spain, 6% in Holland, 6-8% in the UK and 4-6% in France. Moreover, on the products which discounters tend to sell, prices for all food retailers tend to be low because non-discounters are forced to match their prices. Indeed, many major food retailers have opened their own discount stores to compete for this important segment of the market. And, pressure from competition at the retail stage has in turn led to pressure on producers to reduce their margins.

Discounters, such as Aldi, make their profits by concentrating mainly on own label products which are often (but not always) of comparable quality to branded goods. They seek to buy these at the lowest possible prices, and then sell them at a similar low level. Hence, goods are often displayed in cartons rather than on shelves, they have to be bought in cash or by Eurocheque, and, at the checkouts, operators are expected to memorise the prices in order to avoid delays.[53] Discounters tend to dominate some products (e.g. canned goods) more than others and, typically, offer much less product depth than supermarkets (or hypermarkets). Table 9.5 shows discounter market shares of selected products in 1997.

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53. In contrast to most other food retailers, Aldi do not use scanners and this accounts for the fact that they are often excluded from analyses of food retailing which use scanner data.

Table 9.5 - Discounters shares of selected products, 1997

Product	Share of turnover, 1997
Canned food	46.7
Chilled food	36.5
Household cleaning products	19.1
Alcoholic drinks	16.0
Fresh food	13.9
Frozen food	13.7
Soft drinks	9.0

Source: Euromonitor, 1998

9.3 Retailer and Buying Group[54] Buying Power

The increase in concentration in food retailing in the last 15 years in Germany has increased retailer buying power with each of the companies in Table 9.3 being sufficiently large to exert buying power. Of the leading groups, the Metro group purchases centrally through Metro MGE Einkauf GmbH and does not belong to any buying groups. In contrast, Rewe and Edeka are co-operatively organised and purchase centrally for their members (Einkaufszusammenschlusse). These groups allow independent supermarket chains to participate in purchasing and hence also act as buying groups. Aldi operates independently and acts as its own buying group. In contrast, Markant is a straightforward classical buying group which groups smaller food retailers together to benefit from buying in bulk.

Most food retailers in Germany make use of their size to increase their buying power. This is not universally true, however, because Edeka negotiates on a regional basis (with 3 regions) for most products. In fact, negotiations only take place at a national level with 7 key suppliers. This reflects the regional nature of the co-operatives which make up the group.

Most of the retailers that we spoke to said that the main factors that they consider in dealing with their suppliers are price and quality. According to one food retail chain, the important factors are the wishes of the consumers and the saleability of products. They would not take on a new product group even if special payments were offered if they did not think the product would sell or it did not fit in with their store image. On the other hand, for comparable products the lowest cost supplier would normally win. In addition to price, continuous product quality is an important factor, as is continuity of supply. As leading retailers have had to face increasing competition from discounters, they have reacted by developing own brands and opening their own chains of discount stores. Own brands probably account

54. The major food retail buying group in Germany is the Swiss-based buying group, Markant. Other buying groups are associated with companies such as Edeka and Rewe.

for about 10% of the market as a whole (ignoring discounters). These products are often purchased from small producers and price is often the key factor.

As in France, bulk buying is an important but not the only factor in negotiations between buyers and producers. In most cases, producers are expected to give discounts for purchases in bulk and, in the competitive retail environment, these are typically passed on to consumers in lower prices. In addition, food retailers may charge fees such as listing fees, fees for positioning products in stores, for sales promotion measures, and so on. There is some evidence that some retailers may on occasion behave anti-competitively. An example is the case of Metro which bought Allkauf in 1998 and found that its competitor was receiving more favourable prices than it was for some of its products. As a result of this, Metro tried to renegotiate its contracts retrospectively to recover the extra costs, although, in this case, intervention by the Cartel Office stopped this going ahead.

A special feature in Germany has been the reunification of East and West. After reunification, many former East German suppliers had difficulties in becoming listed with West German retailers, and, as these latter spread into the East (with their existing suppliers), East German production came to a standstill. Discounters, in particular, have moved into the East with about 250 new outlets being opened in 1996 alone. The Government has attempted to overcome the listing problem by helping East German producers to improve product quality, and this has enabled some, but not all, to be listed by the major chains. Reunification has also been important as the major West German retailers have moved into the East.

Refusal to purchase can also be used in some situations where negotiations break down. A leading producer, for example, which tried to introduce an open pricing policy for its washing powders in 1996 was apparently delisted by several large retail chains. By and large, however, refusal to purchase is relatively rare. In some cases, it is very difficult to refuse to purchase especially where a large dominant brand is involved. In such circumstances, a retailer has to sell the brand because of customer demand (so-called, "must-stock" brands). Producers with strong brands are also in a stronger position to resist retailers' demands for lower prices, and, we were told, the larger brands continue to make high returns for the firms involved.

Smaller suppliers are in a less favourable position and, given the strong retail competition that exists, they are under very great pressure to reduce prices.

German companies and buying groups are also members of international alliances. Edeka is a member of AMS (which includes Casino and Safeway), Markant is a member of EMD (with, for example, Britain's Today's group and Span's Euromadi) and Rewe, the Swiss Co-op and the Dutch company Markant work together in Eurogroup. These alliances appear not as yet to have had any major effect as far as retail purchasing power is concerned (see Appendix 2).

9.4 Products

9.4.1 Washing powders and detergents

Washing products in Germany are divided into 3 categories: detergents, softeners and special washing products (e.g. additives for detergents). According to the German retail panel (GFK) sales in January-October 1998 (excluding Aldi) were DM 1.8bn for detergents, DM 0.4bn for softeners and DM 0.6bn for special washing products. Henkel is the largest producer of detergents with 46% of the market, followed by Proctor and Gamble with 29% and Unilever with 12%.

Table 9.6 - Market shares (% of sales) for detergents, 1997

Group	Detergents
Henkel	46
Procter and Gamble	29
Unilever	12

Source: Euromonitor, 1998

Alternative data for detergents from the household panel (which includes Aldi) are shown in Table 9.7. Henkel is the market leader again with 45% of the market, Procter and Gamble is in second place with 26% followed by Unilever with 13% and others (including Aldi with about 10%) with 16%. Henkel has increased its market share by 6 percentage points between 1987 and 1997, whilst Procter and Gamble and Unilever have lost market share in more or less equal proportions – see Table 9.7. Own brands are more successful in Germany than in France (where they account for about 6% of sales), although this is accounted for by Aldi's market share.

Table 9.7 - Market shares for detergents, 1987 and 1997

Group	Market share (% of sales)	
	1987	1997
Henkel	39	45
Procter and Gamble	29	26
Unilever	15	13
Others (including Aldi)	16	16

Source: Euromonitor, 1998

The supplier side of the market is dominated (as in France) by a few large firms although the actual ranking differs between them. In France, P&G is the largest firm with about 38% of the market followed by Unilever with 23% and Henkel with 21%. In Germany Henkel, which was formed from a number of separate firms, is, however, the market leader.

An important feature in this market has been the attempt by a leading producer to introduce open pricing policies for its washing products, such that prices set would be common across Europe, with set discounts for cost savings and so on. Its strategy may be seen as an intention to eradicate the national bargaining that takes place and, thereby, avoid the need to give bigger discounts to larger retail chains. Not surprisingly, this policy has been resisted, particularly in France and Germany, and as a result of this there was a boycott of products by major German retailers. While this lasted for only a few months, the matter has as yet not been fully resolved and, at present, the supplier still has to negotiate bilaterally with each of the supermarket and buying groups.

Although washing powders are a very basic commodity, there is strong brand allegiance and, with the exemption of Aldi, the market is dominated by three major European firms, which rely heavily on advertising to promote their goods. In addition, the major manufacturers produce products for each market segment (standard powders, concentrated powders, etc.) and this would make it difficult for a new producer to enter with only one brand (e.g. a standard powder) because the market is divided a number of ways. Given the strength of brand allegiances, food retailers are limited in the extent to which they can exercise buyer power in this market, although not entirely so as even the largest producers can face the credible threat of being delisted.

9.4.2 Coffee

The major part of the retail coffee market in Germany is roast and ground coffee with annual sales of about DM 8bn. Instant coffee, in contrast, only accounts for 10% of the retail sales. These figures, in fact, are the exact reverse of the case in the UK.

Until recently roast and ground coffee was dominated by KJS. However, a merger between Tchibo and Eduscho in 1998 has created an effective duopoly in this market (Table 9.8). KJS has a market share of 30% and Tchibo/Eduscho has a market share of 28%. The market also has two other big players: Albrecht (Aldi) with 18% of the market and Nestlé (with its Dallmeyer brand) with about 10%.

Table 9.8 - Market shares for roast and ground coffee, 1998

Group	Market share (% of sales)
KJS	30
Tchibo/Eduscho[1]	28
Albrecht (Aldi)	18
Nestlé (Dallmeyer)	10
Others	14

Source: trade estimates
[1] *Tchibo merged with Eduscho in 1998.*

In this market, prices are typically set by negotiation between suppliers and retail chains or buying groups. Given the competitive nature of the downstream market, pressure is clearly put on the major producers to keep prices low in order, in particular, to compete with Albrecht. This implies that an upper limit is put on the prices that the market leaders can charge, notwithstanding their large market shares, and this may be an instance in which competition is quite strong even though the leading firms have large market shares. The market share of Albrecht shows again the strength of discounters in Germany and that consumers are willing to buy a product if it is comparable with the brand leaders and it is sold at a lower price.

The instant coffee market is much smaller than the roast and ground coffee market, and the market leader is Nestlé (see Table 9.9). In fact, there are two sub-markets within instant coffee:*pure* instant coffee (where Nestlé has a much larger market share than 30%) and *speciality* coffees (e.g. cappuccino), which have grown in importance over the last three years, and which are dominated by own brands. In this latter market, in particular, discounters have been able to gain market share by reducing prices, and competing directly on price. This contrasts with the UK (see chapter 11), where own brands and secondary brands are often seen as of inferior quality to branded goods, and hence their market share tends to be relatively low. In Germany, however, consumers have been persuaded that own brands are of sufficiently quality, and, therefore, they compete directly with the major brands.

Table 9.9 - Market shares for instant coffee, 1998

Group	Market share (% of sales)
Nestlé	30
KJS	10
Private label and others	62

Source: trade estimates

Nestlé does not supply own label but relies on the strength of its own brands to maintain market share. There have been instances of delisting in this sub-market but this is relatively rare. Both the major suppliers (Nestlé and KJS) and the supermarket/buying groups recognise that it is important to have Nestlé (and, to a lesser extent, KJS) brands on the shelves, and this not only prevents delisting, but also strengthens the bargaining position of the leading brands. Nestlé, in particular, appears to be in a strong position to resist retailer buyer power in Germany.

9.4.3 Butter and margarine

As in France, there are major differences between the butter and margarine markets in Germany. Butter is, essentially, in competitive supply and is often delivered locally from local dairies. On the other hand, margarine is dominated by Unilever with a 60% market share (see Table 9.10). Unilever is by a great margin the largest producer with brands such as Rama, Becel, Homa-Gold, while Aldi, in second place, has a much smaller market share of about 13%. The main own brand supplier to Aldi is Rau which accounts for about 6% of Aldi's 13% market share, and the rest of the market is made up mainly of own brands.

Table 9.10 - Market shares for margarine, 1998

Group	Market share (% of sales)
UDL (Unilever)	60
Aldi	13
Others (mainly private label)	27

Source: trade estimates

Unilever is clearly in a strong position in this market, and this presumably helps it in resisting demands for price discounts. Very few food retailers (apart from discounters) could risk delisting Unilever's products, although this has apparently happened occasionally in the past. Hence, while buying power is important in Germany, Unilever is probably able to resist pressure to reduce prices to a considerable degree, though smaller producers are in a considerably weaker position.

One new feature in the market has been the attempt by some retailers to demand a Euro-bonus (in the form of an additional discount of 3%) related to the total of their purchases of margarine across Europe. This bonus is not related specifically to any cost savings in handling goods, etc. It seems likely, in the future, that more demands of this type could be made by food retailers as international alliances grow stronger and as food retail companies expand into other countries.

Margins for own brand suppliers of margarine appear very low in Germany and, in some cases, so low that they may not even cover the cost of capital. In this part of the market, purchases are put out to tender and usually the lowest price wins. Quality, of course, is also a factor, but given an acceptable level of quality, sales usually go to the lowest bidder.

It seems likely that Unilever will continue to dominate the market in Germany, in part by introducing new products (such as margarine with olive oil), and also because of its strong brands. Own brand market shares may, however, increase to some extent, and retail buyer concentration is also likely to rise.

Butter is a slightly smaller market in Germany than margarine and, as noted above, appears to be very competitive. The largest brand is probably Kerrygold (from Ireland) with a market share of about 10%, but the market mainly consists of small producers and own brands. Since the quality of butter is defined by law, supermarkets and buying groups mainly buy on price, and this means that suppliers' margins can be very low - we were told of the order of less than one per cent, compared to 6% in the UK and up to 10% elsewhere. This side of the market is, therefore, very similar to own brand sales of margarine.

CHAPTER 10 – FOOD RETAILING IN SPAIN

10.1 Market Structure Characteristics and Evolution

Food retailers are the most important single component of Spanish retail sales, covering 44.5% of the total retail market in 1996. Over the last decade the structure and organisation of food retailing has changed considerably, with the market becoming technological, sophisticated and increasingly concentrated. The dominant players have become the hypermarkets and supermarkets groups which have increased both in number and average size, selling a large variety of food and non-food products and offering a variety of additional services to consumers.

The market is divided between five main kinds of players:-

- hypermarkets (with sales areas in excess of 2,500 sq. m., long uninterrupted trading hours, large free parking facilities and 40% of sales devoted to sales of non-food products);
- large supermarkets (sales areas over 400 sq. m., 70% of which, on average, is dedicated to food retail distribution);
- small supermarkets (sales areas around 250-400 sq. m and at least two tills);
- convenience stores; and
- independent retailers.

Table 10.1 - Market Shares in Spanish food retailing by outlet type (% sales in value), 1987-1995

	1987	1988	1989	1990	1991	1992	1993	1994	1995
Hypermarkets	15	18	20	23	26	29	31	31	33
Large Supermarkets	12	12	12	12	12	12	12	13	14
Small Supermarkets	25	27	29	30	30	30	31	31	31
Convenience Stores	16	16	15	15	14	13	13	12	10
Independent Retailers	32	27	24	20	18	16	15	13	12

Source: Distribucion y Consumo, Diciembre-Enero, 1996

Due to differences in ownership (which will be discussed later), it is necessary to distinguish between the hypermarket and supermarket sectors, and then between large and small supermarkets. As we can observe in Table 10.1, the hypermarkets dominated the market in 1995 with 33% of total food turnover, more than doubling their market share in 1987-95. Both large and small supermarkets[55] have increased

55. Until the arrival in Spain in 1994 of the German based discounters Lidl and Tengelmann, the main discounter in Spain (Dia) had used small supermarkets as its main outlets.

their market share over the period but to a smaller extent (17% and 24% respectively). On the other hand, convenience stores and, in particular, small, independent retailers, have suffered a continuous decrease in market share (by, respectively, 38% and 62%).

A more detailed picture is offered by Table 10.2.[56] This shows that the five biggest retail groups of the Spanish food retailing sector controlled 32.6% of the market in 1996: Promodes (9.7%), Pryca (7.1.%), Eroski (6.3%), Alcampo (5.1%), and Hipercor (4.4%). Promodes increased its market share by 2 percentage points in 1993-6 whilst Pryca's market share increased slightly and the other three leading firms also increased their market share. Five-firm concentration increased from 23.9% in 1993 to 32.6% per cent in 1996. While the main business of all of these groups is in hypermarkets, Table 10.3 shows that all the groups enjoy a direct or indirect presence in the supermarket or discounter business.

Table 10.2 - Fast moving consumer goods (FMCG): retail structure, 1995-1997

	1993 %	**1996** %
Promodès	7.8	9.7
Pryca (Carrefour)	6.9	7.1
Eroski	3.2	6.3
Alcampo (Auchan)	3.6	5.1
Hipercor (El Corte Ingles	2.4	4.4
C_5	23.9	32.6

Source: Authors' estimates (see Chapter 7)

Table 10.3 Composition of the main groups in the Spanish FMCG industry

Group	
Grupo Promodes	Continente, Dia, Punto-Cash, Punto de la Plata, Iliturgitana, Simago
Pryca	Pryca, through Comptoirs Modernes (Comodisa, Maxor, Supermercats Economics)
Gidae	Eroski, Syp, Unide, Cenco, Becodis, La Merced
Grupo Alcampo	Alcampo, Sabeco
El Corte Ingles	Hipercor, Supermerados El Corte Ingles

Source: Trade sources

Promodes, Pryca and Alcampo are French owned: Pryca's main shareholder is Carrefour BV; Promodes' main shareholder is Promodes France; and Alcampo's leading shareholder is the Auchan group.

56. In this case the reference aggregate is the total revenue in value of the Fast Moving Consumer Goods Industry, as defined by AC Nielsen.

Carrefour entered the Spanish market in 1973, Promodes in 1976 and Auchan in 1979. The other two major chains are Spanish owned, with Hipercor a subsidiary of the major Spanish retailing group, El Corte Ingles.

While 5 firm concentration is lower in Spain than in the other countries in this study, it is clear that it is growing at an increasing rate. A key feature in this has been the expansion of the French retail chains in Spain. In a relatively short space of time (since the mid-1970's), French groups (in particular, Promodes) have built up a strong position in Spain. While much of this has been by direct investment in out-of-town hypermarkets, mergers and take-overs have also been important. Some of the principal take-overs in the period 1996-8 are shown in Table 10.4.

Table 10.4 Principal mergers and take-overs, 1996-1998

	Acquired company	Acquiring company
1996	Jumbo (Pan de Azucar)	Alcampo
1996	Expresso (Pan de Azucar)	Alcampo
1997 Merger	Almacenes Gomez Serrano	Mercadona
1997 Agreement	UNIDE/mercat	Eroski
1997	Sabeco	Alcampo
1998	Dairy Farms	Promodes
1998	Hilario Osorio	Unigro

Source: Trade sources

Although the growth of hypermarkets and large supermarkets has been beneficial to consumers as a whole, concern has been expressed in Spain over the effect of this on small retailers and suppliers. This resulted in the passing of the 1996 Commerce Law (*Ley de Regulacion del Comercio Minorista*) which aims to limit the market power of the major retail groups. Its main provisions are:-

- except in the regions of Valencia, Catalunya and Galicia, two levels of authorisation are now required for the construction of out-of-town supermarkets or hypermarkets: a planning and zoning permit from the local authority and an authorisation from the regional government which is based on existing coverage and retail saturation levels. This has complicated enormously the opening of new outlets. Although this can seem to be a limiting factor in the hypermarket expansion process, it is also gives a strategic advantage for the incumbents and a barrier to the entry to new competitors. There is also evidence that some of the major chains in the past have bought large cheaper sites in excess of their needs, and can now enjoy a serious advantage by not selling/renting them, or renting them at very high prices.

- to limit hypermarket opening hours (especially restricting Sunday opening to eight Sundays in a year). The immediate consequence of this has been further price cuts by the hypermarkets to recover from the Sunday loss of sales.
- to prevent selling below cost. The effect was to prevent hypermarkets from pricing their best selling items below cost, and is expected to enable the supermarkets to regain a competitive position.
- to prevent retailers and buying organisations stretching the terms of payment to suppliers. Delaying payments represents financing without interest which arguably has been used by the retail chains both to operate in the financial markets and to finance their expansion process. It follows that a hypermarket which is able to invest efficiently in the financial markets could be profitable even when setting prices below costs. The 1996 Law stipulates that any payment delayed by more that 90 days will require a letter of credit, and any payment delayed more than 120 days is subject to a possible demand for a banker's reference by the supplier. However, the real effects of the regulation have been limited and terms of payment to suppliers of the big chains (in 1997 they were on average 118.33 day for Continente, Pryca and Alcampo) are still well above the average of northern European countries.

Although the 1996 Commerce Law is expected to slow down the rate of closure of independent outlets, the overall trend is a continuing reduction of their number and an increase in the degree of concentration of the Spanish food retail market.

However, the domestic firms have been active in their response to the advance of foreign-owned hypermarket groups. For example, ARDE (Asociacion para la Reforma de la Distribucion Espanola) was formed by some 30 small- and medium-sized supermarket chains to lobby on behalf of Spanish-owned businesses. At the same time, Alcampo, Pryca and Continente formed Instituto de Estudios de Libre Comercio as a lobbying force, with Eroski being represented, to seek to limit the extent of legislation.

Another important element for the future configuration is the possible expansion of the discounters, which could deeply affect the supermarket sector. Whereas it is expected that the strategy of the small supermarkets will be to add discount outlets or to convert existing ones to discounting, it is very likely that the strategy of the larger supermarket chains will be expansion via the opening of new outlets or acquisition of small local chains, a strategy which they have followed in the past in order to control both out-of-town and in-town locations.

10.2 Retailer Buying Power

In Spain, the major food retailers are not part of buying groups (although they do have some indirect involvement).[57] Rather they use their own buying power to extract discounts from suppliers. (There are,

57. For example, Eroski is a member of the GIDAE buying group with Syp and Unide.

however, also two leading buying groups with 44% of sales - see below.) Large retailers, on average, account for between 10% to 20% of the sales of large manufacturing companies and more than 25% of the sales of small and medium sized companies. In addition, retailers control the shelf-space available to producers and are increasingly introducing own brand products which compete with branded lines.

Table 10.5 shows the operational costs, revenues and gross margins of 3 of the top retailers with the average of the rest. With no significant difference in operating costs or point-of-sale turnover, the gross margins of the larger hypermarket chains are more than three points higher than the rest. This indicates that whilst these chains were able to extract large discounts from suppliers, they failed to pass at least some of these lower costs on to consumers.

Table 10.5 Figures for aggregated balances[1], 1997

	Aggregated balances of Pryca, Continente and Alcampo	Aggregated balances of other 800 distributors
Operational Costs (% of total revenue)	15.84	16.04
Point-of -sale turnover (days)	40.68	40.52
Gross Margin (% of total revenue)	19.29	16.16

Source: Registro Mercanti, 1998
[1] Figures include some other goods such as white line appliances.

The large food retailers take their purchasing decisions on the basis of a two step procedure. In the first stage, the supermarket carries out a selection among prospective candidates using as criteria price, interest in the brand, guarantee of supply, and so on. The second and most interesting step is the elaboration of what is commonly called the "*plantillas*", in which the retailer makes explicit the concrete conditions of the supply relationship. The standard conditions of these supply contracts are the following:

- a listing fee which is paid simply for store presence;
- slotting allowances for shelf space;
- additional monetary sums to locate products in end-of-aisle displays;
- fixed end-of-year rebates: payments in addition to per unit compensation linked to volumes of sales achieved;
- demands for long terms of payment that do not match product turnover. Cruz, Fernandez and Rebollo (1997) show that the length of the term of payment is directly related to the size of the distributor;

- return of unsold units (especially relevant for fresh food and vegetables);
- contributions to special promotions such as "3 for 2 deals",
- small and local manufacturers either have to pay a fee to the hypermarket to refill the shelves with their products or have to do it themselves.

From the configuration of the supply contracts specified above it is clear that the discounts obtained by hypermarkets from their suppliers are not simply associated with cost savings. The hypermarkets obtain discounts making explicit use of their bargaining power when negotiating with suppliers and obtain reductions that are not related to buying in bulk.

We were also told of a number of practices in Spanish food retailing which more clearly emphasise the exercise of buyer power.

- contributions to store openings, remodelling and extensions. Examples are:
  - a leading retailer's "plantilla" sheets suggests that the firm XXXX should pay to each new store opened during 1996 the amount of XXXX ptas as an *opening contribution.*
  - in February 1996, Simago (Promodes group) required from its suppliers 1% of their sales in 1995 because of economic problems and to finance store reconstruction (El Pais, 18-02-96).
  - one group required a contribution of between 10.000 and 50.000 ptas for each one of its stores to be refurbished.
  - Alcosto (associated with the IFA buying group) asked suppliers to give a percentage retrospective discount on 1993 sales to finance expansion (Cinco Dias, 25-2-97).
- retrospective discounts over sales in the previous period in the event of mergers, acquisitions ("wedding gifts") or anniversaries. Examples:
  - Alcampo after buying Jumbo and Sabeco in March 1996 asked suppliers for a retrospective discount of 1% of the previous year's sales (Cinco Dias, 4-11-1998)
  - Eroski after agreement with Unide and Mercat, under the threat of delisting, required from the suppliers 3 millions ptas or a 2% discount on 1997 sales (Expansion, 3-2-98, Cinco Dias, 4-11-98)
  - Continente (Promodes group) after acquiring Simago in 1998 required from suppliers a 1% or 2% discount on total sales in 1998 (Cinco Dias, 4-11-98)
  - examples of requirements of anniversary discounts are the IFA buying group in 1997 (Cinco Dias, 5-2-97) and another buying group also in 1997.
- unilateral increases in discounts without compensation for suppliers.
- application of a regressive end-of-year rebate to penalise those suppliers that did not reach target levels of sales.

- "exclusive purchase" arrangements which are common practice for the supply of private labels.

On the face of it, these practices go beyond what one would normally expect in a straightforward trading relationship.

Also in Spain, in particular, another practice needs to be considered. While in most northern European countries terms of payment for food and household goods are generally between as little as 9 and 12 days, the terms of payment of the largest Spanish distributors are sometimes as long as 120 days. The length of these terms of payment is extremely long if compared to an average point-of-sales turnover of between 7 and 20 days. The possible repercussions of these delays in payments in the Spanish FMCG industry are:-

- an increase in the costs of Spanish manufacturers relative to other European manufacturers who do not experience these delays;
- a drain on manufacturing funds, limiting the possibility of investment in new product development and productivity improvements;
- in the opinion of the manufacturers a latent financial risk given the possibility of retailer bankruptcy.

The Alcampo, Eroski and Continente retrospective discount episodes described above have been investigated by the *Comision de Seguimiento del Observatorio de la Distribucion Comercial* (Observatory of Commercial Distribution). They concluded in their report that the requirement of payments greater than indicated in the contract signed between supplier and retailer could be considered a unilateral and retroactive violation of the contractual conditions and therefore not binding by law. These practices could be also considered as an abuse of dominant position and so could be referred to the *Tribunal de Defensa de la Competencia* (Defense of Competition Office).

10.3 Buying groups

The importance and number of buying groups has increased over the past decade. These are made up of predominantly independent and smaller retailers seeking to obtain buying economies to compete more effectively with the major chains of multiples. As shown in Table 10.6, the two leading buying groups are Euromadi and IFA with market shares of 22.2 and 22.1% respectively in 1996. These groups account for much larger market shares than even Promodes (9.7%) and Pryca (7.1%). In addition, Eroski is a member of the Gidae buying group with Syp, Unide and Cenco-Becodis La Merced.

Table 10.6 Retail buying groups, 1996

Group	Market Shares %
Supermarket Groups	
Promodes	9.7
Pryca	7.1
Eroski	6.3
Alcampo	5.1
Hipercor & Supermercados El Corte Ingles	4.4
C_5	32.6
Buying Groups	
Euromadi (excludes Syp and Simago)	22.2
IFA	22.1
C_5[1]	67.4

Source: Authors' estimates (see Chapter 7)
[1]Concentration ratio calculated omitting Alcampo and Hipercor.

Table 10.7 shows the most significant members of IFA and Euromadi in terms of sales and percentage of Pryca sales. As can be seen, these chains are, individually, much smaller than Pryca, and, typically, represent small to medium sized supermarket chains. A significant number of these firms have sales of around Ptas 100 billion. The main aim of these firms is to obtain discounts from suppliers to enable them to compete with the leading retail chains; in addition, some mergers are also taking place, as, for example, in the recent merger of Enaco and Ahorramas.

Table 10.7 Size and leading members of buying groups, 1996

		Sales 1996 in Billion Pts	% of PRYCA sales
IFA			
	GIC-AIE	125	21.0
	Caprabo	90	15.1
	Superdipol	90	15.1
	Enaco-Ahorramas	83	13.9
	Osoro-Uvesco	62	10.4
Euromadi			
	SYP	102	17.1
	Unigro	92	15.4
	Simago	70	11.8

Source: Nielsen, 1998

The major food retailers also have an indirect relationship with the main buying groups as shown in Table 10.8.

Table 10.8 Penetration of major retailers into buying groups

	Description
Continente	Promodes owns 34% of Ilurgitana de Hipermerados, 66% of this belongs to Luis Piña S.A., a member of Euromadi.
Continente	Promodes acquired 100% of Simago, associated to Euromadi.
Pryca	Carrefour owns 24% of Comptoirs Modernes (which controls Comodisa, Maxor and Supermercats Economics that are associated to IFA).
Mercadona	Merger agreement with Gomez Serrano, a member of Euromadi
Eroski	Creation of the Buying Group GIDAE in association with SYP and UNIDE

Source: Trade sources

Although the major buying groups represent smaller chains, they also have restrictions on who can join; for example, Grupo IFA requires a minimum annual turnover of Ptas 10 billion, and other factors such as common interest and performance are also taken into account. This suggests that the smaller retailers will have to merge (or be taken over) in order to survive.

In terms of their activities, Euromadi and IFA perform broadly similar tasks in terms of their central buying activity in that they (i) negotiate rebates, (ii) agree purchase prices, (iii) agree payment terms, (iv) agree promotional activity, and (v) act as the payment point. While the individual members undertake some of these activities on their own behalf (e.g. negotiating rebates, purchase prices and promotional activity), they are left to agree range and listing, dispatch conditions, generate orders, be the delivery point and be the invoice point.

10.4 Own Brands

Own brands are becoming increasingly important in Spanish retailing in general and in food retailing in particular. The market share of own brand products in retailing in 1994 has been estimated as 8.3% with a higher penetration for food products, 11.1%, than for non-food products, 6.7%. Although this is low if compared with the own-brand penetration in the UK (39% in 1996), it is growing fast, nearly doubling in 1990-94.

The role and importance of the own-brand products has drastically changed in the 1990's. Whereas they were first introduced in supermarkets as a cheap and low-quality alternative to branded products with the aim of stimulating sales especially during a recession, in the last few years major retailer own brands are characterised by an increasing degree of sophistication and a deeper market penetration. Since 1990 own brand products have increasingly been used both to compete with branded products and to create loyalty to retail chains.

The approach to own-brand production varies across manufacturers, especially among those who already produce for brands. Some of them have opened up to the market for own labels, whereas others base their strategy (and advertising) on the very fact of not producing own brands. Among the firms that do not produce own brands, as they consider it harmful to their reputation, are Kellogg's, Coca-Cola and Gillette. Brand producers involved in the production of own-brands include Danone, McCain, Mahou (a subsidiary of Guinness), Casera (brand leader in the Spanish lemonade industry) and Campofrio (brand leader in the Spanish roast ham industry).

A phenomenon quite relevant from the marketing point of view is that Hipercor specifies on the own brand products the name of the producer. If we consider that own brand products are located on the shelves close to branded products, that they look very similar and that they are 10% to 20% cheaper, the fact that the consumer can identify the producer, if well-known, makes the marketing advantage of own brand products evident.

It is commonly argued that two factors explain why own brand product margins are greater than brand product margins. On the one hand, retailer bargaining power is greater when negotiating the wholesale price of own brand products; on the other hand, because own brand products are unique to each retailer, they offer some protection from direct retailer-to-retailer competition.

Furthermore, in Spain branded products appear to have repeatedly been used as the main competitive category to build store traffic, having been sold on a very low margin or even at a loss in order to attract consumers to the shops.

Because they contribute to making the threat of delisting credible, own brand products strengthen the bargaining power of the retailers if they are perceived as a close alternative to branded products. It is difficult to find evidence about this, but this argument may be linked with the "wedding gift" requested by Eroski at the moment of the creation of GIDAE because it was apparently made under the threat of delisting.

Moreover, the involvement in own-brand production by some branded goods producers implies that they share some cost-information with retailers, which they can then use when negotiating the price of branded goods.

It is also worth noting the effect of the increasing importance of own brands on the decline of secondary brands. These products, which used to be cheaper alternatives to the main brands, have in many cases disappeared from the retailers' shelves. The reason is twofold: on the one hand, secondary brands are unable to compete on price with own brand products (due to the need to support brands through promotions); on the other hand, sometimes they have been delisted by the supermarket chains because they could not match the conditions requested by the retailers. For some of these secondary-brand producers the only alternative has been the conversion to own brand production.

10.5 Products

10.5.1 Washing powders and detergents

The Spanish market for washing powders and other detergents is a mature market and laundry detergents are considered low-cost, low-margin, volume shifting goods. In order to obtain a picture of the importance of this product in Spain compared to other EU markets, we consider the average per capita expenditure on textile washing products in 1997. Inspection of Table 10.9 reveals that the average per capita expenditure on textile washing products in Spain is intermediate between other EU countries. The average expenditure (25.97 ecus) is similar to the French (25.39 ecus) but lower than the average expenditure in the UK and Italy (27.80 and 30.72 ecus respectively).

Table 10.9 Average per capita expenditure on textile washing products in ECUs (1997 exchange rates)

Country	Average per capita expenditure (in ECUs)
Italy	30.72
UK	27.80
Spain	25.97
France	25.39
Germany	23.89

Source: Market Research in Europe, July 1998

The total size of the Spanish market in 1997 was Ptas 98.35bn, down from Ptas 103.31bn in 1993, representing a decrease in the real value of sales of 4.8%. This is similar to other European countries such as Italy, Germany and Benelux. The main factors explaining it are:-

- competition among leader manufacturers and with private label producers which has restricted the value growth of sales. Many companies, such as Procter & Gamble, have been forced to cut prices and offer special promotions;

- consumers have moved back from more expensive concentrated powders to cheaper standard powders;
- there has been increasing penetration by private labels and discount stores.

The Spanish market for washing products is dominated by 4 large firms: Henkel and P&G who each have 20% of sales, followed by Benckiser with 17% and Unilever with 13%. The key brands are listed in Table 10.10. In addition, own brand shares account for a further 14% of sales. The market is quite similar to that in other EU countries (although the mix of market shares varies from country to country) and prices and terms and conditions are, again, determined by negotiation between the major firms.

Table 10.10 - Main producers' washing powder brands

Groups	*Brands*
Benckiser	Colon, Elena, Vial
Henkel	Blancol, Dixan, Micolor, Mistolin, Perlan, Wipp
P&G	Ariel, Dash
Unilever	Luzil, Skip

Source: Market Research in Europe, July 1998

A major feature of the Spanish market is the importance of the two buying groups, Euromadi and IDA, in addition to the major supermarket chains. These groups, of course, represent many independent retailers and, through mergers, also parts of the leading supermarket chains. The evidence we collected in Spain suggests that sales by leading manufacturers to the leading five supermarket chains were of the order of 40% of total sales, and that a similar figure also applies to sales to the buying groups. If buying groups are, therefore, included with the leading supermarket chains, producers are dependent on these groups (and chains).

We have already highlighted some of the practices in retailing in Spain which might be considered as manifestations of buyer power. In this sector, as elsewhere, we again heard comment on the terms of payment of supermarket chains in Spain which often exceed 100 days and are much longer than in the north of Europe. In addition, retroactive discounts, "wedding gifts", etc., were also mentioned in this case. These issues, in fact, appear to be fairly widespread in Spain, and were also raised in the two other product groups discussed below.

10.5.2 Coffee

Instant coffee accounts for a relatively small part of the Spanish coffee market, with sales predominantly consisting of roast and ground coffee. A number of suppliers have established quite strong market positions (see below) but with no particular dominant firm and overall concentration in the supply of coffee is relatively low.

Consumption of coffee in Spain has been fairly constant at about 70,000 tonnes per annum over recent years. The real value of coffee took a dip, however, in the early 1990's (to around Ptas 48bn per annum) before increasing in the mid 1990's (to around Ptas 55bn). These changes, however, reflect changes in the World price of coffee rather than dramatic changes in consumption.

Table 10.11 shows per capita sales of coffee (in ECUs per capita) in several EU countries. In this group, Spain has a relatively low consumption of coffee, similar to the UK, but much less than in Italy, France and particularly Germany (which has an exceptionally high figure).

Table 10.11 - Per capita value of sales (ECUs per capita), 1995

FRANCE	18.23
GERMANY	41.21
ITALY	18.12
UK	12.36
SPAIN	11.33

Source: Consumer Europe, 1995

For 1995, three companies had market shares in excess of 10%: Nestlé (producing instant coffee) and Douwe Egberts and KJS (producing mostly roast and ground coffee). Nestlé is the leader in the Spanish coffee sector in terms of production output, with a volume share of 16% in 1995 with its *Nescafé* and *Bonka* brands. The second and third players in the market are *Douwe-Egberts* (*Marcilla*) and *Kraft Jacobs Suchard* with 12% and 11% respectively. The rest of the market (over 60%) is, however, accounted for by small suppliers and own brands.

While there are leading producers in Spain, the supply-side of the market is, in contrast to some of the other countries considered, relatively unconcentrated. Under these circumstances, both retailer buying power and competition between firms can lead to lower prices and lower margins. A leading trade organisation told us that both large and small suppliers are continually under pressure to reduce prices in this sector, and that this, in turn, puts pressure on them to reduce their costs. Leading producers (e.g. Nestlé with instant coffee) have an advantage over smaller producers in that consumers wish to buy their brands and this allows them to resist buyer pressure to some extent. Smaller producers, however, do not enjoy this luxury and, for them, competition appears to be very strong.

10.5.3 Butter and margarine

The traditional Mediterranean diet in Spain is characterised by high consumption of vegetable oil (especially olive oil) and by low levels of consumption of saturated fats. This is illustrated in Table 10.12 which compares per capita consumption of butter and margarine across several EU countries. Spanish consumption of butter is only one tenth of the level in, say, Italy or the UK, and only about one thirtieth of that in Germany and France. On the hand, consumption of margarine is lower in Italy than in Spain, but consumption in the UK and Germany is much higher than in Spain.

Table 10.12 - Per capita value sales (ECUs per capita), 1995

	Butter	Margarine
France	18.19	6.11
Germany	21.67	17.11
Italy	7.72	0.68
UK	6.75	11.71
Spain	0.79	2.12

Source: Consumer Europe, 1995

With respect to the relative importance of butter and margarine in the total yellow fats sales, margarine predominates. The relative share of this product has, though, been decreasing over recent years, but it still accounts for around 70% of total yellow fats sales.

The evolution of the sales of margarine and butter in Spain over the period 1990-95 can be observed in Table 10.13. This table shows a decline in the sales of margarine both in volume (-30.61%) and in real and current value (-40.62% and -22.20% respectively).

In contrast, sales of butter both in volume and in current value increased during the period (+40% and +17.61% respectively). An increasing preference for taste and confusion about the healthiness of margarine have been factors explaining this pattern. This increase in volume has been accompanied by a decrease in real value (-10.33%), provoked by a competitive environment characterised, in particular by the low-price policy of *Pascual* (the leading producer of butter in Spain) and the increasing importance of own brand products.

Table 10.13 - Sales of margarine and butter, 1990-1995

	Margarine			Butter		
	000 Tonnes	Ptas Billions	Ptas Billions in 1990 prices	000 Tonnes	Ptas Billions	Ptas Billions in 1990 prices
1990	49	17.21	17.21	5	4.26	4.26
1991	51	18.07	16.94	5	4.56	4.27
1992	51	17.75	15.71	5	4.44	3.92
1993	45	16.78	14.03	6	5.16	4.31
1994	37	14.34	11.45	7	5.14	4.10
1995	34	13.39	10.22	7	5.01	3.82
Change	-30.61	-22.20	-40.62	+40	+17.61	-10.33

Source: Consumer Europe, 1995

The butter market in Spain is dominated by local (Spanish) manufacturers. For 1995, the market leader was *Pascual* with a 19% market share, followed by *Arias* and *CLAS* (Central Lechera Asturiana), with respectively 14% and 13% of the market. Other firms with notable market shares include Puleva with 7% and Remy Picot with 3%, with own label accounting for 13% of the market, and the remaining third taken by small independent firms.

In the margarine market, *Agra* (a subsidiary of Unilever) is the leading producer with its brands *Tulipan* and *Flora.*

As noted above, competition in the butter market has been intense in recent years with a decline in the real value of sales at the same time as a significant increase in volume. This has been due, in part, to the policy of Pascual to build market share. In addition, butter (like coffee) is regarded as a basic product by retail grocery chains whereby low prices of leading brands are used to attract consumers into shops. These factors have led to strong pressure on prices in the butter case. As far as margarine is concerned, pressure is of another sort: namely, the substantial fall in demand that has taken place. This has also led to pressure on prices, although, in this case, Unilever would appear better able to resist. Supermarket buying power is also regarded as important in this case, although probably more so for smaller manufacturers of margarine.

CHAPTER 11 – UNITED KINGDOM FOOD RETAILING

11.1 Market Structure Characteristics and Evolution

Food retailing is the single most important component of UK retail sales, with 47% of the total market in 1997. The last twenty years have witnessed an enormous change in its structure and organisation. This has shifted the market from being rather unsophisticated into being highly technological, sophisticated and concentrated. Large multiple stores have become dominant, selling a variety of food and non-food products, and offering many additional services to their customers.

The retail market can be divided into three main groups:

- large multiple stores;
- smaller multiple stores (symbol groups and convenience stores) and discounters;
- independent retailers and specialist outlets.

The last of these groups has been losing share significantly, as shown in Table 11.1.

Table 11.1 - Market share evolution, 1992-1997

	1992	1993	1994	1995	1996	1997
Large multiples	62.9	64.3	66.0	65.9	65.6	67.0
Smaller multiples	16.0	16.1	16.2	16.2	16.2	16.1
Discounters	8.4	7.5	5.7	6.5	6.6	6.2
Independents	10.4	9.4	9.3	8.6	8.0	7.3
Off licences	2.3	2.6	2.8	2.8	3.6	3.4
Total	100	100	100	100	100	100

Source: Euromonitor/ONS/trade estimates

A more detailed analysis is offered in Table 11.2; showing the multiples dominance resulting from a group of four supermarket chains. Other supermarket groups are much smaller, with only Kwik Save having a market share above 5 per cent. Co-operative retail stores, as a group, had 5.0% of sales in 1997.

Table 11.2 shows the development of market shares in the UK for 1993-6. Four major firms dominate the market with Tesco and Sainsbury being considerably larger than the third and fourth ranked firms (Asda and Safeway). Other firms are considerably smaller with Somerfield, the fifth ranked firm, having a market share of only 4.5% in 1996.

Table 11.2 - Market shares, 1993 and 1996

Group	1993 %	1996 %
Tesco	13.7	18.5
Sainsbury	14.8	14.2
Asda	7.9	9.7
Safeway	9.2	9.3
Somerfield	4.8	4.5
C_5	50.4	56.2

Source: Authors' estimates (Chapter 7)

Concentration has increased markedly in the 1993-6 period with the major multiples pursuing active policies of new store development. Over this period Tesco has overtaken Sainsbury to become the market leader with a market share of 18.5% in 1996 compared to Sainsbury's 14.2%. Asda has also gained significant market share in the period, rising from 7.9% in 1993 to 9.7% in 1996, taking it from the fourth to the third largest food retailer.

The main reasons that have led to these changes can be summarised as follows:

- **Cost advantages: sunk costs and economies of scale and scope**

These include:

- floor space, economies of scope and product proliferation: larger stores can stock and sell many more products, which is consistent with consumer preferences.
- cost advantages from the existence of buying power (see below).
- economies of scale in logistics and distribution.
- wholesaling and distribution are internalised, and the retailer controls them directly. Suppliers now transport much of their merchandise to a centralised depot which then allocates it to the outlets. New technology, with fridge and freezer capacity, enables the retail chain to transport in a single journey many different items to each outlet, reducing the number of journeys and therefore reducing costs.
- technological progress. The adoption of EPoS (electronic points of sale), EFTPoS (electronic funds transfer systems) and electronic scanners have greatly improved the efficiency of distribution and stocking activities, with needs being communicated almost in real time to the supplier.

- **Legal and institutional advantages**

- at the beginning of the decade it was relatively easy to obtain planning permission to build out-of-town stores, but the recent tightening up of regulations makes it much more difficult to obtain permission, providing a strategic advantage to the incumbent firms.

- Partially as a result of the *Sunday Trading Act* 1994, late-night opening (with a few stores having 24-hour opening) and Sunday opening have become the rule for the large multiples, weakening the position of smaller retailers operating as convenience stores.

- **Strategic advantages**

- related to consumer loyalty, reputation and advertising that have as an effect the restriction of the residual demand for a potential entrant.

The four major multiples are now investing heavily in building retail brands and consumer loyalty, through the use of loyalty cards and the spread of their own brand products. Loyalty cards additionally provide the retailer with detailed information on consumer tastes and changing preferences.

- **Social changes**

Over time, British customers have moved towards one-stop shopping and bulk shopping. This in turn is due to a variety of social changes. Also supermarkets have increased the amount of non-food items sold (27% of their total turnover in 1997) including books, music and clothes.

These factors have served to allow the major retailers a competitive advantage over their smaller rivals. The indication is that the market will concentrate further, with the large multiple stores increasing their shares through new store openings and possibly mergers.

1.2 Retailer Buying Power

In Chapter 7, the UK market was characterised as a duopoly in which the two leading firms have significantly higher market shares than other leading firms. Nevertheless, the two second ranked firms (Asda and Safeway) also each have close to a 10 per cent market share, and the five firm concentration ratio (56 per cent in 1996) is the highest of the four countries considered here.

Consistent with their size and position in the market, the leading four retail groups appear to have significant buying power over suppliers. This has manifested itself partly as a way of increasing efficiency by reducing costs and, partly, by their ability to negotiate price discounts and other favourable terms and conditions. There is no doubt that consumers have gained from the development of the supermarket chains in the UK in the form of higher quality products, easy one-stop shopping, more choice and lower prices in the long run. For instance, the index of real food prices (published by the ONS) has fallen significantly in the last eleven years from 100 in 1987 to just 89 in 1998. Nevertheless, concerns have been expressed about supermarket buying power in the UK and its effects on economic welfare. Three issues have come to the fore:

- The prices and profitability of supermarkets in the UK;
- Possible monopsony power, in particular in relation to UK farmers; and
- Fees and rebate schemes.

11.2.1 Supermarket Prices and Profits

The first issue concerns the pricing and profits of the UK retail grocery chains. Claims have been made that supermarket chains use their buying power to obtain substantial discounts from suppliers but they fail to pass these benefits on to consumers. For instance, a leading Sunday newspaper (*The Sunday Times*) has run a campaign over the past year to show that UK food prices are considerably higher in the UK than in Europe and the US and retailers exploit their power in other ways. The UK Office of Fair Trading has taken up these concerns and commissioned a report to look into this issue in July 1988, and, has subsequently made a reference to the Monopolies and Mergers Commission (now renamed the Competition Commission) in April 1999 (OFT, 1999). The Commission has a year to produce a report examining the sector and consider the profitability issue and examine possible abuses of buying power.

Evidence on prices and profitability is always difficult to interpret but there does seem to be a*prima facie* case to suggest that prices and net margins are higher in the UK than in some other countries. For instance, Table 11.3 shows net margins in 1994 for a number of leading French and UK supermarket chains. Although, the comparison is fairly crude, it suggests that margins are higher in the UK and this could be a sign of monopoly abuse.

Table 11.3 - Profit margins-net profits after tax in %, 1994

	1994
Carrefour	1.3
Promodes	0.8
Casino	0.8
Sainsbury	5.2
Tesco	4.8
Safeway	4.8

Source: Keynote, 1996.

It is important to note, however, this comparison could be misleading. In particular, comparisons of net margins do not take into account the amount of capital invested by different supermarket chains and, hence, may be subject to systematic bias. Typically, investment is higher in the UK; partly because of the high cost of land but also because UK supermarkets tends to provide a higher quality environment for grocery shopping and hence, typically, invest more in their supermarkets.

It is also argued that prices for a representative basket of groceries are often higher in the UK than in other EU countries or the US[58]. This might, however, in part, reflect the strength of the pound in recent years. Moreover, it also raises the issue of how "representative" any particular basket of groceries is. The UK has higher taxes on some goods (e.g. on alcohol) and, a larger proportion of its sales are on own brand/private label goods (see below). This means that comparisons of branded goods between countries could be misleading in comparing food prices depending on how far own brands are priced below branded goods.

In its investigation of prices and profits of leading supermarket chains, the OFT took account of these points but, nevertheless, found that "there is a level of profitability which requires further investigation" (OFT, 1999). The reference to the Commission, therefore, will provide an interesting appraisal of whether (and by how far) prices and profits are higher in the UK.

11.2.2 Problems for Farmers

Another important issue has been the relationship between UK supermarkets and farmers, and, in particular, whether supermarkets have been exerting monopsony power in agricultural markets. This has been, in particular, in relation to livestock prices and has led to confrontations between farmers and supermarkets.

It is difficult to distinguish between this possibility, however, and the simple effect of a fall in demand. Demand for red meat, in particular, has fallen dramatically in the UK in the last few years as a result of a combination of factors (the BSE crisis, the high exchange rate and a long term decline in demand). Hence, undoubtedly, marginal farmers have been forced out of business while prices for remaining farmers are very low, but this is what one would expect if there is a fall in demand. Evidence of monopsony (in this case, oligopsony) power would exist (see Chapter 4) if the supermarket chains restrict their demand and hence pay below the competitive price.

As noted in Chapter 4, however, this is difficult to test (even with a considerable amount of information)

58. *The Sunday Times* (23/8/98 and 30/8/98) compared a common basket of grocery goods across several countries. The UK was found to have the highest total price for the basket (indexed UK = 100) compared to the Netherlands (61), Belgium (62), France (74), Germany (65) and USA (69).

since it requires knowledge of what firms are willing to pay for these goods (at the margin) or what is the competitive price in the absence of monopsony (or oligopsony) power. This problem area is discussed further in Chapter 12 below.

11.2.3 Fees and Rebates

In our interviews, various types of behaviour were identified as possibly involving anti-competitive behaviour. Of course, negotiations between buyers and suppliers can be confrontational and this was clearly recognised on both sides. It was suggested, however, that major buyers are able to dictate particularly favourable terms and conditions on suppliers. These include:

- *listing allowances*: payments made to supermarkets to list a new product, and place it on their shelves for a set number of weeks.
- *special promotions*: paid for by producers and typically involving promotion over a two week period at the end of an aisle (called "a gondola" in the UK).
- *two-for-one (or similar) offers*: these can be suggested by the supermarket chains or their suppliers, and typically involve suppliers having to make discounts on the products involved.
- *over-riders*: these are payments made at the end of the year by suppliers (i.e. rebates), if particular sales targets have been met.
- *drop allowances*: allowances given to suppliers for delivering goods to a central depot. (It was argued that supermarket chains kept some of the benefit of this for themselves.)

These kinds of fees appear to be paid in each of the countries in our sample and it is clearly not necessarily the case that they should be regarded as anti-competitive (although as we have seen in earlier chapters, over-riders have been regarded with some scepticism in Spain and France). Apart from specific contractual terms, the leading supermarket chains also have significant power over small (including small own brand) suppliers, in negotiating the lowest possible prices.

11.3 Buying Groups

With the increase in market concentration over recent years and the increasingly dominant position of the four leading chains of multiples, joining a buying or a symbol group is an important element in the survival of small retailers. Table 11.4 shows the main buying groups (first three in table) and symbol groups (second three in table), for 1996. The table also shows the leading four retail chains in order to give an idea of the relative importance of buying groups.

Lekkerland UK is part of Lekkerland Group Europa, and Landmark is a member of BIGS (Buying

International Group Spar), Today is a member of EMD (European Marketing Distribution), and Spar is a member of Spar International; thus, over half of these groups have international affiliations. At the moment, however, most of these groups operate at national level, and the main role of these international linkages is information exchange.

Table 11.4 - Buying groups (and multiples) turnover, 1996

	No. of members	Group turnover £m	% of Tesco's turnover
Landmark	32	1500	13
Todays	435	6800	59
Lekkerland	11	270	2
Spar	2400	1300	11
Londis	1415	251	2
Mace	1150	500	4
Tesco		11560	100
Sainsbury's		10214	88
Asda		6010	52
Safeway		6060	52

Source: Mintel report on wholesaling and cash and carry, June 1996

Both buying and symbol groups give their members the advantage of enhanced economies of scale in purchasing. In the case of symbol groups this corporate identity goes beyond this purchasing activity, and extends to marketing support for retailing. In this latter case, members operate under a symbol group fascia, and are subject to disciplines as regards unity of style and coherent product offering, although retaining their own financial autonomy. A very recent variant of the symbol group is the development of *logo fascias*, where the traders sign a three-year agreement to purchase a given value of stock in exchange for marketing services and preferential prices on shop fittings and equipment. Buying groups differ from symbol groups because their members operate autonomously and are united only with respect to purchasing activity. Membership of both types of group is relatively fluid and requires firms to satisfy certain requirements of operational performance which vary across the groups consistent with their particular aims.

Although buying groups operate in the UK, they only supply a small (and declining) part of the market. This contrasts sharply with the experience of some other countries (e.g. Spain). In the UK, buying groups are at a disadvantage because they do not buy on the scale of the major supermarket groups, and because they cannot guarantee sizeable shelf space to major suppliers. The net result is that they obtain lower discounts than the major retail chains. As the independent sector continues to decline, it is anticipated that their importance in the UK will decline still further.

11.4 Own Brands

Own brands have become a major feature of UK food retailing. Their market share, in aggregate, is estimated at 37% in 1996 (Table 11.5), but is much higher for the major multiples as can be seen in Table 11.6.

Table 11.5 - Estimated own brand shares of total retail sales

	1990	1991	1992	1993	1994	1995	1996
Own Brand Share	24.1	25.7	27.8	31.3	32	34.1	36.7

Source: Euromonitor, 1998

Table 11.6 - Own brand share of total sales, for major retail chains, 1994-1995

	1994	*1995*
Sainsbury	66	68
Tesco	56	59
Waitrose	56	57
Safeway	52	57
Somerfield	45	48
ASDA	41	43
Co-ops	41	39
Kwik Save	13	20

Source: Keynote, 1996

Own brands cover a wide range of products, and can be divided into two categories: high quality and low quality products. Own brand products were first introduced with the aim of competing directly with branded products. Their quality level has been improving over the last couple of decades and, at the high end, is now considered very close, if not identical, to the quality level of branded products. This allows them to compete with the latter for consumers located in the upper and medium segment of the consumer distribution. In supermarkets, they are usually located on shelves very close to the branded products where they are given a generic name (for example the name of the supermarket) and tend to mimic very closely the packaging and presentation of the branded products.

Low quality own brand products represent a much smaller segment of the market, and their introduction can be linked to the arrival in the UK of those discounters who offer products of a lower perceived quality at a lower price. Their aim and characteristics are therefore different: they are basic products, of lower perceived quality level, with basic packaging (with the aim of reducing costs) and a name that strongly suggests their competitive approach (e.g. *Tesco Value, Sainsbury Essentials, Safeway Savers*), and they are offered at a very low price, in order to compete in the lowest segment of the market. Table 11.7 shows the proportion of high and low quality own brand products by value in the major supermarkets in 1996.

Table 11.7 - Proportion of high and low quality own labels (% of total sales), 1996

	HQ	*LQ*
Tesco	41.0	3.8
Sainsbury	52.4	1.3
Safeway	36.6	3.6

Source: Marketing Week, 28th June 1996

A breakdown of own brand shares by product category is given in Table 11.8, illustrating the high and increasing penetration levels for many key food items.

Table 11.8 - Own label share per category of product

	1993	*1996*	*change*
Chilled and ambient pizzas	86.2	88.2	2.0
Prepared salads	82.0	88.0	6.0
Frozen and chilled poultry products	74.1	78.5	4.4
Fresh poultry	64.7	75.3	10.6
Frozen poultry	59.8	65.0	5.2
Morning goods	66.9	74.8	7.9
Cheese	66.3	72.3	6.0
Milk	53.6	64.2	10.5
Cream	56.2	63.9	7.7
Frozen vegetables	59.5	59.3	-0.2
White fat & oils	51.3	58.0	6.7
Wrapped bread	47.4	57.9	10.5
Fruit juice	48.9	57.0	8.1
Defined frozen poultry products	46.3	56.5	10.2
Canned fruit	44.2	56.0	11.8
Chilled desserts	48.7	54.0	5.3
Frozen fish	53.7	52.5	-1.2
Cakes & pastries	45.3	52.2	6.9
Wet fish	-	51.2	51.2
Pastes, spreads & pates	36.7	49.8	13.1
Plain & savoury rice and pasta	44.3	49.6	5.3

Source: Super Panel/MAPS, 1997

Overall, the share of own brand products has been steadily increasing in the 1990's, (see Table 11.5). An important consequence of this has been the disappearance from supermarkets of secondary brands (selling less than the leading branded goods in a particular category). For most of their manufacturers the only chance of survival has been to start producing for supermarkets' own labels. Moreover, in some product areas it is now the case that the only branded product sold by a supermarket chain is the brand leader, so that competition within the supermarket between branded products has lost importance in favour of competition between the brand leader and their own brand products.

As has been suggested for other countries, UK supermarket chains tend to set high margins on own brand products. Examples of this are provided by Table 11.9 for 1993 (more recent information was not available). In part, this is because the supermarkets use their buying power to obtain very low prices from own brand suppliers. However, supermarkets are much more closely involved in bringing own brand products to market and hence incur costs (e.g. in relation to packaging, marketing, legal matters and logistics) which are not borne on branded goods and this makes comparisons of gross margins difficult. Nevertheless, there seems to be no doubt that UK supermarkets make higher profits on own brands if only because margins on branded goods are very low.

Table 11.9 - Retailer gross margins (%), 1993

	Own label	Brand leader
Baked beans	18	2
Soft drinks	26	26
Household detergents	20	6
Paper products	26	6
Cigarettes	10	8

Source: Independent Grocer/PLMA, 1993

As the importance of own brands has increased and their role has changed, some brand manufacturers have started producing for own labels. These include Unilever, Nestlé, PepsiCo, Danone, McCain, Campbell, Allied Lyons and others, including, recently, Heinz. Not all manufacturers agree to produce own labels, however, and some of them (e.g. Kelloggs', Coca Cola and Gillette) consider it prejudicial to their (quality) reputation.

The relationship between producers of branded goods and retailers has become more complicated since the former have started producing for the latter's own label goods. There is evidence that in some cases production deals can be used as negotiation tools, for example, for the stocking of other branded goods by the same manufacturer, so the relationship is mutually beneficial. However this is not always the case, as evidenced by the growing number of claims and complaints by manufacturers, and by the forming of a special association to protect their rights, the British Brands Group. Apart from unfair competition claims against "copy-cat" producers, manufacturers have also complained about shelf space and poor in-store product positioning offered by the supermarket chains. Another point about this relationship is that brand producer involvement in the production of own labels entails sharing some cost information with the retailers. The latter can therefore use this information in the negotiation of the price of branded goods.

11.5 Products

11.5.1 Washing powders and detergents

The share of detergents and other cleaning materials in average consumer expenditure is similar to the share of product groups such as bread, rolls and sweets and higher than the share of the other two products considered in this analysis. This market share has slightly decreased over recent years - see Table 11.10.

Table 11.10 Share of average consumer expenditure in detergents and other cleaning materials

	A	B
1993/94	3.16	0.63
1994/95	3.14	0.62
1996/97	3.07	0.60
Rate of Change 93/94-96/97	-2.83	-4.64

Source: Family Spending, CSO, 1998
A: Average weekly consumer expenditure (AVCE) on product /Den2
Den2= AVCE in Food and non-alcohol drinks - (AVCE in Restaurant and cafe meals + AVCE in take-away meals eaten at home + AVCE in other take-away food and snacks + AVCE in state school meals and meals at work) + AVCE in alcoholic drinks + AVCE in Greeting Cards, stationery and paper goods + AVCE in Detergents and other cleaning materials + AVCE in Toilet Paper + AVCE in Toiletries and soap (grocery business)
B: Average weekly consumer expenditure (£) on product / Total Average weekly consumer expenditure (£)

The UK market for washing powders and other detergents can be considered mature and saturated. Laundry detergents are a basic commodity, and, therefore, their value growth depends very much on technological innovations that add value and justify price increases. The limited growth in nominal terms (see Table 11.11) of market sales over the period 1993-97 (up 10.31%) can be explained mainly by two factors: on the one hand, the period has been characterised by fierce price competition between two brand leaders (Procter & Gamble and Unilever) and retailer own brands, and, on the other hand, a regression from more expensive concentrated detergents to cheaper standard detergents has taken place.

Table 11.11 - The market for washing powders and detergents by nominal value (£m), 1993-1997

	1993	1994	1995	1996	1997
Detergents	805	815	823	849	888

Source: Market Research GB, July 1998

The market can be considered a virtual duopoly in which Procter & Gamble enjoy a dominant position with 56% of the market in 1997 and Lever Bros (Unilever) with a 28% market share (Table 11.12). The importance of private label products in this sector is limited in the UK context but is still significant. In the last five years the biggest supermarket chains have invested in complete washing powder lines (Sainsbury's *Novon*, Safeway's *Cyclon*, Tesco's *Advance* and Asda's *Integra*, all produced by independent Robert McBride) but this has not had a major effect on leading firm sales. This is almost certainly due to the strong brand image of the major products, fostered by heavy advertising, although own brands have increased their share from about 9% in 1992 to 15% by 1997.

Table 11.12 - Manufacturers' share in the washing powders and other detergents market

		1996	1997
P&G		**55.9**	**56.0**
	Ariel	25.1	24.o
	Bold	12.4	14.3
	Daz	11.5	10.3
	Fairy	5.6	6.1
	Dreft	1.3	1.0
Lever Bros.		**28.0**	**27.6**
	Persil	21.3	22.0
	Surf	3.9	3.4
	Radion	2.8	2.2
Private Labels		**14.3**	**15.2**
Others		**1.8**	**1.2**

Source: Mintel, 1998

As far as buying power is concerned, this is a classic case where major European-based producers face major supermarket chains. Bargaining takes place between the major suppliers and the major supermarket chains and own brands act as a bargaining counter for the supermarket chains. A leading producer has attempted to supply washing powder on a European-wide basis offering open terms and conditions across EU states. In practice, however, bilateral negotiations with each major retail group are still the norm.

11.5.2. Coffee

The UK coffee market is distinguished from the market in the other three countries studied in that instant coffee is very much more important than roast and ground coffee in the UK. In 1997, retail sales of instant coffee were £653 million (89%) compared to just £82 million (11%) for roast and ground coffee (Table 11.13). This is almost exactly the reverse of the position in Germany and similarly is different from that in France and Spain. On the other hand, the UK market in roast and ground coffee has been growing faster than instant coffee in recent years (by 55% in nominal terms, compared to 25% for instant coffee between 1992 and 1997) but, of course, from a much lower base.

Table 11.13 - Retail sales of instant and roast & ground coffee (£m)

	Instant	R&G	Total
1992	523	53	576
1993	515	52	567
1994	582	59	641
1995	662	79	741
1996	650	81	731
1997	653	82	735

Source: Mintel, 1998

The instant coffee sector is dominated by Nestlé with 58% of the market in 1996, followed by KJS with 22% and own brands with 16% (Table 11.14). Nestlé's dominance is maintained by strong advertising of its major brands (e.g. Néscafe and Gold Blend) and this has meant that it has apparently been able to resist pressure from supermarket chains to reduce its price. It has been helped by the fact that own brand coffee is perceived as inferior in quality to branded goods, and this has meant that own brand sales are relatively low compared to other grocery items in the UK. Even with improvements in the quality of own brand products in recent years, consumers still perceive them to be inferior, and have tended to continue to buy branded products.

Table 11.14 - Manufacturers' share in the instant coffee market, 1992-1996

	1992	1994	1996
Nestlé	54	54	58
Kraft Jacobs Suchard	23	22[1]	22
Own brand	15	17	16
Other Brands	8	7	4

Source: Mintel, 1998
[1] includes Allied-Lyons products for 1994

There is no dominant producer of roast and ground coffee. Three firms, however, have market shares above 10 per cent: Sara Lee (Douwe Egberts) (15%), KJS (14%) and Paulig (13%) (Table 11.15). Of these, Paulig has seen substantial growth in market share since 1992. In this sector, own brands are much more important with 42% of sales in 1996, and this is just above the UK average for own brand sales. The strength of the own brand sector means that supermarket chains may be better placed to extract lower prices from the leading suppliers than say from the leading instant coffee producers.

Table 11.15 - Manufacturers share in roast & ground coffee

	1992	1994	1996
Sara Lee	11	13	15
Kraft Jacobs Suchard	19	16[1]	14
Paulig	6	21	13
Lyons Tetley	19	-	-
Own Label	38	39	42
Other Brands	8	10	16

Source: Mintel, 1998
1 includes Allied-Lyons products for 1994

It seems likely that changes in consumer preferences will induce further growth in the roast and ground coffee sector in the next few years, at the expense of instant coffee and tea.

11.5.3. Butter and margarine

Butter and margarine can be considered as two independent sub-markets within the yellow fats market. In 1996, joint retail sales in these two sub-markets accounted for £906 million, of which £344 million (38%) corresponded to sales of butter and £562 million (62%) corresponded to sales of margarine.

Tables 11.16 and 11.17 show the overall evolution of the UK market for butter and margarine and other spreads in the period 1992-7. Over this period the market experienced negative growth in real terms (-5.13%) and in volume (-7.07%). The main factors underlying this fall were the reduction in home baking, the increased use of convenience foods and health related issues. The market for butter was more or less stable (Table 11.7) but the market for margarine and other spreads fell by 8.7%.

(10)

Table 11.16 - The UK market for butter and margarine, 1992-1997

	Tonnes	£m at 1992 prices
1992	495	837
1993	486	825
1994	475	810
1995	462	802
1996	459	793
1997	460	794

Source: Mintel, 1998

Table 11.17 Retail sales of butter and margarine and other spreads in the UK (£m at 1992 prices)

	Margarine and Other spreads	Butter
1992	540	297
1993	527	298
1994	513	297
1995	506	296
1996	492	301
1997	493	301

Source: Mintel, 1998

Table 11.18 shows the market shares in margarine and other spreads in 1994 and 1996. Van de Bergh Foods (Unilever) is the leading producer with 43% of the market in 1996, followed by St.Ivel with 25% and Dairy Crest with 10%. Own brands make up most of the rest with a share of 19% in 1996. An important feature of this part of the market is the development of new products such as margarines made from sunflower oil, olive oil, and so on. Whilst these developments offer scope for new entry, active development of new products by the leading firms has tended to keep new entrants at bay. This is an example of product proliferation on the part of incumbent firms.

Table 11.18 - Market shares in the margarine and other spreads market, 1994 and 1996

Company	1994 (%value)	1996 (% value)
Van de Bergh Foods	42	43
St. Ivel	25	25
Dairy Crest	12	10
Own label	18	19
Others	3	3

Source: Mintel, 1998 and Own Label, 1997

In the butter segment, three brands dominate; Anchor with 35% of the market, Lurpak (MD Foods) with 18% and County Gold (Dairy Crest) with 11%, whilst a fourth brand, Kerrygold, has 5% (Table 11.19). Own label products account for nearly a quarter of the market (24%). In contrast to other countries in our sample (e.g. Spain and Germany) local supply does not appear to be a major factor in the UK. Nevertheless, concentration is moderate in this sector, and the strength of own brands is such that this market is seen as relatively competitive in the UK. Butter is also one of the products used by supermarket chains to attract customers into their stores, so that margins on branded butter are generally very thin. This benefits the consumer, but (possibly) at the expense of putting pressure on the prices of the smaller suppliers.

Table 11.19 - Market shares in the butter market in 1994 and 1996

	1994 (%value)	1996 (% value)
Anchor	32	35
Lurpak (MD Foods)	18	18
Country Gold (Dairy Crest)	11	11
Kerrygold	5	5
Own label	23	24
Other	11	7

Source: Mintel, 1998 and Own Label, 1997.

CHAPTER 12 – ISSUES AND LESSONS ARISING FROM THE CASE STUDIES

12.1 Introduction

In this part we have examined food retailing in four member states: France, Germany, Spain, and the UK, and in three product groups: washing powders and detergents, coffee and butter and margarine. In all four countries, there have been considerable increases in concentration in food retailing in the last 20 years. In France (and, to some extent, Germany), there has been rapid growth in large hypermarket groups, and these organisations have also moved into other EU markets (such as Spain); in the UK, food retail seller concentration is the highest of the four countries, and the UK has the most developed own label sector and developed emphasis on one-stop shopping and high retail service; Germany is of interest because of the high market shares of discounters, and the effect this has had on competition at the retail stage, and between suppliers and retailers; and Spain is an example of a country with more traditional retail outlets and lower concentration, but where concentration is now increasing rapidly and the sector appears to be in a transitional phase.

The three product groups given special attention in fact yielded five sub-products for investigation as the coffee market was clearly segmented into roast/ground coffee and instant coffee, while fat spreads were divided into butter and non-butter (margarine) spreads. The examination of these five sub-products provided a variety of experiences concerning buyer power in the different countries. Initially, the products were selected because they were all major products within the consumer's shopping basket and represent clearly different elements of the basket of regularly purchased items from grocery stores. In the case studies, however, it became clear that for the purposes of analysis these products can also be divided into two categories: products in which relatively few producers face large buyers and engage in bilateral bargaining (washing powders, instant coffee and, in some cases, roast and ground coffee, and margarine) and products where generally competitive suppliers face large buyers (butter, and in some other cases, roast and ground coffee). While, in both categories, similar types of issue arose in terms of buyer power, there was some concern that competitive suppliers might experience greater difficulties than more oligopolistic firms; often they have more at stake than larger firms (because delisting of their product might well force them out of business).

The studies show that buyer power is indeed a feature of food retailing in all four countries considered but significant differences exist between them. In the UK, four chains dominate the market and buying groups are not a major feature. In contrast, in the other countries, buying groups are much more important and account for a significant proportion of sales (see table 7.10). Second, food retailers in

France (and, to a lesser extent, Germany) have been involved in considerable cross-border activity, notably in Spain but also in other countries, including Germany with Intermarché's acquisition of Spar in 1998. German discounters have also been moving into other countries, including France and the UK, while UK food retailers have made some tentative steps to move into other countries (e.g. the recent move of Tesco into Ireland and Poland). Spain is of interest because retail sales have become dominated by French supermarket/hypermarket chains which appear to be able to exert considerable buyer power. In Germany, while significant buyer power exists, this is accompanied by strong competition at the retail level.

In terms of the representativeness of the countries studied, table 7.4 (chapter 7) shows that the UK has slightly above average concentration in food retailing (a five-firm concentration ratio of 56% as opposed to the EU average of 53% in 1996), while France has slightly below average concentration (51%), Germany has somewhat lower concentration (45%) and Spain (of the four) has low concentration (32%). Spain is representative of the southern countries in the EU which tend to have lower concentration in food retailing (particularly Greece (28%) and Italy (12%)) while the other three are more typical of the average level of concentration in the EU. However, the studies do not cover any of the very high concentration countries (e.g. Finland and Sweden) where specific issues may be of concern (but see the discussion in Appendix 1 on the Finnish Kesko/Tuko merger case).

With regard to the three products studied, it is more difficult to say that these, or indeed any other, three products could be considered representative of all food and other daily goods items sold by grocery retailers. But the three products selected are all major items in the typical consumer shopping basket and they do cover the different broad categories of product sold by retail chains, representing clearly different elements of the basket of regularly purchased items from grocery stores.

In the next section we return to the issue of market definition, now using the case studies to illustrate our earlier discussion. Section 12.3 then recalls the framework of chapter 3 and reviews what we have learned from the case studies about the applicability of that framework. The chapter closes in section 12.4 with a specific example of the short-run/long-run trade-off which overlays much of the discussion of the welfare impact of buyer power in general.

12.2 Market Definition Issues

An important initial step in assessing the existence of market power is to consider the definition of the market. As discussed in section 4.3 above, this involves two aspects of the market: its geographic extent and the substitutability of products. In addition, in the buyer power context, two types of market are, typically, involved: the retail market where food retail chains act as sellers to final consumers and the upstream market where they act as buyers of products for resale downstream. The extent of the market is crucial in each of these dimensions: if it is defined too narrowly then the market power of the major retail players may be overstated, and if it is defined too broadly, market power may be understated.

In food retailing, consumers usually shop locally so that, from their point of view, the market is basically local (sub-regional). However, on a broader view, supermarkets and hypermarkets in each country (although less so for Spain) have penetrated many of these local markets and, given that they typically adopt uniform prices across most markets, it makes sense to view them nationally. In some markets, of course, there are gaps in the chain of substitutes so that changes in prices in some areas do not necessarily have a significant effect elsewhere. For example, it could be the case that in a rural area, there is no supermarket nearby, and, in fact, consumers shop locally in smaller shops. In this kind of case, one could find a break in the chain of substitutes such that the appropriate market for these consumers is (strictly) local. It is also possible that markets can be supra-national where consumers are near to borders (e.g. in the Benelux countries) and so can shop elsewhere if national prices rise. However, partly through lack of data (at the more disaggregated level), we take the pragmatic view that retail markets can be viewed as national in most cases.

In the product sense, markets can be defined where it is possible to identify a gap in the chain of substitutes for a particular good. If we take a product in a particular geographic region, then we can consider the following hypothetical experiment: suppose the price is at the competitive level and the firms in the market (as currently defined) increase prices permanently by 5-10%, what is the effect on their profits? If sales are reduced significantly, then we conclude that the market as defined is too narrow and needs to be widened, but if they are not (and assuming that one starts from a relatively narrow definition), then the level of market aggregation is correct.

In the instant coffee case, for example, the question is: can we regard instant coffee as a market in itself, or should we widen the definition to include roast and ground coffee, other hot beverages (such as tea), other soft drinks, etc.? In the UK, where instant coffee dominates the retail market, an increase in price of 5-10% (from a competitive level) would be likely to have only a limited effect on profits from roast and ground coffee sales (in our view), hence the market can be defined at this level. In France, Germany and Spain instant coffee is only a small part of the total coffee market but (we would argue) that a similar argument would apply i.e. that a 5-10% increase in price from the competitive level would have only a relatively small effect on profits from roast and ground coffee sales. In these countries, instant coffee has a niche market but it is still appropriate for it to be seen as a market in itself as substitution to roast and ground coffee (or other beverages) is not likely to be great for such a price rise.

In washing powders (in all countries) it is clear that no close substitutes exist and here there are no real ambiguities about the definition of the market. In the case of butter and margarine (or non-butter spreads), things are less clear cut since the products are more substitutable. In a given geographic region, a 5-10% rise in, say, butter prices from competitive levels may have a significant effect on the profits of butter producers, and one might, therefore, consider these goods as one product as far as defining the retail market is concerned. At the very least, therefore, one would want to look at this issue in defining the market, given also that it might make a significant difference in determining market power in the market (in particular) for margarine.

A similar type of approach can be adopted in considering the market upstream. In this case, a market can be defined in terms of the effect a *reduction* of 5-10% in the price paid to suppliers; if this causes suppliers to refuse to supply goods which, in turn, limits the range of goods that supermarkets can offer, then supermarket profits will be reduced and the market definition would be too narrow. On the other hand, if the supermarkets can introduce such price reductions and suppliers are forced to comply with them, then the market will be defined at this particular level.

Clearly, markets may not be defined at this level in the same way as at the retail level. As far as the geographical extent of the market is concerned, supermarket chains typically buy at the national level although in some cases (e.g. for fresh vegetables and butter-see below) they may buy more locally, and, in others, they may buy internationally. If we consider an example (washing powders), suppliers of washing powders may be forced to accept a 5-10% cut in price if implemented by a hypothetical monopsonist in a country since to refuse to supply at that level would be very costly for them indeed. Yet at a regional level, the price cut is likely to be resisted. If this is the case, then it makes sense to view the market as national rather than regional since at the latter level suppliers would be much more likely to play regions off against each other. If, however, suppliers of washing powders are big and powerful in many countries in Europe (or more widely) then they may be prepared to refuse to supply supermarkets if faced with a 5-10% price cut even at national level, in which case the market may be seen as supra-national. In our view, this market is more readily seen as national rather than supra-national because even the large producers (Unilever, Proctor & Gamble, etc.) would probably have too much to lose at national level.

A similar analysis can be applied to instant coffee, roast and ground coffee and margarine. In the case of butter, particularly in Spain and Germany where butter is typically sourced from local (or regional) suppliers, the definition of the market is more likely to be at the local (or regional) rather than national level. In these cases, suppliers at the local/regional level may not be able to resist a 5-10% cut in price and hence the appropriate market definition will be at the regional level.

On the product side, the issue centres on whether a hypothetical monopsonist in a given geographic area can reduce price for a product by 5-10% such that suppliers can (or cannot) refuse to supply. For a narrowly defined product (e.g. tuna in olive oil), suppliers will be more likely to able to resist such a price cut and hence the market will be defined too narrowly. If the hypothetical retail monopsonist tried to reduce price by this amount for all canned fish in a given geographic region, it may be less easy for suppliers to resist and hence the market will be defined at this level. In the case of coffee, for example, in a particular country, although producers may produce both instant, and roast and ground coffee, it is likely that a hypothetical reduction in price of, say, roast and ground coffee by 5-10%, would not induce sufficient refusal to supply to make this change unprofitable, and hence roast and ground coffee would be a suitable market definition.

12.3 General Application of the Buyer Power Framework

With the above comments on market definition in mind, we now return to the buyer power framework as set out in chapter 3. Our purpose here is to draw on the case studies to illustrate the applicability of the framework – to ask, is it a potentially helpful tool to the policy maker? However, while we use the case studies as the context for making the appraisal, we should stress that it is not our objective to attempt a substantive appraisal of the effects of buyer power per se. To do this would take us beyond the scope of the project and would require considerably more information and time.

The framework, as represented by table 3.1, poses five questions that should be considered in analysing buyer power. We consider each of these in turn from a general perspective, but bearing in mind that the application of the framework is intended to address specific cases of alleged abuse of buyer power. In practice, it is clear that in some cases buyer power provides economic benefits (e.g. where it leads to countervailing power to that of oligopolistic suppliers which reduces prices to the final consumer). In other cases, however, buyer power can lead to possible policy concern (e.g. where retailers impose unfair terms and conditions on suppliers or where retailers create dependency relationships with small suppliers which may adversely affect supplier viability/efficiency or distort competition at the retail or producer level in an anti-competitive manner).

1. Is there significant buyer power?

This is, of course, the key preliminary question and without it there is no reason to proceed in an investigation. Two factors are identified as providing evidence for this: significant proportions of the product as a whole purchased by a firm and significant arrangements of terms of purchase (such as listing fees) by a firm.

Our case studies indicate that large buyers do have this power in each country studied, whether in the form of retail chains or buyer groups, where their size and market share allows them to extract more favourable terms from suppliers compared to those obtained by small independent/unaffiliated retailers. Bulk buying economies of the large groups are a key factor accounting for the advantageous terms they receive. But additional benefits can be derived from the strong strategic position held by large retail/buyer groups, where they can credibly play off suppliers against each other when offering contracts (say, for supplying an own-label product line) or credibly use a threat of delisting even against significant brand producers.

Such buyer power might generally be found in most EU member states where large buyers dominate market purchases. However, it is less certain that this might apply in countries such as Italy and Greece where buyer concentration is very low and where traditional food retailing continues to predominate. But even here the indications are that retailer concentration will increase substantially in the next few years and similar issues of buyer power may then arise as well.

The five-firm buyer concentration measure gives an indication of the extent to which suppliers are likely to be dependent on the major buyers in each country. From table 7.10, for the UK, where buyer groups are not significant, the largest five retail groups accounted for 56% of food distribution in 1996. In the other three countries, the presence of large buyer groups raises buyer concentration significantly above the corresponding retail concentration level such that in France the largest five buyers accounted for 78% of food purchases in 1996, while the figures for Germany and Spain were 50% and 49%, respectively.

In practice, though, individual suppliers will be more dependent for their sales than indicated by these levels, given that unless they produce "must-stock" brands which all retailers will wish to take, their sales will be concentrated on particular key buyers. Our survey highlighted the extent of this dependency for suppliers in each of the three product groups considered. For instance, an own-label supplier made all its UK sales to the top four retail chains. A leading branded goods producer estimated that 75% of its sales in Germany went to its top five customers (four leading retail chains and a leading buying group) and that this had increased from 33% in 1988. In Spain, the importance of the buying groups is apparent. For example, one major supplier had 45% of its sales to the five largest retail chains, but its major customers were the two leading buying groups accounting for (a further) 50% of its sales, while for another leading supplier its respective figures were 47% and 39% (i.e. 86% of sales went to its seven largest buyers).

Apart from the ability to extract (per unit) price discounts from suppliers, major buyers also appear well placed to obtain other favourable terms in the form of the up-front fees and other financial benefits they can command from suppliers, principally in the form of listing fees, payments for special promotions, over-riders, drop allowances and so on – see the country reports for further details. The majority of these allowances involve fees paid to retail/buyer groups for services rendered and they are typical in all four countries, but the forms vary in significance. Thus, for instance, suppliers of a new product commonly pay a major retail chain a listing fee to take a new product and stock it for a set number of weeks. Suppliers normally pay a fee for taking an end-of-aisle display associated with a promotion. And retail chains may link discounts they require to the year's value of sales, requiring suppliers to pay a rebate at the end of the year if certain sales targets have been met.

Some of these practices may be seen as part of "normal business" which offers advantages to the supplier, such as the extra sales that can be generated through end-of-aisle displays.[59] While such fees allow retailers to increase their profits, and they are clearly exploiting their positions as leading buyers, nevertheless the gains suppliers can make means that, from a business perspective, it would seem reasonable to pay for access to the retailer-controlled scarce resource (i.e. display or shelf space).[60] Other practices, on the other hand, appear more directly detrimental to suppliers, especially where little is offered in return for a payment to the retailers. In Spain, for example, apart from the considerable length of time retailers take to settle accounts, it seems to be quite common for suppliers to be asked to make a payment when a new store is opened, or on the anniversary of an existing store or something similar. In addition, in other countries, suppliers are sometimes expected to make retrospective payments at the end of a year even though these may not be part of the order agreed.

2. Is buying power against relatively powerless suppliers?

Two factors are relevant in answering this question: absence of evidence that suppliers dictate terms of sale and low seller concentration in the upstream market.

59. One supplier interviewed reported that a two week end-of-aisle promotion by the retailer led to a 26 fold increase in sales; a demand which they were only just able to meet.

60. The argument is essentially over property rights. With the growth of large supermarkets, a market has been created in shelf space or end-of-aisle displays where the supermarkets have the property right. Nevertheless, because the retail chains themselves have market power in these markets, they are likely to extract a higher rent than

Clearly, in any supermarket, a range of products (such as fresh produce and certain canned goods, etc.) will be produced by relatively atomistic suppliers, as will many own brand goods. In such markets, strong buyers will attempt to obtain the lowest possible prices from suppliers by "squeezing" as much profit as possible out of them. Moreover, retailers may, potentially, engage in anti-competitive practices (such as *ex post* rebates, or demand for payments to support special store events), which a small supplier may be forced to pay rather than risk being delisted.

It is evident that oligopolistic competition characterises the suppliers' side of the market for several of the products considered in our case studies, where supplier concentration was relatively high, for some countries. However, two of our sub-products better approximate the case of competitive supply: butter, and (in part) roast and ground coffee. Butter is supplied competitively in three of the four countries, where the UK is an important exception as the four leading brands/producers (Anchor, MD Foods (Lurpak), Country Gold (Dairy Crest) and Kerrygold) accounted for 69% of sales in 1996. The supply of roast and ground coffee is competitive in two countries: Spain and the UK (although in the latter case, roast and ground coffee has a much smaller market share than instant coffee), and appears less competitive in the other two, France and Germany: the largest two firms (KJS and Douwe Egberts) have a combined market share of 60% in France, and the largest two firms in Germany (KJS and Tchibo/Eduscho) have a combined share of 58%.

Our investigation suggests that margins for competitive suppliers of butter and roast and ground coffee are indeed squeezed by the large retail chains. In the UK, for example, it appears that many own brand producers operate on very thin margins, and that retail grocery chains are always keen to pressure suppliers to lower prices further. This also seems to be the case in France for butter, where the risk of being delisted might make suppliers reluctant to complain.

Whether these situations amount to the exploitation of monopsony (or, more strictly, oligopsony) power, in the traditional sense (see chapter 2) is not immediately obvious, given that in these cases it is not clear whether supply is less than infinitely elastic (i.e. the long run supply curve slopes up). Agricultural markets may be examples, such as livestock markets, where farmers can conceivably earn intramarginal rents given that increasing output may cause prices to rise (and vice versa). But for many grocery items long run supply curves might typically be horizontal. In the case of coffee, for instance, prices are likely to be determined primarily by the world price of coffee and it seems unlikely that there would be major differences in costs between producers of roast and ground coffee. The case of butter is more

in a more competitive market.

speculative, where the localised supply of producers might vary due to differing farming costs, giving rise to the possibility that supply curves might be upward sloping.

For the other products under our consideration, seller concentration is relatively high, notably for washing powders and instant coffee. The issue is here about the share of economic surplus (profits) between the trading parties. This is generally determined through bilateral bargaining (though recognising that agreements may affect the total level of surplus available), rather than supplier viability detrimentally affected by the exploitation of monopsony power. In these markets, where oligopoly characterises both producer and retailer competition, the leading suppliers appear better able to resist retailer pressure to reduce prices and to pay other fees and rebates. In contrast, smaller producers, either producing secondary brands or own-labels are less able to resist such pressure and transfer prices appear much closer to competitive levels.

3. Does the buyer itself have significant selling power?

From the discussion in chapters 2 and 3, if selling power is present in the downstream market, buyer power may be a means of strategically enhancing the former, with potentially adverse welfare effects. If, on the other hand, the final market is generally competitive, buying power is more likely to be socially desirable where the benefits of reduced costs from lower intermediate prices are passed on to consumers by lower retail prices being set.

As in the case of upstream market power, one can use the five firm seller concentration ratio as a structural measure of market power in the retail market, as reported in table 7.4. In these terms, the UK has the highest concentration ratio (at 56%), followed by France (51%), Germany (45%) and Spain (32%). These figures mask some important differences between the different countries, however. Spain is relatively unconcentrated although the top three firms have market shares between 6% and 10% (tables 7.6 and 10.2). Germany and France are classified as symmetric oligopolies in table 7.6 with each of the five leading firms having a market share in a narrow band between 9.4% and 11.9% in France and 6.7% and 10.9% in Germany. In the UK, however, two firms dominate the market with shares of 18.5% and 14.2% respectively, but with two second-tier firms with market shares of 9.7% and 9.3%.

In the UK, in particular, there has been public concern that the leading retail chains have been abusing their market power to set high prices and earn high profits and this has led recently to a referral of the industry to the (newly designated) Competition Commission (see OFT (1999)). While we await its verdict (due in mid-2000), there is concern that the state of retail competition might be quite different in the UK than, in particular, Germany where discounting is more commonly seen. On face value at least, typical net margins are much lower in Germany than in the UK: 1-2% and 5-7%, respectively. These differences suggest a cautionary note about using concentration ratios to indicate the presence and abuse of market power, since structural measures may not on their own show the extent of competition. Other (performance) measures, such as prices and margins (though having their own limitations), may prove useful.

For Germany, although concentration is quite high, the market appears very competitive. The main engine of this competition is undoubtedly the hard discounters (such as Aldi and Lidl) which accounted for 22% of food retail sales in Germany in 1997, and operate with very low margins. These chains compete on price, inducing other leading chains such as Rewe and Metro to compete on prices as well. In contrast, discounters are much less significant in the UK, where the leading retailers have emphasized retail service provision, with the result that price competition has appeared softer (though it has shown signs recently of intensifying).

Moreover, the intensity of rivalry at the retail stage may have implications for the total share of surplus available between the two levels and pressure for suppliers to cut costs and accept lower margins. It was reported to us by some interviewees that negotiations between suppliers and retailers are more relaxed in the UK than say in France or Germany, and that negotiations generally lead to "satisfactory profits" being earned on both sides. In Germany, however, the reverse appears to be true, and competition at the retail stage appears in turn to lead to greater pressure on suppliers to cut prices (and thus reduce their profits).

4. Are there significant productivity gains associated with buyer power?
If so, this can be argued in mitigation of high buyer concentration.

The case studies show quite clearly that there are significant economies of scale associated with handling large orders. All the suppliers interviewed accepted that there were significant logistic and handling economies associated with selling in bulk, and they all offered discounts to customers to take account of this. The food industry (like many other industries) now uses complex technical modelling to determine the logistics of supply, and to make arrangements with the aim of minimising handling costs, and delivering in bulk is a key factor in this. Indeed, quite a few companies will not allow retailers to arrange their own deliveries because it would upset their logistical arrangements.

Several producers commented, however, that multinational retail chains were increasingly aggregating orders across European countries in order to qualify for a bulk discount, even though there was no logistical advantage at all. These producers try to resist such bulk discount requests, although we were told of one case where a supplier was delisted until it agreed to pay the extra European-wide discount.

Although cost savings are associated with bulk orders, many suppliers would argue that large retailer and buying groups also try to use their buying power to extract further discounts which are not related to cost savings, and it is clearly these discounts which are a possible cause for concern.

5. Does the buyer attempt to constrain its suppliers' other actions?
If this is so, the arrangement should be treated with suspicion. Examples of this might be exclusive supply arrangements, specific custom designs or arrangements, idiosyncratic specifications or charging structures not obviously related to costs or the goods specified, etc.

As discussed above, it appears quite common for the major groups to command listing fees, special promotions payments, over-riders, drop allowances, and the like. The majority of these allowances involve fees paid to retail chains for services rendered. Where these practices serve to raise costs for producers, these might be generally passed on to all retailers in the form of higher intermediate (unit) prices, with the effect of, in particular, raising the costs of smaller retailers (who are not in a position to command such allowances), potentially distorting retail competition. In this case, price competition might be dampened, serving to raise retail prices. If so, the practices may be clearly anti-competitive.

However, it is important to acknowledge that there may be important efficiency arguments in favour of these practices. These fees are frequently transfers from large suppliers to large supermarket chains, and while suppliers may object to them, they may have little effect on overall social welfare. In fact, if these fees have no other effects a standard welfare analysis would say they are neutral. Moreover, as retailers might contend, such practices as volume over-riders could benefit suppliers by helping them to develop volume and benefit from economies of scale, leading to lower production costs which could ultimately feed through to lower retail prices.

12.4 Trade-offs between short-run and long-run effects

The interviews conducted for the case studies have raised a number of issues beyond the immediate effects of buyer power. In a number of places in this report, we have suggested that there is the potential for a classic trade-off between the short and the long run. While increasing buyer power may have immediately enhancing welfare effects, in counteracting producer power and lowering intermediate prices, in the long run welfare may be harmed if variety is reduced and seller power in retail markets is increased. We close this chapter by pointing to one specific example which has emerged from the case studies.

A common concern raised by producers and representatives of small retailers was that large retailers often appear to sell key branded goods at a loss (as "loss-leaders"). The practice was regarded as more of an issue of retailer power in general, and large retailer pricing tactics, than buyer power specifically. But these may be connected given that producers may have little credible threat of withdrawing supplies to discourage such behaviour given the significant detrimental impact this would have on their profits. The practice can of course have direct impact on smaller retailers who are not able to compete at all on such goods. In these instances there is the suspicion of predatory motives, though the counter-argument is that it is merely a promotion exercise as part of a "high-low" pricing strategy (as opposed to "every-day-low-pricing" usually adopted by discounters) to increase total sales levels for the retailer.

The latter point notwithstanding, selling goods below cost by retail chains demands slightly more attention. In this case, because major retail chains sells a range of goods, they have freedom to set individual prices below cost if they so choose. This often means that well-known branded goods are sold at a low price which may be below cost and that the chain attempts to recover its costs by charging higher prices on other goods. Such a policy may clearly damage rival firms who sell a more restricted range of goods. From the point of view of having a "level playing field", therefore, such a practice could well be distortionary and hence be undesirable from a welfare point of view - even though some consumers will clearly benefit from the policy, at least in the short run.

The concerns of branded goods producers are mainly on different grounds. For them, their prime concern is that brand investment may be undermined by such activity if it encourages consumers to perceive the product as low quality, thus adversely affecting their intellectual property and discouraging them from investing in building up brands. The implications are long term in nature; branded goods competition will ultimately decline and reduced variety may result.

CHAPTER 13 - SUMMARY AND CONCLUSIONS

Our report has been structured in a straightforward linear fashion, running through economic theory to measurement and policy issues, before confronting the empirical evidence. The evidence is investigated in two complementary ways - statistical analysis of the overall picture, followed by more detailed case studies on some individual member states and products. What does the report tell us?

At the heart of this work are the "buyer power propositions" in chapter 3. We suggest that these provide a useful checklist when competition policy makers confront specific "real world" examples of potential concern. Similarly, in terms of the present report, they also provide an obvious framework and identify some of the key concepts and perspectives to be pursued in the subsequent chapters. Some of these perspectives are very familiar within the broader competition policy debate and might be seen as following directly from intelligent application of standard approaches. Perhaps most important, the propositions confirm that a simple-minded blanket policy approach to buyer power, in retailing or elsewhere, would be ill-advised since specific cases will often involve evaluating a trade-off between efficiency and the abuse of market dominance.

However, in other respects, the analysis of buyer power within food retailing raises a set of more specific and perhaps more crucial issues. Consider, for example, concentration and the market shares of leading firms. Given the special nature of the retail market, it is essential to distinguish three aspects of concentration - information on buyer concentration alone is quite insufficient. So far as the exchange of products between manufacturer and retail buyer is concerned, we are interested in the distributions of both producers and retailers. These will affect the price and conditions of exchange and thus the division of rents between the two sets of firms. Yet, the relative bargaining strengths of the two sets of firms may be largely irrelevant to final consumers if the retailers, in turn, have no market power in the final distribution market. In other words, an overall assessment of social welfare must be based on an assessment of producer, buyer and (final) seller concentration.

13.1 The structures of EU Food Retailing and Manufacturing

We begin by summarising our main findings on the structure of the food retailing sector.

Traditionally, academic economists have devoted far less attention to retailing than to manufacturing. This means that most of the available evidence on the structure of retailing to date has been produced by firms of consultants or industry experts. Whatever the relative merits of their studies per se, they lack the generality, consistency and careful attention to measurement detail that is more typically the hallmark of academics or governmental statistical agencies. One major purpose of this project has been to step backward from the numerous and competing sources of information, in order to reconstruct a consistent and integrated overview of the structure of EU food retailing as a whole, as well as that of the individual member states, and the leading firms therein. This has yielded the following six "headline" facts.

I. **Aggregate EU retail food seller concentration is high by comparison with manufacturing industry generally.** The twenty largest firms account for 40% of aggregate EU retail food turnover, the analogous figure for EU manufacturing being much lower, at 14.5%. Also, in contrast to the general tendency in manufacturing, aggregate EU retail food concentration is rising - by over 4% points between 1993 and 1996. The leading French and German operators (and, to a lesser extent, UK firms) dominate in the overall statistics. If we take the step, useful for some purposes but misleading for others, of including buyer groups as single entities, retail buyer concentration is even higher than retail seller concentration.

II. **Retail seller concentration within member states is also high and rising.** The average 5 firm seller concentration ratio in member states rose from 41% in 1993 to 44% in 1996. However, as we document more fully below, there are important and interesting differences between countries.

III. With the notable exception of the UK, **buyer concentration is even higher** - on average, by about 10% points than seller concentration.

IV. **Cross-border operations are expanding rapidly.** Of course, "globalization", to use a portmanteau term, is not peculiar to this sector, but some features of food retailing are particularly interesting in this respect. As yet, we do not see US (other than the limited entry of Wal-Mart into the German market) and still less Japanese or Korean multinationals moving into the area. At present, it is mainly just German and French firms which are involved in these activities. Two broad types of development may be identified: (i) movement by the very largest French or German firms into their neighbouring Community countries (Austria, Spain, Portugal, and to some extent Italy); (ii) more pervasive and dispersed expansion by discounters (notably Aldi and Lidl) - rarely occupying the top 3 or 4 places in any one nation, but moving broadly into a range of countries. We may speculate that this relates to exploitation of the specific assets developed by these discounters together with the desire to escape from the constraints on growth in the home country.

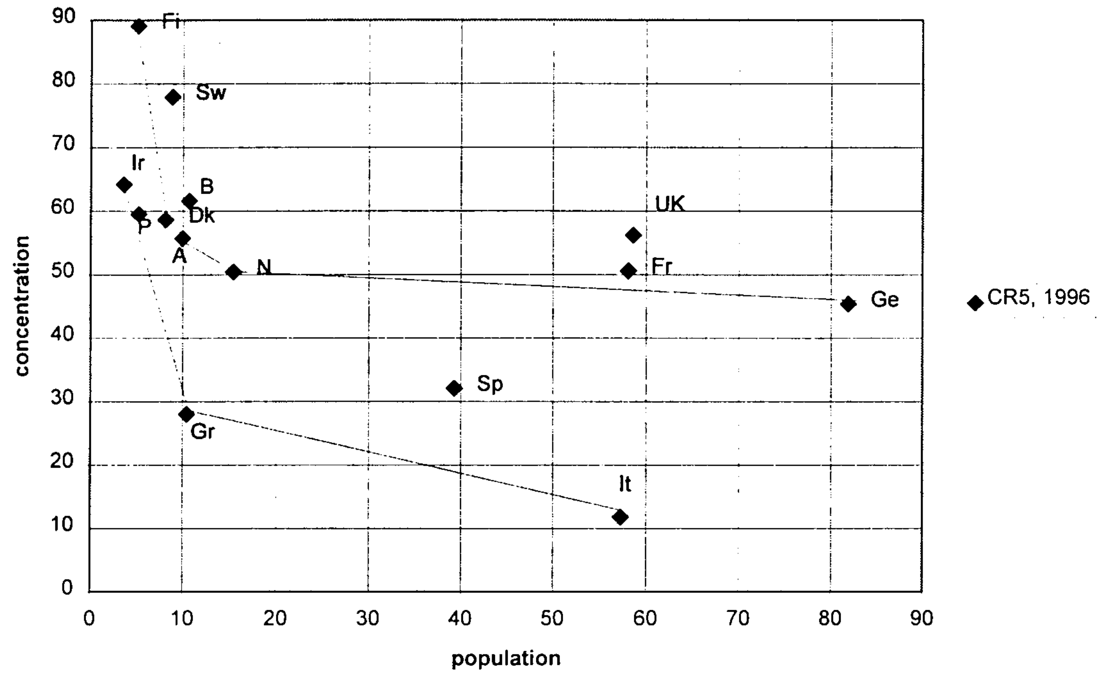
V. This leads us into **the key role of the discounters as a force for intense competition**, particularly in Germany. We see an important potential force for changes in the market generally arising out of this experience. There is a strong contrast between Germany and the UK, for in the latter country the market leaders have been able to hold on to their dominant position through segmentation of the market within the store. More broadly, discounters are amongst the rapidly growing retail formats. Although they are rarely the market leaders, they are nevertheless very influential (as we see in the case studies on Germany and France particularly).

VI. Another feature which seems to be accelerating within food retailing in the Community is **mergers between operators.** We see these as being of three different types: (i) as a means of new cross-border entry for multinational firms (MNEs) -this carries no obvious immediate market power connotations, but merely changed ownership, (ii) within-country acquisitions by leaders of medium sized competitors -creating an increasing mass in the upper tail of the size distribution at the expense of the middle part of the distribution, (iii) more rarely, mergers amongst the leaders - notably Kesko/Tuko in Finland and Rewe's acquisition of Meinl in Austria. The EC has rightly become interested in both of the latter two cases.

There is also a seventh observation - probably more accurately referred to as a "stylised fact" - which we detect from the statistical analysis of Part II:

VII. Currently, there is a **dual structure apparent in food retailing within member states**. Figure 13.1 has been constructed by combining information from table 6.1 and table 7.4 to depict the relationship between concentration and market size. (Admittedly, these focus on seller concentration, but this appears, from II above, to underpin the lower bound to buyer concentration in the market.) The more developed markets, to us, demonstrate a different technology from the less developed ones (where traditional small retailing formats still prevail). The lower bound curve of the developed markets can be seen as described by the points representing Finland, Denmark, Austria, the Netherlands and Germany, but with each of Sweden, Belgium, France and the UK having concentration above that line. Another lower bound is described by Ireland, Greece and Italy, with Portugal slightly above and Spain in an intermediate position.

Figure 13.1 Concentration in European Food Retailing



Turning to the *manufacturing* sector, we wish to add two further "headline facts".

VIII. **Producer concentration in the typical food manufacturing industry is fairly high:** on average, the 5 firm concentration ratio, for 3-digit industries at the EU level, is 30%, which is 4% points higher than the average for all manufacturing industries.

IX. There is an **increasing importance of the world's largest food MNEs**: this is tabulated statistically in Part II, and notable examples arise in the case studies on coffee and margarine in Part III.

13.2 Implications for Buyer Power and Policy Concerns

Thus, the food sector in the European Union can be characterised as one in which there are significant concentrations within both the industry producing foodstuffs and the retail industry selling those products on to final consumers. Having said this, there are important differences between member states and between different types of foodstuff; moreover, both sectors are also clearly in a state of noticeable structural change. Therefore simplistic generalised "headline" policy implications are inappropriate - either on the extent or the impact of buyer power. Nevertheless, drawing together the above structural mapping, the more detailed findings of the case studies, and the insights from economic theory, a number of clear conclusions emerge. These to some extent carry suggestions as to the relative importance of cases for investigation.

1. There is a clear difference between buyer power when exercised against small manufacturers as opposed to large multinational manufacturers. In the former case, even when exercised by groups with no retail seller power, buyer power may have adverse impacts on the food producers - at worst, threatening their survival, and, at least, constraining their capacity for independent decision-making with respect to, for example, product variety and innovation. Having said this, we have found little specific evidence of harms to small producers in practice, though, if available, evidence on numbers exiting and contrasting survival rates of food producers might prove interesting.

2. Apart from this, the role of strong buyers can be a positive one, at least in the short-run, given the extensive concentrations in key parts of the food manufacturing sector. Buyer power exercised against manufacturers with significant market power of their own is less likely to be a problem for the manufacturers (other than reducing their profits). Indeed, it could have a positive short run impact for consumers if reduced intermediate prices lead to lower retail prices.

3. One example of this is the growth of own brands, which are still clearly on the increase in most member states. These are obviously relevant to buyer power, in changing the relative bargaining strengths of manufacturing suppliers and retailing buyers. In the short run, they provide the consumer with more choice, especially on price. Moreover, we have little evidence that they have been exploited by retailers - for example, as a bargaining weapon to support short-run refusals to stock well-known manufacturers' products (though, this is not completely unknown). The large MNEs with prime brands appear to be generally well positioned to resist buyer power. However, the position of secondary producers appears much more vulnerable, where a credible threat to de-list their products may be exercised by powerful retailers to extract considerable concessions from them in bargaining.

4. We believe the main competition question is whether buyer power has an adverse long run impact in that it reduces choice both in terms of product and retail-offer variety. In this respect, it is akin to predatory pricing. The problem for policy is to encourage competition whilst discouraging activities which will lead in the long run to lack of choice for consumers. This focuses attention on the question of barriers to entry into the retail activity. If these were low, no long run adverse impact would be expected, but we suggest they are not low, for a variety of institutional reasons (such as

planning regulations and zoning restrictions) along with strategic aspects (incumbency advantages from experience, reputation and sunk investments in physical and human capital, together with efficient logistics and distribution networks).

5. This brings to the fore the question of how buyer power is or should be measured from the viewpoint of competition policy. By analogy with seller power, we would anticipate that evaluation of a merger between powerful buyers should in the first instance focus upon the extent to which the players, if combined, would control the *purchase* of particular products or services. So, for example, it is relevant to evaluate the proportion of lettuce (and other horticultural production) in the country which a merged supermarket group may be expected to purchase. Just as in selling power, this is to be considered as a first pass to examine the potential need for detailed investigation.

6. Without free entry at the retail stage, the longer-term impact raises an important link between buyer power and seller concentration in the retail market. To the extent that the larger retailers are able to exploit their bargaining strength at the expense of their smaller retail rivals, cost advantages will be a significant force making for increased concentration amongst sellers in the retail market. It is for this reason that, even in a study on buyer power, it is legitimate, indeed essential, to focus to some extent on changing retail seller power.

7. On this issue, there is no reason for supposing that there will not be further consolidation and concentration in food retailing. In part, this will reflect a convergence as the dual structure noted in VII above disappears - for example, we would predict that countries such as Italy will move more towards the position of countries such as France, Germany and the UK. However, there is also continuing evidence of further concentration even in the latter group of countries: an example, as we write, is the proposed merger between Asda and Kingfisher in the UK, although the latter has no existing significant presence in *food* retailing.

13.3 Issues for Further Consideration

1. In the present study, we have not been able to explore the welfare implications of retail mergers in detail (but see the comments in Appendix 1). However, in an obvious way, they encapsulate the inherent trade-offs raised by the general issue of buyer power. Future case study analysis of specific mergers could usefully explore the relative effects of buyer power in reducing prices, and seller power in increasing them. Whilst this was outside the brief of this project, such an analysis could provide powerful and detailed additional insights.

2. An increasingly frequent characteristic of mergers is their cross-border nature. As already noted under VI, the cross-border merger, to date, has usually been the mode of initial entry by an MNE from one member state into another. However, there is no evidence to suggest a tailing off in this activity, and this raises the likelihood that we may be entering a second stage, in which the, now established, MNE makes further acquisitions, thereby increasing concentration - both within the individual member state concerned, and in the EU as a whole. To the extent that increased scale at the European level further enhances buyer power, this raises the prospect that even large, but uni-national, players within individual member states may be increasingly exposed to cost disadvantages. The implications of this may well be a question on which practical cases can focus.

3. In principle, the cross-border alliance of independent retailers raises similar issues. In our opinion, these are an interesting development to be watched - although, at present they probably have no real bite (see Appendix 2 and the case studies).

4. Reflecting the nature of our research brief, in this chapter we have tended to focus on aggregate implications at the EU level. Nevertheless, it should be acknowledged that different levels of aggregation provide sometimes different insights. At the aggregate EU level, we anticipate that, as the market becomes more integrated, more countries will move towards the position represented by the first set of players in Figure 13.1. It is worth observing that cross-border activities are most advanced amongst the largest players in this developed market group. Thus we may speculate that with integration will come the increased activities of such players across Europe generally. If so, despite the increased size of the market, concentration may not fall as might otherwise be anticipated and buyer power will be enhanced. Indeed, the relatively high concentration of Germany strongly supports this view. There is then a question as to whether the system will come to represent more closely what appears from our studies a relatively healthy degree of competition, as in Germany, or the more questionable behaviours exhibited in the French and UK markets. In particular, this raises the issue of whether policy levers are available which can nudge the market in one direction or another. One interesting possibility is of cartel exemption for retail buying groups. In addition, some of the smaller, especially Scandinavian, countries do raise specific issues: their small national markets inevitably lead to very high seller concentration, and, at present, they have been immune to incursions by MNE retailers from the larger member states.

5. Inevitably, a relatively small-scale project such as this leaves open a number of avenues which the Commission may want to explore further. Examples we have already mentioned include: the impact of mergers and cross-border operations and alliances on buyer power; the special features

of the smaller member states; and the implications for consumer choice of own brands. Arguably, future research should focus on consequent structural developments in food manufacturing, with special emphasis on the smaller manufacturers of secondary brands. It seems likely to us that concentration in manufacturing *in the food area as a whole,* and not just food retailing, will continue to increase, and any problems we have identified are likely to become more acute over time.

6. We noted in section 13.2 (point 5) how buyer concentration measures would provide a first pass check of the feasibility of the exercise of buyer power. But the potential for dominance is not the same as dominance itself; policy is concerned with evaluating its manifestations. These come through and can be tested in behavioural and performance factors. The former are relatively difficult to establish. (In a contract, formal or informal, how can it be ascertained that one party has dictated the terms to an unusual degree?) Turning then to performance, the (ex post) share of the margin on a good will be an important factor. If, over time, total mark-up across all stages is maintained or enhanced, but the relative share of the buyer increases at the expense of the seller, to the extent that the seller appears to be earning infra-normal profit, then we suggest this is strong evidence of buyer power being exercised.

7. Primarily, this study has been of an investigatory nature rather than designed to create or develop a series of policy pronouncements. Indeed, we feel we should not be engaging in the detailed proposal of policy, since this is a matter for the Commission, not independent researchers. However, we feel we should add a few words on the subject. First, we do not see that at present there is a pressing need for new policies (i.e. beyond existing ones) to be developed for Europe, to cater for the specific problem of high buyer power. Second, by implication, whilst the Economic Dependency laws developed in some European states have attractive features, they also can easily create perverse incentives and could ossify competition. Therefore, so far as the Community is concerned, we see the case for introducing them as being not proven, though accept that the economic, social and political context may make such policy measures attractive to particular member states but not for others.

APPENDIX 1
POLICY TOWARDS RETAIL MERGERS

Introduction

While organic development has been an important driver of increased concentration in food retailing in most countries, mergers have additionally played a critical role and appear to be on the increase - as discussed in chapters 6 and 7 (e.g. see Table 7.7) of the report and evidenced by Table A1.1 below.

Table A1.1 - Retail Mergers 1990–1998

Ahold/Schuitema (1990/1992)	Tesco (UK)/ABL (Irl) (1997)
Promodès/Codec (1990)	Auchan/Leroy (F)/La Rinascente (I) (1997)
Promodès/Plaza (1990)	ITM/Intermarché (F)/Spar Handels AG (D) (1997)
Promodès/Dirsa (1991)	Metro (D)/Makro-SHV (NL) (1997)
Carrefour (F)/Euromarché (F) (1991)	Migros (CH)/Globus (CH) (1997)
Ahold/Jeronimo Martins (1991)	Casino (F)/Franprix/Leader Price (F) (1997)
Ahold/Jeronimo Martins/Inovacao (1992)	DIA (Promodès (E+P)/Minipreco (Auchan) (E+P) (1997)
Casino (F)/Rallye (F) (1992)	Promodès (E)/Simago (E) (1997)
Delhaize (B)/Alfa Beta (GR) (1992)	Spar Handels AG (D)/Pfannkuch (D) (1997)
ICA (Sweden)/Hakon-Gruppen (Norway) (1992)	Spar Handels AG (D)/Pro Verbraucher (D) (1997)
Metro/ASKO (1992)	FDB/NKL/KF (DK) (*case known as OBS Danmark*) (1997)
Promodès/BRMC (1992)	Promodès (F)/Catteau (ex Tesco UK) (F) (1997)
Spar/Dansk Supermarked (1992)	Promodès (F)/GS (I) (1997)
Tesco/Catteau (1992)	Comptoirs Modernes (F)/PG (ex-Delhaize le Lion (B)) (F) (1997)
Carrefour (F)/Il Gran Sole (I) (1993)	Walmart (US)/Wertkauf (D) (1998)
Migros (Switz)/Zumbotel (1993)	Tengelmann (G)/Gruppo PAM (I) (1998)
Promodès/Discol (1993)	Vendex (NL)/Bijenkorf (NL) (1998)
Rewe/Budgens (1993)	Metro (D)/Alkauf (D) (1998)
Delhaize le Lion (B)/PG (F) (1994)	Metro (D)/Kriegbaum (D) (1998)
Promodès/Marinopoulos (1994/95)	Vendex (NL)/De Boer-Unigro (NL) (1998)
Kaufhof/Horten (1994, *department stores*)	Vendex-De Boer-Unigro (NL)/KBB (NL) (1998)
Karstadt/Hertie (1994, *department stores*)	Somerfield (UK)/Kwik Save (UK) (1998)
La Rinascente/CEDIS (1995)	La Rinascente-Auchan (I-F)/Colmark (I) (1998)
Auchan (F)/Pao de Acucar (P) (1996)	Edeka (D)/Adeg (A) (1998)
Ahold (NL)/Caprabo (E) (1966)	Rewe-Billa (D-A)/J. Meinl (A) (1998)
Auchan (F)/Docks de France (F) (1996)	
Promodès (F)/Garosci (I) (1996)	
Rewe (F)/Billa (A) (1996)	
Kesko (FN)/Tuko (FN) (1996)	
Ahold (NL)/CSC (1996)	

Source: AIM, October 1998

Traditionally, mergers have been examined by competition authorities at the national level as this has been the appropriate forum as they have generally involved retailers from the same country seeking to merge. However, cross-border mergers between retail groups have become more common in recent times and consequently the European Commission has taken on investigations of merger proposals. This move has been partly due to increased cross-border proposals (e.g. the recent *Metro/Makro* concentration[61]), but as even national concentrations can have international ramifications, say on foreign producers and so require Commission investigation. Obversely, the European Commission can refer cases to Member States following a request under Article 9 when it considers that an examination by the national authorities is most appropriate.[62]

The review of Commission investigations by Morgan (1994; 1997) shows that the Commission has generally taken a favourable view. But a key recent exception arose in the case of *Kesko/Tuko*[63], which we discuss below raises issues about the key questions of concern in such investigations and possible remedial action arising.

Theoretical Considerations

Greater concentration in markets is generally of concern to policy makers since, in the absence of cost savings resulting from the exploitation of economies of scale and scope, competitive pressures may be eased such that firms may be able to increase their profits by raising prices, and thus serve against the public interest. Double marginalisation, where markups are separately imposed by manufacturers and retailers, should be a particular concern because of the likelihood of the strengthened of output-reducing impact potentially leading to a more than doubling of monopoly welfare loss, *ceteris paribus*.

Yet in the case of retailing, as noted above, competition authorities in Europe have broadly remained impassive towards increased consolidation through merger, with the view that greater concentration may offer benefits through reduced costs which feed through to lower prices. For example, this line of argument has been suggested by UK authorities, e.g. MMC (1981) and OFT (1985), arguing that consolidation in the sector can enhance retailers' ability to extract discounts from manufacturers which would then, as a result of intense competition between retailers, be passed onto the consumers in the form of lower prices - i.e. benefits along the lines of Galbraith's (1952) controversial countervailing power hypothesis.[64]

However, this argument is contentious since greater concentration at the retail level may afford firms a simultaneous increase in both their buying and selling power. Whilst the former improves their relative

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61. Case No. IV/M.1063, 28/11/1997.

62. For instance, this has recently been the case with the proposed acquisition of Casino by Promodes (both French supermarket chains), referred to the French authorities for investigation (31/10/1997).

63. Case No IV/M.784 (OJEC L110, 26/4/1997).

64. This is controversial since an arms-length relationship would suggest that prices rise along with retail concentration. See for example the critical view by Adams (1987). Also there are different views on what the hypothesis actually is - see Connor *et al.* (1996).

bargaining position, thus exerting downward pressure on intermediate prices and hence reducing the problems of double marginalisation, the latter allows for increased price-cost margins, effectively increasing the total surplus available to firms. If the second effect sufficiently dominates, increased concentration may in fact permit increased intermediate prices, which combined with increased retail margins may lead to distinctly higher final prices, other things being equal.[65] Only in situations where final market competition is likely to remain intense (e.g. where retailers compete head to head on prices and consumers exhibit little store loyalty), and thus margins remain low, is it clear that countervailing power benefits are likely to prevail. In other circumstances, for instance where firms are markedly differentiated, the combination of increased buyer power and increased seller power can lead not only to higher retail margins, but higher final prices as well.

In the specific context of a merger between key buyers or cooperative buyer behaviour (i.e. the formation of a buyer group) we can observe that pooling resources to make purchases may yield efficiency benefits from reduced costs and consideration needs to be given to how great such benefits are when set against any anti-competitive effects. For instance, pooling resources to make purchases such as through the formation of a buyer group may allow for reduced administrative and distribution/warehousing costs. However, for there to be a clear welfare benefit it should be the case that this collective purchaser power does not transfer through to increased selling power downstream, so that the benefits of any reduced costs are passed on to consumers.[66]

Practical Considerations

In terms of assessing the welfare effects of a merger, the first problem confronting a competition authority is determining the appropriate definition of the market, and specifically how narrowly or broadly this is defined. As discussed in chapter 4 above, there are two key dimensions which need consideration: the geographic extent of the market and the substitutability between products offering similar services. Here there might be considerable differences between the selling side and the buying side of the market, giving rise to the need to consider each separately (as indicated by the separate questions in Table 3.1 in chapter 3 of the report). To give an example, consider the market for retail grocers. On the selling side, competition may be localised with consumers facing a limited number of stores (within an easy travelling distance) in a given geographic area, as well as segmented by retail service (e.g. superstore as opposed to small convenience store) but with a wide product choice and many near substitutes for a particular food brand or

65. Dobson and Waterson (1997) provide a theoretical analysis examining these effects and the market conditions which support or work against beneficial countervailing power.

66. This is conceivably the case with international (cross-border) retailer buying alliances in the EU where these are characterised by one alliance member in each member state (i.e. generally not direct competitors in selling output), but account also needs to be taken of supplier economic dependency arguments and any abuse of monopsony power before drawing conclusions.

item. In contrast, on the buying side, except perhaps for locally grown fresh produce, the market for purchasing grocery items will be national or international, but because of the specific nature of supply for particular brands/items the product dimension might be defined quite narrowly, and moreover individual suppliers may be economically dependent on particular distributors (especially when long duration contracts are a market feature).

The US authorities have traditionally taken a much more stringent line on proposed mergers involving retailers than the European authorities, choosing quite narrow market definitions, despite the fact that the generally less restrictive planning controls in the US mean that entry will be more straightforward. This is most notable in the Supreme Court's stance in enforcing Section 7 of the Clayton Act in *Von's*,[67] where the merger of two grocery retailers operating in Los Angeles was prevented even though they only accounted for 7.5% of sales in Los Angeles, based on concerns of the trend towards increasing concentration in this local market.

A recent noteworthy illustration of the sophistication to which competition authorities can apply economic analysis was illustrated by the case of *Staples/Office Depot*[68] in the US, involving office stationery superstores. Concerning market definition, the Federal Trade Commission (FTC) argued that the relevant product market was the sale of office supplies through office supply superstores, as such superstores were significantly different from small independent stationery stores and large diverse general retailers (like Wal-Mart). The FTC produced econometric evidence which showed that there was substantial cross elasticity of demand among consumers of the various superstores but there was relatively little cross elasticity between the superstores and other sources of consumable office supplies. In light of this very narrow market definition, concentration was found to be very high with Office Depot and Staples representing the two largest chains, and with OfficeMax the only other major supply superstore chain in the US. Moreover, the evidence showed that prices were on average substantially higher in cities where only one office supply superstore chain was located than where two superstore chains competed, and even higher than in cities where all three chains faced each other. For example, the studies indicated that the difference in prices between one-chain cities and three chain cities was around 13%. Overall, the econometric analysis provided strong evidence that the proposed merger between Staples and Office Depot would have a significant anti-competitive effect in raising prices.

In addition to retailer seller power, competition authorities may also consider the nature of supplying industries and whether the retailers command buying power over these. As expressed by question 2 from

67. *United States v. Von's Grocery Company*, 384 U.S. 270 (1966).

68. *Federal Trade Commission v. Staples, Inc. and Office Depot, Inc.*, Civ. No. 97-701 (TFH) (1997) - see Pitofsky (1997).

Table 3.1, if the buyer power is against relatively powerless suppliers then there are concerns about abuse of monopsony power, which might include a detrimental impact on producer (suppliers') surplus and the long term viability of suppliers. On the other hand, buyer power is linked with significant seller power at the upstream level then, as argued in chapter 3 above, it is more likely that the existence or enhancement of buyer power is beneficial, that is buyer power may have a socially beneficial countervailing effect by negating the detrimental effects of upstream seller power. The overall effect on welfare in these circumstances will turn on the extent to which retailers themselves have significant selling power, as expressed by question 3 in Table 3.1.[69]

The Kesko/Tuko Decision[70]

All of the above issues came very much to the fore in the recent Kesko/Tuko proposed concentration considered by the European Commission.[71] This case involved a proposed merger between two of the leading Finnish supermarket chains.

The Commission analyzed the market in three ways:

- the retail market for daily consumer goods[72]
- the cash and carry market for daily goods
- the market for procurement of daily consumer goods

The Commission distinguished, at the retail level, between "supermarkets and other stores that are able to provide the kind of wide selection that enables the consumer to purchase most of the household necessities in a `one-stop shop' with attendant convenience such as parking facilities, trolleys etc" on the one hand and other shops (such as kiosks and petrol stations) on the other hand (para. 18). The relevant market is then defined quite narrowly as "the provision of basket of fresh and dry food-stuffs, and non-food household consumable, sold in a supermarket environment" (para 20). So far as the geographical market was concerned, the Commission analyzed a store's catchment area as an area within 20 minutes by car from the supermarket in question (para 21).

The Commission observed that the average market share of the largest retailer in each member state of the EU is 18%. Kesko, the market leader, had 39.9% before the merger; the Finnish retail market was

69. A more straightforward case in welfare terms is where the buyers face relatively powerless suppliers, but themselves have selling power (i.e. the buyer has both monopsony and monopoly power). In these circumstances, social welfare at both the upstream and downstream level can be detrimentally affected.

70. All references are to Case No IV/M.784 (OJEC L110, 26/4/1997).

71. The necessary "Community dimension" was found on the basis that 30% of Kesko's purchases were imported.

72. Daily goods are described as the "basket of daily consumer goods that consumers expect to find in a supermarket environment" (para. 18).

accordingly highly concentrated. With Tuko, its share increased to 59.6% (para 93). Even excluding purchases made through Kesko/Tuko by independent retailers such as Stockman, Kesko's share was still 55% (para 98).[73] Moreover, in different local areas, Kesko's share varied between 40% and 90% (para 99). The market share at this level led to a presumption of dominance by Kesko, which was reinforced by its control over large retail outlets (para 117), customer loyalty schemes, use of private label products, its distribution system, and the position of Kesko's central organs as buyers of daily consumer goods (para 106). All these factors were viewed as raising barriers to entry (para 106).

In terms of buyer power, Kesko was perceived to be an essential "gate keeper", where no major supplier would be able to manage without Kesko. Suppliers were found to be dependent on Kesko for 50-75% of their sales in Finland. Conversely, Kesko was found not to be dependent on any individual supplier to the same extent (para 151), with private label (commanding 20-30% of its sales) being a key element in its buyer power (para 152).

Given these findings, the merger was prevented on the grounds that it would create a dominant position and would significantly impede effective competition. The Commission rejected Kesko's offers to divest certain wholesaling and cash and carry outlets, together with the creation of a new block (para 162). Since the prohibition decision, Kesko has been asked to sell the assets it acquired from Tuko in order to restore competition on the retail and cash and carry markets (see Reuters 19/2/97).

Issues Raised by *Kesko/Tuko*

The Commission's analysis and coverage of the issues was broad, taking account of seller power, buyer power and productive efficiency concerns and we view this as desirable given the nature of the market. However, the decision ultimately rested on a structural interpretation of the market, not detailed economic analysis, for example estimating the impact on retail prices as in the *Staples/Office Depot* US case. In the latter case, localised pricing was a feature of the market and thus scanner data from individual stores could be used to infer local competitive conditions. However, in the context of grocery retailing, if (nationally-operating) firms apply common pricing across their stores (i.e. no variation to account for specific local market conditions) then such data cannot be used in such a direct manner to assess the impact of increased concentration resulting from a merger by comparing price differences in structurally different local markets. Nevertheless, such data can still prove useful in terms of market definition, specifically identifying the extent of market segmentation by store/service types.

73. In the cash and carry market its share was estimated to be 80% (para 146).

Another issue concerns the extent to which the merger consolidates the market. In *Kesko/Tuko*, the combined firm would have controlled nearly 60% of the national market and in some local areas this would have been as high as 90%. The national figure is clearly the more appropriate one concerning issues of buyer power - given that buying is generally undertaken at the national level. But as far as seller power is concerned, consumers are geographically constrained thus making markets local (with catchment areas determined by a few minutes drive-time for consumers from the store), though the perspective taken on concentration levels depends on a view of the firms' pricing policies. With localised pricing, the individual concentration level in each market is relevant, where high levels can give cause for concern that a merged entity may be able to exercise greater market power, but where the problem may be alleviated through selective store divestment in such areas to prevent concentration rising significantly. On the other hand, when considering seller power by firms operating national pricing policy it is the impact on the average of local concentration levels which takes on significance since it is the merged firm's average (perhaps suitably weighted) market share across the various local markets which is more likely to be a key influence on its pricing policy (specifically, its ability to set prices above costs), rather than its share in any particular local market. In this case, selective divestment makes less sense, and, rather, complete prohibition may be the only viable structural remedy.

A striking, and thus far exceptional, feature of the Kesko/Tuko proposal, at least relative to other merger proposals, was the extent to which market concentration would have increased as a result of the merger. It is not only the fact that the proposal involved the number one and three organisations, but that the market already appeared to be highly concentrated (compared to other countries) prior to the merger. This observation naturally begs the question to what extent is Kesko/Tuko unique and at what levels of market concentration and market share should authorities block retail mergers? For example, would, say, a merger be generally acceptable if it involved firms not ranked in the top three places? Alternatively, would an acquisition by a leading firm be generally acceptable if the target was not a leading firm (e.g. not in the top 5)? Thus far the answer to these latter two scenarios appears to be in the affirmative; that is, competition authorities have allowed such mergers to progress. But with pressure for further consolidation in the sector, competition authorities are increasingly likely to face proposals where the firms already separately hold (relatively) high market shares and where concentration is on the increase as a result of natural market forces. Drawing a line between what is acceptable and what is not poses a significant challenge to authorities. For example, in the UK, it became clear that a proposal between the number three and four retail grocers to merge would be challenged and so the proposal was abandoned, but subsequently a merger between the numbers five and six was allowed without even a formal investigation. Equally, a further critical factor, apart from the effect on absolute levels of market concentration, and relevant to merger proposals involving smaller rivals, must be a view on the extent to which the market is naturally concentrating and whether the combination of two smaller rivals can yield more effective competition to the leading firms. Clearly, it is not the rankings of firms per se which is the issue, but the extent to which mergers between the very largest firms create asymmetries in the market which might allow for the exploitation of market power which competition from (smaller) rivals might not be able to check. These concerns may of course be allayed when it is anticipated that considerable economies of scale and general cost-savings will materialise from the merger.

It was also apparent from the Kesko/Tuko case that there were no signs of existing or impending foreign entry into Finnish food retailing which would act as a key stimulus to retail competition. In other European countries cross-national entry has been a feature which has led to increased retail diversity and new competition, particularly from the rise of multinational hard discounters. The absence of such activity in a particular country may be indicative of the extent of barriers to entry in that market, where domestic firms are protected by institutional restrictions and strong incumbency advantages (e.g. associated with store locations, experience, reputation, and supplier networks).

This point, in turn, raises the issue of treatment towards cross-border mergers. Where these represent a means of effecting entry by simply changing ownership with no (direct) impact on domestic concentration, they might generally be welcomed (assuming that aggregate EU concentration is not greatly increased) if domestic retail competition is enhanced as a result of better management practices being introduced and other efficiency benefits arising which allow the firm to operate with lower costs. However, for cross-border acquisitions where the acquiring firm already has a presence in the market, the same concerns apply as with a merger between domestic rivals. Recent events in Austria provide an interesting case in this regard. The German organisation Rewe entered the Austrian retail grocery market through its acquisition of the largest Austrian group, Billa, from Karl Wlaschek in 1996. More recently, though, Rewe has sort to acquire Julius Meinl, the number six food retail group in Austria. Given that the latter organisation is particularly well represented in Vienna and other key populous areas, as is Billa, this merger proposal has raised concerns that it would lead to significant increases in concentration in certain key local markets and as a result has been the subject of (currently on-going) investigation by the European Commission.

Finally, in regard to suppliers, we can note from the Kesko/Tuko case that domestic Finnish producers were clearly constrained in their options of through whom they could sell their products given that there were only four major retailers, jointly controlling around 90% of the market. The geography of the country and, in particular, the relative distance to neighbouring markets meant that switching to supply markets in other EU countries was not generally credible. Consequently, there was considerable potential for retailers exploiting the vulnerable position of producers (principally for those producers that had invested in plant and production capacity in Finland, as opposed to those simply exporting to the country), facilitating the exercise of monopsony power. In other EU countries, this problem might not be so significant when producers can more readily switch to neighbouring geographic markets, but will remain an impediment when sunk investments are required in establishing logistics/distribution systems to supply domestic retailers.

APPENDIX 2
THE COMPETITION EFFECTS OF CROSS-BORDER RETAILER BUYING ALLIANCES[74]

This note summarises the potential pro- and anti-competitive effects of cross-border alliances of retailers when acting as buyers. These alliances have become an important feature of European retailing, and appear to be quite extensive as indicated by the number and membership of the key alliances recorded in Table A2.1 at the end of the note.

Features of Cross-Border Retailer Alliances

The major international retailer alliances operating in Europe differ in their composition and range of activities quite markedly - for convenience Tables A2.2 to A2.7 at the end of this appendix provide details of six of the key alliances to illustrate their similarities and differences.[75] However, for the purpose of this note examining their economic effects, we can make some generalisations, based on their common elements, and assume that cross-border European retailer alliances have the following characteristics:

- one alliance member in each member state (i.e. generally not direct competitors);
- membership typically includes the biggest players in the retail sector in any individual member state (as well as smaller players);
- alliances may share buying price information;
- in fewer cases, alliance members may actually buy from international suppliers as a single unit (NB: various degrees of collaboration are possible between the sharing of buying price information and acting as a single purchasing unit);
- even where a central buying function exists, alliances probably do not include obligations on members to buy through the central buying organisation;
- alliances may collaborate on the sourcing of private label products;

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74 We would like to acknowledge that this summary draws on work developed independently in part by Derek Ridyard (NERA).

75. In addition, see Robinson and Clarke-Hill (1995) for a more detailed discussion of the structure and form of these alliances and how their activities differ.

- alliances do not include formal no-complete undertakings (though they could have the *effect* of making cross-border incursions less likely).

Possible Pro-Competitive Effects

There are three main pro-competitive effects of cross-border retail alliances.

Single Market Facilitation

Sharing of buying price information is likely to increase pressure on suppliers to reduce inter-state price discrimination. This may have complex effects with uncertain impact on net economic welfare, but the elimination of price discrimination will always include an element of allocative economic efficiency benefit (gains from trade argument).

Buying collaboration may also facilitate the introduction of new branded products from one member state to another. This will improve competition between European suppliers.

Other forms of sharing retailer know-how within alliances may speed up the process of implementing best practice (e.g. in distribution, IT systems). This will improve competition between retailers.

From the European Commission's perspective, single market facilitation is an end in itself as well as a means to greater competition. In practice this means that the Commission will give all benefit of any doubt to the above effects being desirable (e.g. the EC Green Paper on Vertical Restraints indicates suspicion of supplier market segmentation).

Countervailing Seller Market Power

If alliances collaborate on purchasing from international suppliers, this may act as a counter to market power wielded by these suppliers. Provided retailers compete, this should improve consumer welfare and efficiency when the gains from reduced purchasing prices are passed onto consumers in the form of lower retail prices.

More Efficient Development of Retailer Private Label Products

Private label development has acknowledged pro-competitive effects (reduces market entry barriers into the production of FMCG products, etc). If retailer alliances speed private label development, some of these pro-competitive effects will apply.

Possible Anti-Competitive Effects

There are six areas of possible anti-competitive effect.

Classic Monopsony Power

If alliances have monopsonistic power, they may (as in classic textbook exposition) reduce buying price and suppress output of suppliers with upward-sloping cost curves and so detrimentally affect the long term viability of competitive suppliers (Blair and Harrison, 1993).

Opportunistic Buyer Behaviour

Product market competition on the supplier side may also be distorted if alliances use their buyer power to act opportunistically against suppliers who have incurred sunk costs. Pushing down prices to variable cost, and eliminating inter-state price discrimination may reduce the returns from productive sunk cost investments (e.g. R&D, advertising) and this could in the long term damage welfare.

Buyer Power Distortions in Retailer Competition

Extraction of differential discounts from suppliers may cause distortions to retail market competition, e.g. giving alliance members a cost advantage that has nothing to do with their efficiency as retailers. This could distort competition.

Arguably, this distortion could be neutralised if all retailers joined (broadly equal-sized) alliances. However, given the start-up costs of organising and running buyer groups, non-members may view access to an existing buyer group as preferable to starting a new group, so that an existing group takes on the characteristics of an "essential facility". In these circumstances, retail competition may be distorted if membership is precluded to certain classes of retailers (e.g. known discounters). Accordingly, it may be possible that buyer groups act as a market disciplining device facilitating "orderly markets" where rigorous retail price competition is avoided.

Anti-Competitive Effects Caused by Private Label

Following Dobson (1998), private label development may also have anti-competitive effects, for example arising from dampening intrabrand competition with the delisting of smaller brands and from retailers free-riding (and therefore undermining) product investments made by branded goods manufacturers. These (as well as the pro-competitive effects of private label) will be magnified if alliances speed private label development.

Mutual Forbearance

In principle, cross-border alliances which draw on one-member per country might be a means of committing to mutual forbearance, i.e. a way of ensuring non-encroachment on each others' territory.

Fossilising Market Structures

A policy of one-firm-per-member-state may ossify national market share rankings by acting as a barrier to mobility when late comers and new entrants are unable to join alliances with the larger firms from other member states (i.e. denial of access to benefits of large alliances and their consequent buying power - that is, a second-mover disadvantage).

Net Effects

With potentially both pro- and anti-competitive effects, the overall net welfare effect is,*a priori*, uncertain. At present, the loose affiliation (e.g. no or little cross-ownership, and continued firm-level negotiation with suppliers) within the alliances, as well as the absence of direct (selling) competitors in the same alliance, and the number of competing alliances, mean that the anti-competitive effects are likely to be limited, beyond what results from any supplier economic dependency problem and lack of retail competition arising at the national level. However, there may be cause for increased concern if there is consolidation of these alliances (through amalgamation), competitors operate in the same alliance, and the alliances become more formalised with cross-shareholdings and mergers resulting in increased market concentration at the aggregate European level.

TABLE A2.1 - LIST OF MEMBERS OF EUROPEAN CROSS-BORDER ALLIANCES

Members	**Alliances**
Ahold (NL)	AMS
Allkauf (G)	AMS
BERNAG OVAG (CH)	BIGS
BWG FOOD/SPAR (IRL)	BIGS
Casino (F)	AMS
Coop Italia (I)	NAF INTERNATIONAL
Coop Schleswig-Holstein (G)	NAF INTERNATIONAL
Coop Schweiz (CH)	EUROGROUP
Cora-Louis Delhaize (F)	EUROPARTNERS
CWS (Coop) (UK)	NAF INTERNATIONAL
DAGAB (SW)	EMD
DAGROFA (DK)	BIGS
Delhaize Le Lion (B)	SEDD
DESPAR Italia (I)	BIGS
Edeka (G)	AMS
Esselunga (I)	SEDD
Euromadi Ibérica (S)	EMD
FDB (Coop) (DK)	NAF INTERNATIONAL
Hakon-Gruppen (N)	AMS
HELLASPAR (GR)	BIGS
ICA (SW)	AMS
Jeronimo Martins (P)	AMS
Kesko (Fin)	AMS
KF-Gruppen (SW)	NAF INTERNATIONAL
La Rinascente (Auchan) (I-F)	AMS
Leclerc (F)	EMD
Markant Food Mktg (NL)	EUROGROUP
Markant Handels AG (G)	EMD
Mercadona (S)	AMS
Musgrave (IRL)	EMD
Nisa Today's (UK)	EMD
NKL (N)	NAF INTERNATIONAL
Rewe-Billa (G)	EUROGROUP
Safeway (UK)	AMS
Sainsbury J. (UK)	SEDD
Selex (I)	EMD
S-Group (SOK) (Fin)	NAF INTERNATIONAL
Somerfield (UK)	EROPARTNERS
SPAR Landmark (UK)	BIGS
SPAR Österreich (A)	BIGS
Superquinn (IRL)	AMS
Superunie (NL)	EUROPARTNERS
Supervib (DK)	EMD
Syntrade Services (CH)	EMD
TRADEKA (Fin)	NAF INTERNATIONAL
TUKOSPAR (Fin)	BIGS
Uniarme (P)	EMD
UNIDIS (DeBoerUnigro) (B)	BIGS
UNIL (N)	EMD
Vendex-DeBoer-Unigro (NL)	EUROGROUP
ZEV-Markant (A)	EMD

Alliances	**Members**
AMS (12)	Ahold (NL)
AMS	Allkauf (G)
AMS	Casino (F)
AMS	Edeka (G)
AMS	Hakon-Gruppen (N)
AMS	ICA (SW)
AMS	Jeronimo Martins (P)
AMS	Kesko (Fin)
AMS	La Rinascente (Auchan) (I-F)
AMS	Mercadona (S)
AMS	Safeway (UK)
AMS	Superquinn (IRL)
BIGS (9)	BERNAG OVAG (CH)
BIGS	BWG FOOD/SPAR (IRL)
BIGS	DAGROFA (DK)
BIGS	DESPAR Italia (I)
BIGS	HELLASPAR (GR)
BIGS	SPAR Österreich (A)
BIGS	SPAR Landmark (UK)
BIGS	TUKOSPAR (Fin)
BIGS	UNIDIS (DeBoerUnigro) (B)
EMD (12)	DAGAB-UNIL (SW)
EMD	Euromadi Ibérica (S)
EMD	Leclerc (F)
EMD	Markant Handels AG (G)
EMD	Musgrave (IRL)
EMD	Nisa Today's (UK)
EMD	Selex (I)
EMD	Supervib (DK)
EMD	Syntrade Services (CH)
EMD	Uniarme (P)
EMD	UNIL (N)
EMD	ZEV-Markant (A)
EUROGROUP (4)	Coop Schweiz (CH)
EUROGROUP	Markant Food Mktg (NL)
EUROGROUP	Rewe-Billa (G)
EUROGROUP	Vendex-DeBoer-Unigro (NL)
EUROPARTNERS (3)	Cora-Louis Delhaize (F)
EUROPARTNERS	Somerfield (UK)
EUROPARTNERS	Superunie (NL)
NAF INTERNATIONAL (8)	Coop Italia (I)
NAF INTERNATIONAL	Coop Schleswig-Holstein (G)
NAF INTERNATIONAL	CWS (Coop) (UK)
NAF INTERNATIONAL	FDB (Coop) (DK)
NAF INTERNATIONAL	KF-Gruppen (SW)
NAF INTERNATIONAL	NKL (N)
NAF INTERNATIONAL	S-Group (SOK) (Fin)
NAF INTERNATIONAL	TRADEKA (Fin)
SEDD (3)	Delhaize Le Lion (B)
SEDD	Esselunga (I)
SEDD	Sainsbury J. (UK)

Source: AIM – September 1998

TABLE A2.2 - AMS

MEMBER DETAILS	STATED OBJECTIVES	ORGANISATIONAL STRUCTURE	ACTIVITIES TO DATE
Based: Zug, Switzerland Established: May 1988 Members: 12 AHOLD (Netherlands) ALLKAUF (Germany) CASINO (France) EDEKA (Germany) HAKON GRUPPEN (Norway) ICA (Sweden) JERONIMO MARTINS (Portugal) KESKO (Finland) LA RINASCENTE (AUCHAN) (I-F) MERCADONA (Spain) SAFEWAY (United Kingdom) SUPERQUINN (Ireland)	AMS (Associated Marketing Services) portrays itself as a marketing and service company. It stresses that it is not a buying centre. It seeks cooperation with manufacturers and suppliers of branded products, private labels and non-branded products. AMS identified a number of "Areas of Opportunity" in which it hoped to "generate benefits for suppliers and partners". These are: - introduction of suppliers to new markets and extension of existing business; - own brand development; - European promotions; - exchange of know-how and information; -bilateral cooperation between members.	AMS has a formal structure with a president and directors, e.g. of purchasing and marketing. The alliance has adopted a system of key coordinators responsible for different product groups and for working with the buyers of the member companies.	Synergy marketing agreements: In return for services the supplier pays a "bonus" to AMS. Prices and conditions are negotiated with the individual AMS members. A number of high profile agreements have been signed with multinational suppliers. Private labels: In 1995, AMS launched a range of 20 private label products called Euroshopper, ranging from nappies to coffee. This range has been gradually expanded to 200 products. AMS plans to extend the range to 300 products. More than half of the products originate from the Netherlands. All products carry a Euroshopper sticker. Products can be found at Albert Heijn and ALLKAUF plans to introduce them in 1996. Bilateral and regional cooperation: The main strength of AMS seems at present to be the network it has created for bilateral and regional cooperation among the members. The three Scandinavian members (ICA, HAKON & KESKO) have already created in early 1994 the Viking Retail Alliance (VRA) to carry out certain activities in common. Safeway and CASINO cooperate through exchanging private labels and other products, e.g. British specialities in France and French themes, such as wine, in the UK.

Source: Trade Sources

TABLE A2.3 - BIGS

MEMBER DETAILS	STATED OBJECTIVES	ORGANISATIONAL STRUCTURE	ACTIVITIES TO DATE
Based: Amsterdam, Netherlands Established: Dec 1990 Members: 9 BERNAG OVAG (Switzerland) BWG FOODS/SPAR (Ireland) DAGROFA (Denmark) DESPAR (Italy) HELLASPAR (Greece) SPAR LANDMARK (United Kingdom) SPAR OESTERREICH (Austria) TUKOSPAR (Finland) UNIDIS (Belgium)	The objectives of BIGS given in 1994 promotional material are "to maximize sales and profits for its members and its BIGS Eurosuppliers through a common buying and marketing activity". In addition, "BIGS encourages cooperation between its members and the industry" and "plays a major role as a coordination point for both customer and supplier". BIGS carries out "combined purchasing by the European SPAR organisations". Since the break at the end of 1992 with the German buying organisation Gedelfi (BIGS originally stood for Buying International Gedelfi SPAR and was based at Gedelfi in Cologne), BIGS highlights far more the international corporate identity of the SPAR retailing brand and the organisation's role as a buying organisation for SPAR. BIGS now defines three "target markets": 1. Suppliers who are currently operating on national markets and wish to expand their commercial activities. 2. Intermediary between global manufacturers and SPAR members, particularly for discussions on strategic and general marketing issues. 3. Private label suppliers for SPAR own brands on an international basis.	The split with Gedelfi led to a reorganisation of BIGS. The organisation moved from Cologne to Amsterdam where it shares offices with International SPAR Centrale. Following the departure of Gedelfi, SPAR Handels AG, which had been by far the largest member of BIGS, also left the organisation. The German Spar's defection to Markant appears to have prompted the restructuring and exit of Gedelfi. In its promotional material, BIGS's organisational structure is outlined as follows: - BIGS has the authority to select suppliers on behalf of its members; - negotiations take place on a national level, but BIGS may also be represented; - BIGS provides support to its members during negotiation process; - monthly newsletter for its members; - regular meetings of members to exchange ideas, experiences and results and to evaluate suppliers.	In 1992-93 BIGS described a number of "tools" which it planned to use in cooperation with suppliers: Euro-promotions, European Distribution Support Programme, BIGS Euro Supplier, International Collection and Del Credere, Euro Purchasing-Marketing, Euro Private Label Sourcing, Euro Logistics. Contacts with branded goods manufacturers have been limited so far and mainly focused on private labels, Euro-promotions and introducing products to new markets.

Source: Trade Sources

TABLE A2.4 - EMD

MEMBER DETAILS	STATED OBJECTIVES	ORGANISATIONAL STRUCTURE	ACTIVITIES TO DATE
Based: Pfaffikon, Switzerland Established: 1989 Members: 12 DAGAB (Sweden) EUROMADI IBERICA (Spain) LECLERC (France) MARKANT HANDELS AG (Germany) MUSGRAVE LTD. (Ireland) NISA TODAY'S (United Kingdom) SELEX GRUPPO COMMERCIALE (Italy) SUPERVIB (Denmark) SYNTRADE SERVICE AG (Switzerland) UNIARME (Portugal) UNIL (Norway) ZEV MARKANT (Austria)	In a February 1994 document EMD listed its objectives as: - To support the national and regional trade in Europe; - To support small and medium sized companies in the industry; - To act as a speaking partner for multinational manufacturers; - To preserve the diversity of the market on the manufacturing side; - To act as a necessary alternative in the process of concentration of retail chains. In its public statements EMD stresses that support of SMEs (both industry and trade) is its key task. Within this framework EMD claims to offer a range of services, including: - Services for branded product manufacturers, e.g. sales promotions at European level, turnover guarantees, market information, opening of new markets; - Private labels, e.g. international comparison of prices for own labels, creation of European private labels; search for new suppliers and available overcapacity; - Others, e.g. centralised international payment, communication network for members, European logistics concepts.	- The main decision-making bodies of EMD are the Board of Directors and the General Assembly. The shareholders meet four times per year. Buyers of the member organisations meet eight times annually. This group is responsible for developing programmes for branded products and for private labels. - buying office, MTO - Markant Trading Organisation - (Markant is a founder member of EMD) has been set up in Hong Kong for non-food products. - EMD could be looking for a French member and a new Dutch member after Markant Food Marketing NV left EMD for EUROGROUP. - In April 1996, EMD established the Czech Marketing Distribution (CMD) procurement and marketing organisation. EMD holds 25% stake in CMD, the remainder is held by 7 Czech trading companies : Coop-Centrum, Interkontakt, M-Holding, Pronto Plus, Food Union, Globus and Rossmann. According to EMD, CMD was set up to help Czech companies faced with an increasing level of concentration and foreign ownership in both the food trade and industry.	Cooperation with branded product manufacturers: At the end of 1993, EMD embarked on a negotiation round with branded goods manufacturers. EMD members have urged their international suppliers to consider working more closely with EMD, citing EMD's very large combined volume and more than 9000 stores. Private labels: The area in which EMD has been the most active is in the development of common private labels for its members. The first such product was launched in Spring 1993, a washing powder with the name Minel. By the beginning of 1994 the Minel range consisted of nine products. The product is presented in a uniform way in all countries. Unity (toilet paper, paper handkerchiefs, kitchen paper, etc.), Breakfast Club (cereals), Rio Bravo (fruit juices, ice-tea) have followed since. EMD's objective is to develop an assortment of up to 150 products based on the same pan-European concept as has been used for Minel by 1996. The prices should be very competitive and should permit smaller retailers to offer products at prices which compare favourably with those offered by large retail chains and by discounters. By generating large production volumes EMD hopes to keep prices low.

Source: Trade Sources

TABLE A2.5 - EUROGROUP

MEMBER DETAILS	STATED OBJECTIVES	ORGANISATIONAL STRUCTURE	ACTIVITIES TO DATE
Based: Cologne, Germany Established: 1988 Members: 4 COOP SCHWEIZ (Switzerland) MARKANT FOODMARKETING BV (Netherlands) REWE (Germany) VENDEX DE BOER UNIGRO (Netherlands)	The stated objectives of Eurogroup (from Cologne trade register) are: * The purchase of goods in its own name, on behalf of the shareholders and on behalf of third parties. * The realisation of various import and export activities and services of all kinds. * The carrying out of market studies, search for new products and procurement sources, exchange of information, experience and know-how relating to the trade, as well as all areas connected to the operation and management of retail and service companies, particularly in the fields of methodology, handling, transport, personnel management and training, new technologies, information technology, etc. * The representation of the common economic interests of the shareholders, in particular in connection with the institutions of the EC and all other relevant authorities, organisations and groups.	Very little information has been published on how Eurogroup is organised. The formal seat is in Brussels, but operations are directed from Cologne.	Procurement offices: In 1992 a non-food buying office was set up in Hong Kong to buy products on behalf of all Eurogroup members. Buying offices were also created in Italy, Spain and the Netherlands for purchasing of fruit and vegetables. Private labels: A common European 200-food product range called Mondofino is sold in identical packaging, with labelling in various languages and bearing the name Eurogroup as well as the logo of Eurogroup's members. Eurogroup has also developed a non-food home- & kitchenware line called Eurocuisine with 70 articles. Private label products are also exchanged by members on an individual basis (eg REWE products to be found in COOP SCHWEIZ stores).

Source: Trade Sources

TABLE A2.6 - EUROPARTNERS

MEMBER DETAILS	STATED OBJECTIVES	ORGANISATIONAL STRUCTURE	ACTIVITIES TO DATE
Based: Vianen, Netherlands Established: Aug 1995 Members: 3 CORA - LOUIS DELHAIZE (France) SOMERFIELD (United Kingdom) SUPERUNIE (Netherlands)	The press release stated that members in Europartners would enable its members to use international market intelligence in sourcing common products and to benefit from a more general exchange of information in areas of joint interest. David Simons (Chairman) said "The logic for creating a consortium is considerable. By joining forces, we will be able to purchase from common sources, whether in the UK or in Continental Europe, products which we all sell. The consortium will initially focus on a smaller number of products, aiming gradually to grow the benefits for the consortium members, its suppliers and customers." In a letter to its suppliers, Somerfield mentioned that the objective of the group was to source common products at the most advantageous price using its collective volumes and knowledge of international markets.	Initial board formed by representatives of each of the three key participating members.	Barely 6 months after its decision to join Europartners, BML-Billa decided to leave the alliance and join EUROGROUP. Cora, Match and Profi have joined the alliance in 1997.

Source: Trade Sources

TABLE A2.7 - SEDD

MEMBER DETAILS	STATED OBJECTIVES	ORGANISATIONAL STRUCTURE	ACTIVITIES TO DATE
Based: no permanent office Established: 1994 Members: 4 AUCHAN (France) DELHAIZE LE LION (Belgium) ESSELUNGA (Italy) SAINSBURY J. (United Kingdom)	Among the objective formally given for SEDD when the creation of the alliance was announced in April 1994 was to develop opportunities in the European market in distribution, marketing, trading and information technology through the exchange of information. In a 1994 EMR report, the objective was summed up as "SEDD has been set up to monitor and compare prices, products and payment terms of the four member retailers. About SEDD, Delhaize managing director Gui de Vaucleroy mentioned: "the SEDD is essentially an exchange of information on buying sources and prices, to try where possible to exchange the best conditions for all four participants ... When we can buy together we do it and when we can have the best conditions of one group we try to do that also." Michael Morgan, Director of International Buying at Sainsbury's confirmed that whilst the SEDD does not represent a central buying point, each member of the alliance can buy on behalf of the other members, which could in effect facilitate parallel importing.	Unlike most other European alliances SEDD has at present no central office and no permanent managing director. The only information on organisation is that buying directors of the member companies hold systematic and structured quarterly meetings.	Informal cooperation had been taking place between the SEDD members before the creation of the alliance was announced. For example, Delhaize "Le Lion" has exchanged private label products with ESSELUNGA (e.g. ESSELUNGA pasta available in Delhaize). SEDD members have taken up contact with international suppliers with attempts to buy centrally or to propose to manufacture private labels. SEDD did not approach suppliers with proposals of introductions in new markets or extension of business with other members of the alliance. It is not clear whether Auchan will keep the ex Docks de France participation in the alliance.

Source: Trade Sources

APPENDIX 3
EFFICIENT CONSUMER RESPONSE: COMPETITION AND WELFARE IMPLICATIONS[76]

Introduction

In the food sector, the whole nature of distribution has been changed by the information technology revolution. Information systems have enabled companies to adopt more tightly managed and efficient business practices whilst adapting commercial relationships with both customers and suppliers. The adoption of "just-in-time" (JIT) principles by manufacturing industry, and refinements such as quick response logistics (QR), has promoted a shift from "manufacturer push" to "consumer pull" in the supply chain with reduced stock levels as a consequence of more synchronised production and distribution, relying on information from electronic data interchange (EDI) and electronic point-of-sale (EPOS) systems. The more recent evolution of these concepts in retailing is called efficient consumer response (ECR) which aims to provide customers with the best possible value, service and variety of products through a collaborative approach to improving the supply chain.

However, concern has been expressed that these developments, whilst widely welcomed for reducing costs and improving efficiency, are not without (potential) costs to competition. Firstly, these systems favour large firms which have access to the considerable resources required, which once implemented put them at a competitive advantage over their smaller rivals, in many cases forcing the latter to exit the market. But apart from tending to increase the rate of market consolidation, the introduction of ECR may have other effects. For instance, in its Green Paper on vertical restraints, the European Commission (1997, point 233) notes that modern distribution techniques "copperfasten" the position of the number one and two brands in the market, where less strong brands are delisted and replaced by the retailer's own brands. Given that the large retailers account for a very significant part of sales, this can represent a very significant barrier to entry for other producers seeking to enter the market. In addition, concern is expressed by the Commission (1997, point 52) that modern distribution techniques are "copperfastening" the nationalistic structure of markets. The Commission's point is that where there is increased cooperation between suppliers and distributors through the use of information technology and a close coordination of logistics, there is a greater investment in the relationship between the parties. This means that the purchaser is less likely to put that relationship in jeopardy to buy goods in the parallel market, unless the price differential in question is great and the potential duration of the supplies is significant. In other words, the increased cooperation can act as a barrier to entry for third party suppliers and reduces the ability to profit from parallel trade.

76. The research assistance of Tim Senior (University of Cambridge) in preparation of this Appendix is gratefully acknowledged.

In light of these points and other concerns about the competition effects of ECR, this appendix provides some background on the development of ECR in Europe before considering the resulting economic welfare implications. The analysis identifies both the pro- and anti-competitive concerns, recognising that while the short run benefits may be substantial due to reduced costs, in the longer term the number of competitors may diminish which ultimately may give rise to adverse effects on competition and potentially lead to reduced product/service choice for consumers and higher final prices.

Background

Initiated in the USA in 1993, Efficient Consumer Response (ECR) is a method of revising manufacturer-retailer relationships in order to reduce inefficiencies in the supply chain, particularly logistics. However, ECR has been promoted as going further than being just another review of optimal ordering and supply regimes, with the argument that if properly implemented it changes the entire relationship between a manufacturer and retailer at all levels, affecting marketing, trading, and supply chain strategies and transforming their culture and attitudes leading to changes in methods of working, training, staff incentives and organisational structures. Central to this is the view that ECR is a response to or manifestation of the transition from the traditional retailing model of "manufacturer push" to "consumer pull". The emphasis is on determining consumer needs and reacting to them, rather than telling or persuading consumers what they desire. The essential element is a reactive information driven strategy where both retailers and, most particularly, manufacturers need to have fast reactions (low lead times) and be flexible.

ECR is more established in the US, but in the past three to four years has received growing acceptance in Europe. There is now a European ECR Executive drawn from the Boards of leading European retailers and European/global FMCG firms. This Executive has identified three key areas that will give an ECR system:

Category Management - where categories are defined consistently between retailers and suppliers, and both jointly manage product categories as business units, coordinating promotions, ranges and product introduction;

Product Replenishment - which involves integrated systems to facilitate the management of production, continuous replenishment (minimal inventories) and automated store ordering; and

Enabling Technologies - which is the use of systems such as Electronic Data Interchange (EDI) and Electronic Funds Transfer (EFT) to support the integration and coordination implied in the two above.

The latter, information technology, is playing an increasing role in the relationships between retailers and their suppliers. EDI can be used to link retailer despatch centres with producers to enable the manufacturer to align production schedules, and Electronic Point of Sale (EPOS) data informs, and in some retailers drives, the replenishment process. This allows fully sales based ordering. Further, EPOS data can be used by the manufacturer to design its production schedules in line with consumer demands, and EPOS influences retailers' sales promotions and marketing activity. Communication between retailer and manufacturer is through the internet, or, more securely, the extranet, an internet-based direct firm to firm link.

This development has not been without problems, though. Some manufacturers have complained that sales-based ordering is inefficient because it is piecemeal, and results in short runs and half-full pallets (e.g. as reported by Fiddis (1997)). Retailers have also needed to ensure that they have retained human interaction within the process to provide a strategic direction to the types and assortment of products within the store. Some retailers (for example, Kmart in the US) have found the move to these systems results in a loss of service from suppliers.

The benefits claimed for ECR are enormous. A survey in the United States by the consultancy Kurt Salmon Associates, the originators for the ECR concept, in 1993 identifies savings of up to 10.8% of retail turnover, or $30bn. Estimates for Europe have been lower, in part because of greater existing logistical efficiency (particularly lower inventory levels). The Coca-Cola Research Group in May 1994 estimated savings of between 2.3% and 3.4% of sales. In 1996, though, ECR Europe and Coopers and Lybrand (1996) estimated the benefits to be around 5.7% of sales turnover. The most recent estimate by Coopers and Lybrand (see Mitchell, 1998) is that the full application of ECR improvement concepts could generate savings worth the equivalent of 7.3% off final consumer prices, amounting to some $42 billion.

These benefits arise in part from reductions in operating cost, and partly from lower inventories (split 85:15 in the 1996 Coopers and Lybrand report). There are varying estimates of to whom these benefits will accrue, but the Coca-Cola Research Group estimates a split 60:40 in favour of retailers. Difficulties emerge in assessing the potential benefits from ECR due to differing interpretations of its meaning. Some manufacturers see it as extending only so far as logistics, whilst others have wholeheartedly embraced a review of the entire way in which they interact with their retailers.

Effective implementation of ECR clearly requires considerable human and financial resources to be dedicated to the task. The basis of relationships is required to shift from adversarial to cooperative, for which both manufacturer and retailer must commit time and personnel to establishing ground rules relating to information disclosure and the extent of systems integration. Significant investment, particular in manufacturing process development and IT then becomes necessary to implement the outcome of these negotiations. It may take a considerable time to reach agreement and then analyze data to draw the conclusions that drive integration. As an example, Walkers Snack Foods in the UK estimated planning activities for category management to have taken 16 weeks with each of its retail customers (Fiddis, 1997).

As a result of the level of investment necessary from both parties, ECR has at present been effectively restricted to large FMCG firms working with major food retailers. The retailers have initially limited the number of suppliers involved, and smaller retailers and manufacturers cannot afford the required investment (PE International, 1997). Whether ECR is rolled out to smaller manufacturers depends on the attitude of the major retailers; at least one major UK retailer (Tesco) has been reported as attempting to refine its ECR systems with large manufacturers, but design them with relatively low IT investment needs so that they can be extended to all suppliers in due course (Charlesworth, 1997).

The application of ECR in Europe at present is uneven and differs in nature. The most common developments are in category management and increasing replenishment efficiency. The ultimate extension of joint category management is for one manufacturer to be a category captain and take on the organisation of the category themselves. This has problems, though, since it requires a considerable degree of honesty and objectivity from the category captain. Determining the optimal profitability of the category within a retailer involves assessing the profitability of each line stocked and may result in removal of some of the captain's own brands or products.

The extension of efficient replenishment is Vendor Managed Inventory (VMI) where the supplier controls the orders for the retailer. It is argued that this increases efficiency as it can eliminate stockouts and closer integrates the manufacturer and supplier. The supplier also has a more transparent view of future demand, and together with the reduction of inventory enables a more optimal planning of production.

However, these two examples are extremes, and are neither frequently applied, nor have been completely successful. For instance, in the US, where VMI has gained some acceptance, Kmart cut back its VMI programme from 300 to 50 suppliers after service levels fell from 99.5% to 70% following its introduction (Fiddis, 1997). More general problems have arisen in seeking to establish category management partnerships, where difficulties have been experienced in selecting the appropriate partner (in terms of performance, cultural fit and existing market share), developing the requisite level of trust and committing the appropriate level of resources.

For large manufacturers, which tend to be supplying branded goods and perhaps also own label, these are key considerations. If resources are to be committed, they need to be sure that the venture will be a success, cultures will fit and both firms are equally committed to the relationship. These are rational concerns for any investment. However, there are real dangers for manufacturers as the retailer is not just a customer, but also a competitor through own-label products. Closer integration and information sharing is difficult in these circumstances. Retailers increasingly demand own label products that imitate branded rivals very quickly, and the time taken for "lookalikes" and "me-too" products to appear has fallen dramatically over the last ten years. Providing the retailer with the precise information about future innovations, promotions and product launches may compromise the manufacturers' ability to earn a return on the new product. In some instances, copycat products arrive almost simultaneously with the branded innovation (Fiddis, 1997).

The most successful model of integrating brands and own-label production in one firm is that of separation of business operations. Firms such as Northern Foods have separated own-label production into an autonomous business unit. This avoids the spillover and capacity conflicts that otherwise may arise.

One of the major problems for retailers in the past has been a mismatch between their stock replenishment needs and supplier production schedules. This has arisen largely through different demand forecasting; often manufacturers have several different demand forecasts within the same firm, each devised along functional lines. In order to fulfil the potential offered by ECR and VMI, retailers and some manufacturers have been working towards joint demand forecasting in a model called Collective Forecasting and Replenishment (CFAR) with the aim that this enable reduced lead times, fewer or no stock-outs and lower inventories (Fiddis, 1997).

Future Developments

As noted above, ECR will place suppliers combining branded and own label production under increasing pressure. It is therefore likely that manufacturers will choose either to concentrate on their brand solely, or with own label in autonomous units, or move to exclusive production of own label. Suppliers, whichever route they take, but particularly if they focus on own-label, will become increasingly integrated with retailers in terms of production, ordering and demand forecasting systems. There will be significant information sharing and increased use of the internet or extranet.

As a result of the increased power of retailers, manufacturers are searching for alternative routes to the consumer, and the internet may provide the opportunity. At present the retailers, usually very quick to adopt new technology, have been reluctant to fully embrace the internet, not least because of their massive investment in property. By providing a direct route to consumers the internet may allow the manufacturers, allied with logistics firms to enable home delivery, to offer a real alternative to major retailers. Clearly, this becomes more credible if, rather than operate internet sites independently, suppliers combine to offer a wide range of competing FMCG products at the same site through a collaborative venture - while effectively a horizontal agreement between competing manufacturers (and thus may possibly be construed as being anti-competitive), this may prove to have significant pro-competitive effects if it reduces costs (by providing a more efficient form of distribution than traditional retailing) and it increases effective competition with retailers.

The retailers themselves may be expected to become even more consumer focused. Product promotions and marketing activities will be informed by EPOS and loyalty data allowing much closer predictions of consumer buying behaviour. In addition, the layout of stores will be changed as product categories are redefined and techniques such as virtual reality are used to create the atmosphere most likely to induce purchases.

Welfare and Competitive Effects of ECR

ECR could deliver huge efficiency savings to retailing and associated manufacturing industries, but at the same time might facilitate collusion, foreclosure and other welfare diminishing anti-competitive practices. The assessment of the welfare impact of ECR by competition authorities such as the European Commission is thus particularly difficult. The development of closer supplier-retailer relationships is a vertical interaction which might fall foul of Article 85 (for this a written agreement is not necessary to establish EC vires) or even Article 86 if the retailer is deemed to be dominant. The former would be a cause for concern if the closer relationship or de facto agreement acted to reduce competition in either retailing or manufacturing or both. Alternatively, if the retailers are considered dominant the imposition of measures such as ECR might be seen as an abuse of buyer power, forcing manufacturers into relationships they do not desire. Against these potential problems are the potential benefits. As will be seen below, it is not clear a priori when ECR is being used in a welfare enhancing or reducing manner, and establishing intent may prove even more difficult.

Pro-Competitive Effects

The main aim of ECR is to focus retailing on the consumer needs and demands. Thus the principle welfare effect arising from the development of ECR and more integrated supplier-retailer relationships is the level of efficiency savings generated and the increase responsiveness of retailers to consumer demands. Suppliers and retailers will be able to align production schedules, demand forecasting and manage categories to enhance sales. This will result in less production wastage, lower order to delivery lead times and the elimination of stock-outs. Retailers and suppliers will be able to respond more rapidly to changing consumer demands and with increasing knowledge of their consumers retailers may be able to offer a more personal service, such as customer remote ordering or delivery by the retailer of staple repeat purchases.

Category management in particular can have significant benefits for both supplier and retailer; Welch's Foods in the US found that once they became category manager at Wal-Mart they lost 55% of their shelf-space but increased sales by 25% (Fiddis, 1997). Developing categories in a joint relationship can result in a redefinition of the category itself, as in the case of Walkers in the UK who now include dips in the snacks category which became apparent from consumer demand research.

The internal design of the store can also be enhanced for consumers through the use of virtual reality techniques to determine the most attractive and sympathetic layout for consumers. The potential for category management to enhance or optimise the choice of products available, though, needs to be offset against the negative aspects of the potential loss of choice arising from the diminishing number of suppliers.

The cost savings may or may not be passed on to consumers. Some of the benefits accrue to manufacturers who may recycle them to consumers in the form of lower costs of production or further product development. In the case of the former the benefit to consumers will also be dependent on the level and nature of retail competition. If it remains intense and at least partly based on price consumers are likely to feel the positive effects of ECR.

Whilst it is a widely held view that the development of ECR may lead to the focusing of retailers on a very few suppliers in each product category to the detriment of secondary brands and smaller manufacturers, this may not be so. If retailers foresee the problems with this approach highlighted below they may maintain a number of smaller suppliers. This may act as a pro-competitive force as the retailers guarantee demand to such firms in order to facilitate their investment, giving small firms greater security and confidence to invest. Small suppliers may also be best placed for producing niche products or developing unusual lines. Some retailers have already recognised this and are ensuring that they retain smaller manufacturers within the supply chain.

The increasing demands of retailers and the problems with trying to manage a relationship with a customer and competitor simultaneously are driving some manufactures to find alternative routes to market for their product. The internet in particular is offering opportunities, as well as the arrival in the UK of Streamline, a home shopping system firm from the US that delivers direct to consumers and sources direct from manufacturers (Fiddis, 1997). It is therefore possible that manufacturers themselves may provide a competitive stimulus in the retail market. Whether this would have happened without ECR and associated developments is arguable. Indeed the nature of the commitments and specific investment necessary for ECR may result in a power shift away from the "power buyer" retailers, placing manufacturers back on a more level footing. Both retailers and manufacturers will each be able to subject the other to hold-up.

Anti-Competitive Effects

The investment necessary to participate in an ECR system will be significant, and will raise further the entry barriers to production of branded goods. As outlined above, the development of the relationship with retailers involves considerable human and financial resources that are unavailable to smaller manufacturers. Further, retailers themselves will wish to limit the number of suppliers involved also because of the cost, and will focus on the leading one or two suppliers in a given category. This will both reduce the number of secondary and tertiary brands and significantly increase the difficulty for new brands to gain access to major retailers. Consumer choice will be reduced and the market power of branded goods will be concentrated in a few firms. This point of concern is expressed by the European Commission (1997) in its Green Paper on Vertical Restraints, suggesting that modern distribution methods would reinforce the position of the market leaders at the time of the introduction of new systems.

The development of category captains is also problematic for smaller manufacturers and new entrants as they are less likely to be able to gain shelf-space, and may not be able to initially demonstrate their value. Unless carefully watched by both retailers and competition authorities, category control by manufacturers may become a route to foreclosure. Indeed, some manufacturers are already stating that they are keen to become captains in order to guarantee a prolonged relationship with the retailer, and to increase the retailer's switching costs in changing brands. This again may prove to be neither good for the retailer nor the consumer.

Considerable investment will also be necessary for own-label production. At present, as it is relatively easy to enter, own-label production can work in a pro-competitive manner as small manufacturers begin producing for retailers and use this as a base from which to launch brands. With the need for IT systems and integrated processes entry barriers will be raised and fewer firms will be able to produce. Perversely this reduction in number of own-label suppliers will concentrate power with those remaining and work against the retailers who are reliant on their output.

Overall for branded and own-label goods, unless managed properly the increased level of industry-specific investment will lead to considerable potential hold-up problems. The increasing demands placed by retailers on own-label manufacturers who also produce branded goods may reduce product innovation, and ultimately may force the withdrawal of brands. This reduces welfare as products are not refined and developed as they would otherwise be, and the loss of brands reduces choice. The implications are considerable, though, because retailers do not develop own-label products, but simply imitate. If imitation became so rapid that investment in brands and innovation were no longer viable a situation of product stasis would result.

Competition in the retail sector is likely to be adversely affected as well. Smaller retailers unable to compete on price and technological sophistication will be relegated to "top-up" shops whilst the majority of shopping is carried out at larger superstores (Fiddis, 1997). Whilst it may be argued that these stores might provide a price constraint to the larger retailers, small shops do not carry the same range and do not have the same physical convenience factors as larger stores. Substitution is thus imperfect and the main constraint on retail prices will be other large retailers. Foreign entry is also rendered less likely due to the information advantage of national firms, as acknowledged by the EC (1997) where modern developments may reinforce the nationalistic structure of retail markets.

However, given information on store loyalty and the nature of consumer choice between stores the focus of competition between other large retailers is increasingly likely be on a non-price basis. This is particularly so once all cost efficiencies have been extracted from the supply chain. In extremis smaller retailers may also bear the fixed costs of production or product development for brands that manufacturers cannot pass on to the large retailers. Prices are therefore likely to be significantly higher reinforcing the divide between the two sectors of retailing, but also considerably disadvantaging those consumers unable to reach the larger stores. Given these are almost invariably the more vulnerable consumers, this should be a cause for concern. Predictions about the development of retailing may also have the same effect. The potential increase in importance of internet shopping and property-less retailers is a significant development, although it is currently not embraced by the major retailers with significant property investments. Nevertheless, if the internet becomes the medium of shopping in the future those consumers without the relevant technology (at least initially, the poorer in society) will be further excluded from the source of cheap goods.

Policy Implications

From the above it is clear that ECR raises considerable policy problems for competition authorities. Large retailers are using their buyer power to work closer with a few suppliers to extract considerable efficiencies from the supply chain. Here, there can be considerable welfare benefits accruing from reduced costs, but there are longer-term concerns that competition may be reduced as smaller firms are forced to exit the market which ultimately may lead to reduced consumer choice and higher prices. In essence, ECR is potentially a key driver of consolidation in this sector with the result that concentration levels are likely to increase more quickly over the next few years than would otherwise be expected. Specific concerns about buyer power arise from the ability (or otherwise) of retailers to induce manufacturers to participate in "partnership" arrangements, which may involve potentially anti-competitive restrictive practices (such as exclusive supply obligations on manufacturers), and the terms of trade involved (e.g. manufacturers paying lump sum fees for product listing and shelf-space allocation, etc.), or conversely in de-listing or excluding certain suppliers, thus denying them effective access to the market.

Clearly per se illegality is not an appropriate response given the benefits involved, and the difficulty in establishing that any anti-competitive results were the ex ante intent. Nonetheless, the development of these relationships needs to be closely monitored by competition regulators, but in doing so an approach to the benefits generated must be determined. In particular this will involve a stance on small retailers: are they essential for local communities and vulnerable consumers unable to reach large superstores? Do they have a critical price limiting function in the retail market place? Or are they hopelessly inefficient small retail units that ought to be relegated to emergency purchasing only? As subjective as well as objective issues these are not straightforward questions, and it seems unlikely economics alone will provide the guidance.

In considering whether a particular practice or ECR-type relationship is pernicious competition authorities will have to decide how much is an unintentional side effect of a welfare enhancing relationship, and what level of negative impact is acceptable to achieve the benefits offered by ECR. Furthermore it is difficult to envision remedies that address the issue directly short of prohibition of the identified practice, which in turn loses all of the benefits. More constructive might be a revision of government or Commission policies on retailing to encourage alternative supply channels that by-pass the retailers or other bottlenecks identified as potentially problematic. Technology is likely to be crucial, and the anticipated problems may not even become reality if innovations such as internet shopping revolutionise retailing.

Perhaps the best regulatory policy then might be a watching brief, with encouragement for and removal of barriers to the development of alternative channels to the consumer combined with a review of policy towards retailing, recognising that ECR and related developments may be speeding up the process of consolidation in the sector.

APPENDIX 4
QUESTIONNAIRES AND INTERVIEWS

This appendix outlines the methodology used in the interviews and questionnaires for the case studies. As noted in the text, a full-scale survey was not attempted, rather interviews were sought for a sample of organisations in each country as a way identifying the key issues as perceived by the different market participants in each country. The interviewees can be divided into 4 types: major (and other) retailers in each of the countries concerned, suppliers of the products selected for detailed analysis, buying groups and other interested parties (e.g. trade associations, competition authorities, etc.). Several interviews were also conducted at the European head office level in relation to the selected products in all 4 countries.

Individual researchers were commissioned to report on a particular country. Each researcher was asked to identify the major firms and other organisations under the four headings noted above, and to select a number under each heading for interview (allowing, of course, for possible non-response). They were then asked to contact the organisations to identify contact names. This was followed by a standard letter requesting an interview from the person involved, followed up by a telephone call several days later to make contact with that person. At this stage, the person involved often asked to see the questionnaire to be used and then the appropriate one (from three different questionnaires used depending on whether the respondent was a retailer, a buying group or a producer) was sent to him/her. This was followed up with a further telephone call to arrange a time for interview. Interviews took place over the telephone (the most frequent type) or face-to-face, or, in a few cases, a completed questionnaire was sent back or written material was sent.

In the survey, we were particularly concerned that the views of retailers (as well as producers and others) should be represented. However, responses from retailers in some countries proved difficult to obtain, although we did make special efforts to do this. In the event, we received responses from retail chains in three countries (Table A.4.1) but we were unable to do so for Spain (despite the use of a follow-up letter in the latter part of the study). For this reason, we are more cautious over the results in the Spanish case.

The results of the exercise are summarised in Table A.4.1. Although the aim was not to contact all the key organisations, we did, in fact, contact a large number of them. In all, 118 contacts were made and we were able to obtain 47 interviews/questionnaires returned (i.e. a 40% response rate). Typical reasons for non-response were that firms did not give interviews or did not want to participate, problems in contacting the people involved and promises of return of the questionnaire which were not fulfilled. Some further interviews were undertaken in the latter part of the study (which are included in Table A.4.1).

Table A.4.1 Interviews/questionnaires by country and type of contact

Type of Contact	France	Germany	Spain	UK	European Head Office[4]	Total
Supermarket/ Hypermarket Chains	2	4	-	3	-	9
Producers[1]	5 (1W,2C,1B)	8 (1W/3C/4B)	7 (3B/2C/2W)	1 (1W)	3 (2W,1C)	24
Buying Groups[2]	1	-	-	2	-	3
Other[3]	3	3	1	4	-	11
Total	11	15	8	10	3	47

Notes:

1 The figures in brackets are for washing powders (W), coffee (C) and butter and margarine (B).

2 Includes 4 interviews with one buying group for France.

3 Includes interviews with producer organisations which also dealt with individual products.

4 These interviews dealt with all 4 countries.

As shown in the table, responses were obtained from 9 supermarket/hypermarket chains, 24 producers, 3 buying groups and 11 others (including several trade associations and retail groups). While the sample is not large, it should be remembered that this exercise was not undertaken as a full scale survey, but as a way of informing our deskwork analysis in each case. In these terms, the interviews/questionnaires were useful in providing relevant information on the key issues in each of the four countries.

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