



British Institute of
International and
Comparative Law

**TRENDS IN RETAIL COMPETITION: PRIVATE LABELS,
BRANDS AND COMPETITION POLICY**

REPORT ON THE THIRD ANNUAL SYMPOSIUM ON RETAIL COMPETITION
HELD IN OXFORD ON 21 MAY 2007

Prepared by

Peter Whelan

Research Fellow in Competition Law

British Institute of International and Comparative Law

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INTRODUCTION

GENERAL

Private label is a growing force across Europe, present in most categories and providing a range of choice for shoppers from the value to the premium. These private label portfolios contribute to competition between retailers, differentiating one retailer from another and building store loyalty. At the same time, the growing sophistication of private label is increasing competition with branded goods suppliers, and the rule of thumb that private labels are cheaper than brands is no longer always true.

The Third Symposium on Trends in Retail Competition, hosted by the Oxford Institute of European and Comparative Law in conjunction with the Centre for Competition Law and Policy and sponsored by the law firm Bristows, and held at St Catherine's College Oxford on 21 May 2007, explores the role of private labels in competition between retailers and between suppliers. It considers the implications for suppliers when an important retail customer is also a major competitor and the issues posed when the retail customer has buyer power.¹

SPECIFIC

The following represents the programme for the symposium:

13h30 **Session 1**

Chair - Professor Ulf Bernitz, *Oxford/Stockholm Wallenberg Venture*

13h45 **Product trends in the European grocery market**

Jonathan Banks, *A C Nielsen*

14h10 **Private label products and the implications for consumers**

¹ The above summary was taken from the website of the Centre for Competition Law and Policy; see: http://www.competition-law.ox.ac.uk/competition/conferencedetail.php?events_ID=1326.

Professor Marcel Corstjens, *INSEAD*

14h30 The Customer/Competitor Dilemma

Pieter Kuipers, *Unilever*

15h00 The business model of branded goods

Dick Bell, *Oxford Institute of Retail Management*

15h30 Session 2

Chair - Dr Ariel Ezrachi, *Director, Centre for Competition Law and Policy; Slaughter and May University Lecturer in Competition Law*

15h50 Retail Consolidation – The implications of mergers and buying alliances

John Ratliff, *WilmerHale*

16h10 Intervention by competition authorities – The implications for consumers

Alena Kozakova, *Which?*

16h30 The European perspective on retail issues

Philip Lowe, *Director General, DG Competition, European Commission*

16h50 Roundtable discussion

17h50 Concluding remarks

Dr Ariel Ezrachi, *Director, Centre for Competition Law and Policy; Slaughter and May University Lecturer in Competition Law*

SESSION I

INTRODUCTORY REMARKS²

Professor Ulf Bernitz,

Oxford/Stockholm Wallenberg Venture

The (on-going) study of the UK Competition Commission into the grocery sector has highlighted the enormous impact of private label goods on the economy. Apparently 50% of the goods sold by Tesco, Sainsbury's and Waitrose are private label goods, and 43% of the total grocery sales in the UK are own branded goods—and this is not just in relation to food and drinks, but all groceries. It must be asked whether these figures will rise in the future and when (and indeed why) they will eventually peak. There have been nuances in the picture suggested by these figures; some trends have been detected in different segments of the market. It should also be remembered that we now have quality own label brands which are 'brands in their own right'.

We focus today on competition policy and the competition policy problems in the retailing sector. A fundamental problem with private labels concerns the fact that retailers/customers become competitors for suppliers: they compete for shelf space and for consumers. A further fact adds to this 'tricky situation': retailers demand detailed information from their suppliers in relation to e.g. new products and marketing plans, and can make use themselves of this information to improve their own position on the market concerned.

There are however other competition policy problems/issues:

- There are 'gatekeeping' problems. A large retailer is equivalent to the gatekeeper of the market and thus may create barriers to entry for both large and small sized producers. The European Commission has looked at these types of problems in merger cases.

² *Note on style:* The presentations summarised in this report are written in the first person and are intended to reflect the style of presentation of each of the speakers. The roundtable discussion, however, consists solely of a list of the most important points submitted during the debate which followed these presentations.

- Another issue that needs to be considered is the emergence of cross-border buying alliances that are created in order to increase the force of the buying power of their constituents.
- Dominance and the possible application of Article 82 is also an important issue. One might, for example, have regional dominance or dominance in a particular locality but not necessarily dominance on the whole of the market.
- Abusive practices (e.g. discrimination, tying, non-cost justified rebates, entrance fees, shelf space fees ... etc.) should also be looked at.
- This topic also brings up the possibility of introducing and maintaining workable codes of conduct.
- Issues relating to copying may also be relevant. (There appears to be a tolerant attitude to copycat problems in the UK as it is difficult to persuade judges to issue injunctions in passing-off cases.)
- The Unfair Commercial Practices Directive may also be relevant. (Although the aim of the directive is to harmonise the law in this area, it appears that its implementation will be very different in different Member States, as they will try to follow their own previously established case law. The UK has interpreted it as not requiring recourse to private actions; but there is debate on whether this is the case.)

A book, edited by Ariel Ezrachi of the Centre for Competition Law and Policy, will be written later this year on competition policy and the retail sector.

PRODUCT TRENDS IN THE EUROPEAN GROCERY MARKET

Jonathan Banks, A C Nielsen

A C Nielsen examines what goes on exactly in the grocery market. It does this in three ways:

- Through use of the information provided by bar codes scanned at supermarket checkouts;
- By being 'plugged in' to 250,000 households that download their purchases to us; and
- Through customised research.

With this information we are able to provide 'broad brushstroke' observations on product trends in the European grocery market. This presentation will concentrate on the things that are most concerning about the grocery market.

Importance of Adding Value

At the moment we don't see many things adding value; but we can do things to add value to products. Even with the introduction of the Euro there has not been a significant convergence of prices across the EU. In fact, there is a high variation of prices in the EU, even within the Eurozone.

Work has recently been completed on price levels in Europe. In those categories of products where it was easy to find data, A C Nielsen calculated the average ratio of £/kg for the last year and for two years ago. In two thirds of the categories prices are less now than they were two years ago when you take inflation into account. Indeed, only two or three categories are in a better position for retailers, so-to-speak, than they were two years ago. An important question about this finding needs to be addressed: what does it mean for the brand leaders? By examining the data one can see that the brand leaders are not immune from this trend; they have been reducing their prices too.

A number of different factors have led to this reduction in prices. *Retailer consolidation* is one of them. Despite what the headlines might claim, globalisation has not come to a halt. The market share of *discounters* has also increased across Europe; there are now more discount stores than before. By contrast, the UK has seen a decline in discount retailing. This can be explained, however, by the demise of Kwik Save, which now only holds a 0.2% market share. In fact, the UK is not an exception to this trend: Aldi and Lidl, for example, have both seen increases in their market shares in recent years. *Other factors* include: the growth of private labels, promotions, improvements in technology, and even smuggling and counterfeiting.

Consumer Concerns

One of the questions constantly posed by A C Nielsen to consumers is ‘what is your biggest concern over the next six months?’. The answers invariably relate to following (and in descending order):

- The economy;
- Health;
- Job security;
- Terrorism;
- Crime;
- Political stability;
- Immigration;
- Global warming; and
- War.

Climate change is a concern that is in its infancy for retailers, so-to-speak, but it is expected to really grow in the future. This concern features higher on the list of priorities for some countries compared to others. France, for example, scores very highly; Eastern Europe, less so.

Job security is a major concern, particularly due to the high level of debt in the economy. In the UK, the average level of debt, not including a mortgage, is £9,000 per household. Bankruptcy, too, is on the increase.

Health, unsurprisingly, is always near the top of the list of consumer concerns. There have, in fact, been increases in the level of awareness of consumers towards the need to eat healthily. What people say and what they do, however, do not always correspond with one another, but this varies from category to category. In the US high sums of money are spent on items that claim to improve one's health; there has, however, been little growth in previous years concerning these items. Nonetheless, there is major concern in the US about obesity, and the link between obesity and cancer.

Growth Opportunities

Four key trends continue to shape the market and drive innovation and growth. Brands that can deliver on at least one, but ideally all four, of the following are more likely to succeed:

- Health/well-being;
- Ethical issues;
- Convenience/practicality; and
- Indulgence/pleasure.

These all represent areas where value can be added, and where consumers will be prepared to pay more. Ethical issues are important; but there is confusion over this and what it means. For example, people often buy local because it is assumed that is it better for the environment, but this may not always be the case. One must not underestimate the concept of pleasure—people will pay more if one delivers as promised! Examples of products where added value include: from concentrate, flavoured milk, dairy substitutes, yogurt drinks, probiotic, and smoothies.

Categories that are enjoying strong growth are predominantly those that have health and convenience associations. Soft drinks have had an especially good year. Paper products have seen good growth and are the only non-food category to make it into the top 10.

New Product Development

Two factors need to be considered here:

- (i) own labels; and
- (ii) packaging.

A study was undertaken into why people decide where to shop. 23 significant factors were identified. People often say that lower prices are important, but they often go to Tesco over Aldi. Why is this? It is partly due to the availability of the private label goods. In most countries own label goods are growing faster than branded goods. Where brands are weak private labels may grow; when brands are strong, private labels will not, however, cause them to become weak. (Good packaging may ensure a strong brand. Gillette for example is not harmed by private labels despite its high price.) To make an own brand work it must be supported by the retailer as a NPD fails in a high percentage of cases. Private labels are definitely on the increase.

PRIVATE LABEL PRODUCTS AND THEIR IMPLICATIONS FOR CONSUMERS

Professor Marcel Corstjens, INSEAD

Private labels are fantastic for retailers, manufacturers and consumers; it is an example of Adam Smith's theory working at its best! It is important that we understand there are many forms of private labels, and that they do not just refer to those products that are 'cheap and nasty'. It is true that some private labels are of that nature, but there are many different types of private labels. The quality of a private label good usually improves with time and investment. Private labels develop from the 'cheap and nasty' to the 'cheap' and can eventually reach a par with branded goods. The ultimate dream of a private label good is to become what is known as 'destination', i.e. a product that causes people to shop in that particular outlet. Very few retailers reach such a position; Harrods is a possible example. Arguably Tesco's own goods would also be seen as 'destination'. Generally in the US and the UK private label goods are somewhere in the middle: they are either cheap goods or are on a par with branded goods.

The most sophisticated retail brands are developing into powerful consumer masterbrands. What does this mean for customers? It can be translated into trust on behalf of the consumer. Consumers should therefore be prepared to pay a little extra to get the brand. If we take a typical portfolio of manufacturers and compare it with a typical portfolio of retailers, until the end of 2003 total shareholder returns were better with the portfolio of manufacturers. *Quaere*: if the retailers are indeed so powerful, how come they are not richer?

Rationale for Private Labels

Advantages for the retailer of private labels:

- They create shopper switching costs.
- They create bargaining power (i.e. they are a good method of transferring bargaining power from the manufacturer to the retailer).
- Not in all cases, but often, they help the retailer obtain higher margins.

Advantages for the consumer of private labels:

- They provide value as they are a reasonable mechanism to provide quality goods at a reasonable price.
- They provide more choice. (There is a question here of whether increased choice is a good thing. There is a cost with choice. Too much choice may lead to consumer fatigue for example. It can be argued that Aldi and Lidl are doing well as one is not presented with the same choices as in other stores and therefore one can shop more quickly.).
- There is a reduction of brand tax.
- Private labels are a useful mechanism for passing monopoly profits from manufacturers to consumers.
- Private labels stimulate innovation. If private labels are doing well and are increasing their market share, manufacturers will be motivated to innovate. If private labels are doing well it is because manufacturers have not devoted enough time to innovation. In the future there should be more research and development for manufacturers resulting in patents and protection for new consumer products. (Obesity is obviously a big issue. If one can innovate in the food categories and reduce this problem, consumers will be prepared to buy these goods. The link between sugar/fat and obesity, and obesity and cancer, has been established. The missing link is addiction to fat/sugar. Research is underway on this issue. But if proof of this link is established then we are in 'cigarette territory'. There are two ideas here: (a) businesses that use a lot of sugar in their products will be in trouble; and (b) consumers will be prepared to pay extra for new products without such ingredients, i.e. new products may add value for which consumers will be willing to pay.)

Disadvantages of private labels:

- Private labels may also reduce innovation as retailers tend to copy and introduce their own version of brands too quickly. This will, however, depend on the category in question.
- They may reduce transparency if the private labels are the only goods stocked in the store.

- Collusive category management practices could also result.
- If the private label became too strong one might also have to deal with a private label tax, negating the advantage secured by the reduction/elimination of the branded good tax. This will be especially the case where high switching costs have been created.

Despite these disadvantages, private labels are good for efficiency.

THE CUSTOMER/COMPETITOR DILEMMA – EXCHANGING INFORMATION, IN-STORE
COMPETITION AND THE CONTROL OF SHELF SPACE AND PRICING

Pieter Kuipers, Unilever

The main theme of this presentation concerns the implications of the triple role of the retailer.

Triple Role of Retailers

This triple role relates to the retailer as customer, competitor and supplier.

Customer: The retailer will have access to confidential information from all suppliers. There is also a relative dependence of suppliers on retailers. The supplier is more dependent on the retailer than vice versa, e.g. 20% vs. 1% share of their respective businesses. For the retailer lost sales can often be replaced in the same channel, e.g. by replacing a brand with an own label or with other products which will still generate profitable sales for the retailer. A loss of 20% of sales for the manufacturer involves a serious risk of bankruptcy. This dependency has been acknowledged, e.g. in the UK Supermarkets report (2000).

Competitor: The fast moving consumer goods (FMCG) retailer's core business used to involve acting as an intermediary in a market where competition occurred between the branded firms. Now, however, the retailer himself, and not a branded competitor, is often the largest product competitor in the store—he is often no. 2, and sometimes even no.1.

Supplier: The retailer is the gatekeeper to the consumer and provides access via his shelves to the market for suppliers; he is the platform for new product development introductions.

Draft EU Vertical Merger Guidelines

There are some interesting points from the section on ‘input foreclosure’:

- Shelf space appears to be a ‘key input’ for branded firms; it is like ‘access to infrastructure’— without it, branded products ‘cannot be effectively sold on the market’ (# 33).
- Foreclosure may take a subtle form, e.g. ‘degradation of quality of input’ (# 32). This could be applied to quality and quantity of shelf space or in-store pricing.
- Do other suppliers (retailers) lack the ability to expand output? (# 35) Branded firms are generally unable to replace 20% of sales lost from delisting by major customer. It is important, however, that branded firms are unable to sponsor entry of new retailers (compare #32).

As for incentives to foreclose (# 39 and following):

- Need to compare level of profits upstream and those downstream, i.e. the profits from sale of shelf space and the profits from private labels. It should be noted that a vertically integrated retailer ‘skips’ a link in the chain.
- One needs to evaluate the diversion of downstream demand away from foreclosed competitor. If products are close substitutes, private labels will be encouraged: to mimic branded equivalent; to persuade shoppers that products *are* equivalent; and to encourage impression that products come from the same source.

Reduced In-Store Competition

As the retailer is both a customer and a competitor there is an increased risk of reduced in-store competition or distortion of competition. This is due to three factors:

- (a) the retailer sets the price of branded goods and of its own private label goods;
- (b) the retailer determines access to (listing/delisting), and in-store positioning on, shelves; and

- (c) the retailer has advance knowledge of new product introductions, promotion plans, prices etc. of *all* suppliers. The retailer receives this information legitimately as a customer but may use it as a competitor. As a result, for example, there may be a launch of a private label good at the time or soon after the branded NPD. There are three important points to be made here:
- i. The more widespread distribution is key to the success of the NPD, the earlier the branded firm must share plans with key customers. (Without access to widespread distribution the product may not be profitable.)
 - ii. The customer relationship increases the branded firm's barrier to take legal action, e.g. in the case of copycat products or misleading customers. The branded firm may also settle earlier with the retailer if a case does exist.
 - iii. It is a myth that private label increases consumer choice: the private label just replaces another brand.

All of these points increase the chances of a reduction in in-store competition.

Pricing Policy Implications

After the US case (*Leegin*) the per se prohibition of resale price maintenance is now under pressure. There is strong support from the Department of Justice and the Federal Trade Commission to replace this prohibition with a rule of reason approach, and look at all the circumstances and the effects. Whilst resale price maintenance reduces intra brand competition, inter brand competition will increase. The US argues that RPM is no different than other forms of vertical restraint. If it were included in the Vertical Block Exemption Regulation a market share of 30% would apply. Accordingly, at market shares about 30% the pro and anti competitive effects must be assessed; the impact of private labels could be examined and it is here that RPM may be justified.

Another option would be for the manufacturer to rent space from the retailer and sell his own goods there. Accordingly, the branded firms would rent a certain amount of shelf space within a product category and would determine the positioning of their products within the rented space. The branded firm would set the price at which retailers then offer products to consumers acting as agents for the branded firms.

Looked at from an access to shelf space/shelf space auctioning perspective there may be an interesting parallel with e.g. pay TV and mobile phone markets:

- Is there concern about ‘content’ having sufficient access to networks?
- Is four national network providers sufficient to rely on free competition for access to networks?
- How many comparable (national) retailers is enough?

In-Store vs. Inter-Store Competition

If all stores only sold private labels (e.g. like Aldi or Marks and Spencer) there would be no in-store competition, only competition between stores. This is already the case in some product categories in the UK, e.g. milk, canned vegetables, rice, chilled meals / pizzas, where there are no or few branded goods left. A one-stop-shopper will not switch to another store just because of unavailability of (a couple of) products but will chose different products in that store. The barriers to switching between stores are higher than between different products in store. In-store competition appears to be more effective than competition between stores; it is therefore worth protecting. But how? We could create Chinese walls between the private label businesses and the procurement of branded goods, so as to prevent access to confidential information.

Conclusions

There may be fierce competition between retailers but the problems identified may still exist. In other words, the retailer does not need to be dominant in order for these problems to exist. It is true that the branded manufacturer needs to innovate. But there is a risk that the branded manufacturer is not given the opportunity to recoup for his efforts to innovate. Either the branded good is copied too quickly by the retailer, or it is not put onto the market. The latter situation occurred with ready-made chilled meals. We shouldn’t take for granted that a branded firm’s product for which demand exists will reach the consumer. Both in-store competition and intra brand competition are required for the maximisation of consumer welfare. In particular, we need to maintain in-store competition.

THE BUSINESS MODEL OF BRANDED GOODS

Dick Bell, OXIRM

The growth in market share of private label products has a direct impact upon manufacturer brands whose share correspondingly decreases. The growth in market share of private label is not constant in all retailers and the effect is not uniform across all manufacturer brands. Growth in private label may result from a policy of increasing the number of private label lines. This may be, but is not necessarily, accompanied by a corresponding reduction in lines of manufacturer's brands. Growth may also arise from better marketing by a retailer of its own products or by more favourable location within their stores. The effect of these activities may differentially affect manufacturer brands. Decisions to reduce lines to accommodate private label range expansion will be based on rates of sale of each item, and the listing fees that manufacturers are prepared to pay.

The loss of volume has a significant effect on the financial viability of manufacturer brands. The financial structure of a brand is typified by large margins after variable cost but high fixed costs associated with developing, marketing and distributing their products. This results in an inability to adjust costs proportionately to changes in volume.

The complexity of the way brands are affected by private label and the subtle financial structure of manufacturer brands are illustrated in this presentation by one case study: laundry products in Spain.

Laundry Market Trends

In 1998 the market was fragmented with no brand having a dominant market share. The aggregate share of private label products at 14.2% exceeded that of the brand leader, Ariel, with a market share of 13.1%. The share of private label products more than doubled in the three years following 1998 to 31.7%. All major brands lost market share between 1998-2001. The larger brands lost proportionately less than the smaller named brands. The collection of small brands retained their market shares. Few of these brands had universal national distribution. The value of the total market

for laundry products increased by 16% between 1998-2001. The loss of market share of even the largest brands exceeded the market growth. The brand leader, Ariel, lost an estimated 10% of its value over this time period. Skip, ranked 5th in 1998, lost 30% of its value. The growth of private label laundry products occurred in all retailers but was significant in two, Dia and Mercadona. In 1998 Mercadona sold no private label laundry products; by 2001 they accounted for 64% of its laundry sales. Dia expanded its own label laundry sales from 43% of total in 1998 to 75% in 2001.

Trends in Laundry Private Label

All retailers, with the exception of Lidl who were at 100%, increased the share of their private label products within the laundry category. Private label was significant in all retailers by 2001 whereas it was significant in just four retailers in 1998. Sales of laundry products accounted for at least 10% of category sales in all retailers, except Sabeco, in 2001. The rate of growth of private label was significant within a short period of time. The rapid growth cannot be explained solely by a significant additional listing of private label lines and a reduction in listing of branded goods.

The Source of Private Label Growth

The growth of private label in general and specifically in laundry products derives from the successful growth strategy of Mercadona. Mercadona grew its share of the Spanish grocery market from 3.5% in 1997 to 12.4% in the second quarter of 2002 when it ranked second to Dia (12.7%). There were four elements in Mercadona's growth strategy:


- A change from a classic promotional policy to a strict application of 'Every Day Low Prices'.
- A rationalisation and disciplined approach to product range which included a strong commitment to developing and promoting its own brands.
- A strong market-led approach to its customers based on a projection of values as a food retailer. This involved food tastings, improved service, training and motivation of employees and heavy advertising both in, and around, its stores.
- An aggressive store expansion plan.

Mercadona has obtained a great acceptance and value in the eyes of its customers. It has positioned itself as ‘value for money’ providing a discount proposition within a supermarket format offering the benefits of one-stop shopping. Other retailers have emulated Mercadona’s strategy, specifically the development of private label. The growth in private label within Mercadona has been achieved by giving the products greater prominence on the shelf and by communicating to customers, through advertising, the benefits of better value. As a consequence, private label share of total packaged groceries in Mercadona had grown from 0.7% in 1997 to 34.2% in 2001.

The Brands Response

Brands that have a high gross margin and a high ratio of fixed costs are profit-sensitive to reductions in volume. A 10% value loss, as experienced by Ariel, can be expected to result in a profit reduction of 46% if fixed costs cannot be reduced. Such a reduction is difficult to absorb in the short term. A 24% volume loss, as experienced by Skip, would lead to a negative profit position. The cost that can most quickly be cut to compensate for reduced volume is advertising. Advertising, however, is used to raise consumer awareness of the brand and is a driver of future volume. Cutting advertising thus cushions the immediate profit reduction but jeopardises future volume growth that would be the source of a profit recovery. This was the case with WIPP: In 1999 market share fell by 0.5% and sales value by 4.3%. Advertising was reduced by a further 46% in 2000. In 2001 WIPP market share fell by 1 share point. As a consequence, Net margin fell from 15% of sales value to 6.2%.

The Business Model for Laundry Brands in Spain			
	Base Situation	10% Volume Reduction Same Costs	10% Volume Reduction: Reduced Advertising
Manufacturer Sales Value	100	90	90
Manufacturing Variable cost	45	40.5 (45%)	40.5
Gross Margin	55	49.5 (55%)	49.5
Advertising & Promotion	15	15	10.7
Sales & Distribution	8	8	8
Fixed Costs	20	20	20
Net Margin	12	6.5 (7.2%)	10.8 (12%)

 Oxford Institute of Retail Management

SESSION II

RETAIL CONSOLIDATION – THE IMPLICATIONS OF MERGERS AND BUYING ALLIANCES

John Ratliff, Wilmer Hale

Mergers: Typical Considerations

Competition authorities typically look at the interdependent relationship between the procurement markets and the downstream supply market. If a large dependency of a supplier exists as regards its retail customers, it may lead to buyer power and to benefits going downstream to these customers; if the benefits of this are passed through to consumers there is no problem. There are two leading decisions on this that provide that if a supplier has 22% of sales with a single purchaser then a threat point may have been reached, where if these sales are lost the supplier may go bankrupt. If there is a spiral effect this buyer power leads to an extraction of benefits from the supplier. If there is an increase in buyer power, there should be an increase in benefits for consumers. If a retailer becomes individually dominant or collectively dominant, however, the regulator will intervene as there may be no buyer power ‘pass through’ and the retailer may be ‘the gatekeeper’ to the market.

The key issue is whether downstream dynamics are still possible: do the competitors have different profiles?; is the market still growing?; is market entry/expansion still possible? There has been greater attention in recent years being placed on related markets; sometimes it is necessary to look at a whole group together. In Commission decisions the own label profile of the retailer is viewed as increasing buyer power, especially for the brands of weaker suppliers. The presence of the retailer in buying alliances may be viewed as negative: although such alliance may act as a counterweight to a merger, they may also lead to cartelisation. Both soft and hard remedies for mergers may be required to prevent this. For example, if Carrefour takes over a chain it may commit to purchasing from the same supplier for the next 5 years (soft remedy); or it may be ordered to sell some stores (hard remedy).

Buying Alliances

Buying alliances may come into play at two levels: amongst chain stores; or amongst smaller rivals to the chain stores. They may be pro-competitive or anti-competitive. The pro-competitive effects include: offering real distribution efficiencies; sponsoring new product offerings/investments; and acting as an antidote to supplier market power. The anti-competitive effects include: the risks of establishing a purchasing cartel (with no real efficiencies); the risks of market sharing/collusion; and the risks of commonality of costs and product standardisation.

There are EC safe harbours for these sorts of structural issues. Cooperation will be lawful if the market share is less than 15% on the procurement market and less than 15% on the downstream market. RBB suggest that this approach should be revised; they suggest 25% market share of the downstream market as a safe harbour. So far, however, we have not seen the authorities bothered by collective dominance in the retail sector.

There are difficult decisions relating to the regulatory treatment of buying alliances. If there is an obligation to buy via the group then they may be more efficient and result in more buyer power. It is difficult to assess, however, whether these alliances are inside or outside of Article 81(1) EC. Otherwise, although mergers represent a tighter, more integrated structure, the structural assessment for buying alliances is similar to that for retail mergers. It is difficult to be sure that buyer power raises smaller rivals' costs, i.e. whether the 'waterbed effect' exists. This theory may be too simple; volume concerns should also be considered.

Consolidation Issues

Retail concentration promotes supplier concentration, as suppliers will wish to have the strongest brand portfolio. With a strong brand portfolio suppliers will be less vulnerable to competition from private labels. More intense retail competition can occur as a result of concentration. The Competition Commission's emerging thinking in the *Groceries* inquiry states that prices have gone down by 7%. But we need to know about retail margins and whether they increase or fall. The cumulative effect of consolidation of chain stores and buyer groups can be a 'wall' for new retail entrants

and suppliers and may lead to a reduction in consumer choice. These are both areas of concern for regulators.

There is a compliance headache for the alleged 'dominant' company. The large chains are often not dominant. There should be more attention on foreclosure effects and the impact on third parties, as well as more focus on must stocks. There may be demands for rebates, with the threat of delisting if they are not given. We also need to recognise the benefits of smaller buyer groups and shops.

Some Recurrent Themes

- A retailer does not have to stock all products.
- Bidding competition for hypermarket 'slots'.
- The need for regulatory intervention to protect market dynamics, but not to stop efficiencies.
- There is a focus on increases in retail margins. This is what the Competition Commission inquiry is about.
- There is an increased focus on market definition and whether the market is national or local. There are more cases relating to national markets at the moment.
- We will continue to have problems dealing with 'own label' competition.
- We need to look at non-competition issues/solutions.

INTERVENTION BY COMPETITION AUTHORITIES – THE IMPLICATIONS FOR CONSUMERS

Alena Kozakova, Which?

There are three questions posed in this presentation: (i) should we protect competition or competitors?; (ii) should we protect consumers or citizens?; or (iii) what is consumer-driven competition?

Competition vs. Competitors

We already know the default answer to the question whether we should protect competition or competitors. The question that should be posed is whether the authorities are really doing this in practice. There are two types of risks that should be looked at: (a) the risks of market concentration; and (b) the risks of buyer power.

Market concentration: Is market concentration necessarily bad? Concentration can bring benefits in the form of lower prices due to the operation of economies of scale. If concentration brings benefits to consumers then it is fine. Should market growth be punished? Supermarkets in the UK grew because they were better than their competitors. Competitors have tried/are trying to ensure that they are punished in front of the Competition Commission.

Buyer power: Is buyer power bad? Dominance is not what is ‘bad’; rather, the abuse is what should be prevented. Buyer power is the biggest risk facing the UK groceries market. It is not a bad thing if we have a concentrated retail market, as it may act as a counterbalance to market power of the supplier. If we are concerned about ‘water bed’ effects then we may need to look at intervention. Has public intervention ever been successful in this area? Two examples demonstrate the potential negative effect of intervention: the ‘Loi Galland’ in France (1996); and the Groceries Order in Ireland (1987).

Loi Galland and the Groceries Order: Who did they mean to protect and how did they attempt to achieve that protection? They were both designed to shield manufacturers from the retailer’s buyer power by banning below net invoice pricing. With these laws there was no direct or indirect link to consumer benefits. As time progressed

they were generally justified by those who enacted them in terms of their effects for consumers. For example, the Groceries Order was justified as preventing a loss of jobs, a reduction in shops, and the prevention of predation. (Similar types of laws were implemented in Belgium, Luxembourg, Germany, Portugal and Spain.) Who did these laws actually serve? As a result of these laws, prices to the final consumers rose. In Ireland for example between 2001 and 2005, those items not covered by the order observed a 5% fall in price. Items covered by the order actually rose by 7%. When it was abolished the prices of those covered fell. The retailers did not compete on the list price but through back margins.

Consumers vs. Citizens' Interests

Should the competition authorities consider other issues and not just competition issues? Should they look at effects on the environment? Or, to the issue of 'ghost town Britain'? They should not; these are political decisions for which the competition authorities do not have a mandate. These issues should be resolved by the people; by their purses, if need be. Planning, however, is an issue that is very relevant to competition and should be looked at by the competition authorities. We must avoid the return to a 'public interest' test. There have been arguments, however, for the introduction of an 'agency for public good'.

Consumer-driven Competition

Price transparency: Is price transparency a double-edged sword? Too much transparency can cause problems, e.g. collusion. If there is too little consumers are unable to make the right choices. To find the optimal level one must weigh the costs vs. the benefits of transparency. With the *Home Credit* inquiry the Competition Commission had problems with transparency. For example, how does one advertise for credit with people of lower levels of literacy?

Innovation: A number of questions need to be posed here. Does innovation have a value in itself? Here we have to consider the benefits of static vs. the benefits of dynamic competition. Should weight be put on dynamic competition? If so, we should remember that this approach creates problems for the authorities. Do competition authorities need to protect innovation? Is product differentiation valuable innovation?

So what should competition authorities do? They should protect competition, not competitors. (If it is not broken for consumers, then don't fix it unless there will be problems in the future.) They should protect consumer interests, not wider citizen interests. (Consumer bodies are best at doing this.) They should also facilitate consumer-driven competition. (If consumers can drive competition, then why not facilitate it for them?)

THE EUROPEAN PERSPECTIVE ON RETAIL ISSUES

*Philip Lowe, Director General, DG Competition,
European Commission*

General Comments on Competition Policy in the Retail Sector

An interesting question that should be answered is ‘what is the most appropriate authority to deal with retail competition issues?’. Over the last 5 years they have not usually been addressed at EC level due to the issues involved (e.g. urban planning) and the fact that the knowledge of these markets is best when one is closest to these markets. The EC is nonetheless involved in this sector, and this involvement is likely to continue as we still need to get some things straight. There needs to be consistency on this issue across 27 of the Member States, and the Commission, as one authority, is better placed to deal with it than 27 different authorities. The Commission has dealt with retail cases before, e.g. *Coca-Cola* and *Ice Creams*; an approach of referring these types of cases to the national authorities has not been adopted.

We need, of course, to listen to what the authorities say and watch what they do; these may be two different things. There has been convergence on what the Commission is trying to do: we are trying to make markets work for consumers. There is now a focus on foreclosure of competitors which will result in a durable harm for consumers, especially in relation to mergers and abuses of market power. We need also to provide transparency to businesses, and tell them what behaviour is safe and what is not. There are still questions to be answered. Like, what is the form of the harm? Is it long term or short term harm?; it is price or non-price harm? There has been some consensus on the ultimate objective of competition law. (The German approach of protecting the small vs. the big competitor goes to the issue of citizens’ vs. consumers’ interests and can be relevant to competition if there are no incentives to enter the market.) In the retail industry this discussion has not stopped just because the local corner shop is gone. The discussion is usually about large retail companies that have developed through mergers and acquisitions. But competition law is neutral about size. The analysis should come back to the ultimate objectives of competition law, i.e. to prevent short/long term harm to consumers. With competition policy in the retail sector there are two aspects to this evaluation:

- (i) the preservation of competition between retailers; and
- (ii) the relationship between suppliers and retailers. (This issue is becoming very topical.)

Comparing prices of textiles across the EC, for instance, is informative. The importing of cheap clothing boomed, as a result of the reduction in trade restrictions. Prices fell as a result. But this hasn't happened in the same manner in all of the Member States. In the UK the share of concentrated distribution is high, and companies can source on the global market. The relatively lower prices here as result highlight the benefits of large size retailers. *Quaere*: is buyer power ever a problem?

Assessing Buyer Power

Assessing buyer power involves assessing the bargaining strength in the buyer/seller relationships. It involves analysis of the alternatives one has as a seller and vice versa. According to the competition authorities it is power not size that matters. It is comparable to 'going through the looking glass'; monopsony is often referred to as the mirror image of monopoly—but there are differences. There is a limited relevance of market share data here. One must look at the outside options, e.g. threat to sponsor entry upstream, private labels etc. There are various theories of harm relating to the assessment of buyer power: predatory buying; raising rivals' costs; spiral effects; and waterbed effects. There is not much room for broad brush presumptions here.

Predatory overbuying: Overbuying inputs as a predatory strategy to cause rivals to exit the market and thereby gain monopsony power was recognised by the US Supreme Court in *Weyerhaeuser* in February 2007. Three questions need to be addressed to evaluate a theory of predatory overbuying: (a) is there entry upstream as a result of higher input prices?; (b) has the dominant buyer seller power downstream?; and (c) are there rivals downstream who do not rely on the input and could 'fill the gap' of a decrease in output on the part of the dominant buyer? In any event predatory overbuying is unlikely in retail distribution: the price of some inputs may be

increased, but this is likely to trigger entry; to cause an increase in the price of all goods is very difficult.

Spiral effect: There is a European Commission decision on this: *Rewe/Meinl*. There are three aspects to the spiral: (a) large retailers obtain larger discounts than small shops (but it can be questioned whether large buyers necessarily get better prices); (b) large retailers can lower prices; and (c) small shops exit, which reinforces the large buyers' position (but small shops may compete on other dimensions, e.g. quality, and break the cycle).

Dynamic inefficiencies: The existence of buyer power may lead to lower investment in new products upstream. However, it is difficult to compare the outcome to the optimal level of investment or product variety. In the longer term harm to innovation upstream should harm the buyer itself. We need to be watchful over these issues in an economy increasingly innovation driven. Negative effects are only possible in special circumstances. For example, where there is market power downstream; 'disruptive' innovation would help new entrants significantly more than the dominant player.

Conclusions

The exercise of buyer power may raise competition issues in narrow circumstances. This is not an area for bright lines; there are difficulties with safe harbours, e.g. establishing them can lead people to believe that there are problems above the safe harbour. It is difficult to get the right wording for those self-assessing their behaviour. In practice, the market downstream is usually the key to the analysis. There is a need for detailed effects-based investigations that take into account the overall context (upstream and downstream...) as well as any countervailing efficiencies. There is a new context to this debate, as we now have 27 Member States working together in a fruitful exchange of analysis and knowledge. We need to show caution; we don't want to disregard any theory out of hand.

ROUNDTABLE DISCUSSION

This section will set out briefly the most important points made during the roundtable discussion that followed the presentations.

Must Stocks

- The use of ‘must stock’ in European Commission decisions is very recent.
- In the Article 82 Discussion Paper in some areas there appears to be a shift towards ‘must stocks’ as opposed to dominance. This appears to be a move away from having dominance assumed at 40% market share.
- A must stock is a key item for certain selection by the retailer, but whether it exists in a given situation depends on the format of the outlet, e.g. whether it is a one-stop shop.
- There has been a movement away from presumptions to analysis of the effects of conduct. A ‘must stock’ implies durable and significant market power and its existence depends on evidence from distributors that without its presence in the range of that product they would not be able to compete on that market.
- As an absolute standard a ‘must stock’ is a product with a position higher than dominance. But a ‘must stock’ may not imply an absolute standard as this does not say how durable the product will be in the market.
- The concept of ‘must stock’ is a relative concept.
- In order to decide how far one would travel for a ‘must stock’ one would have to examine the brand equity.
- If a real ‘must stock’ existed, it would be an essential facility.

Private Labels as Communication

- If private labels are communicating to the consumer that the retailer has vetted a good and guarantees its quality it may be very difficult or impossible to eliminate them from the market.

- Communication of such values may vary between retailers and products. In the UK consumers might expect Tesco, for example, to put its name on the line, so-to-speak, with its private labels.
- Some retailers would accept responsibility for the quality of their private labels, but there are enormous variations; some put their name on the line by responsibility, while others just buy cheaply and emphasise the low price.
- Part of the brand image may be to accept responsibility for the private label.
- According to research undertaken by Which? consumers do not punish private labels as much as they do branded goods. If private labels do well, they will be rewarded; if not, they will not be punished.

Buyer Power

- Buyer power is only really an issue if market power exists downstream.
- The main concern with buyer power is its ultimate effect on the final consumer. It is important to draw the distinction between immediate and longer term consumer detriment. In the longer term there may be foreclosure effects due to vertical consolidation, which may, e.g., reduce consumer choice.
- The Commission has not disregarded the possibility of upstream foreclosure causing a long-run downstream consumer harm. However, as a general rule it will look at any immediate effect on the intermediate and final consumer.
- An important inquiry is whether the retailer is able to negotiate better terms from suppliers as a result of his buyer power.
- The larger the percentage of private labels in the category the more likely there will be a distortion of inter brand competition, and the more likely there will be a reluctance of the supplier to innovate. There are problems even with private labels having less than 40% of the market.
- Urban planning is an important issue here.
- It is easier to reach a definite conclusion on whether conduct is abusive when we are examining a market for a final product.
- If the consumer has no choice between retailers then the retailer has downstream market power. (Cf. This is seller power.)
- The whole issue here is whether one wishes to have choice in store or not.

- Evidence is needed that consumer choice has been reduced. (Cf. We only need to look closely at the product categories, e.g. chilled meals.)

Auctioning Shelf Space

- The model of auctioning of shelf space, and allowing the manufacturer to sell his own goods and at a price determined by him, may bring desired benefits, such as transparency as with private labels, and when retailers set the prices of branded goods we are not really sure of the ‘real’ price of the good.
- There is an example of such a practice: Spars in Austria that have shops inside them selling coffee. This reduces intra-brand competition but increased inter-brand competition.

Miscellaneous

- European law does not prevent an NCA³ from applying an economic dependency law to the retail sector. Such laws could be used to prevent discrimination against manufacturers.
- The acquisition of information by the retailer of future plans of suppliers has the potential to distort competition in the market; it may need to be addressed through the use of Chinese walls. It is acceptable to impose a responsibility on the retailer, as without such responsibility innovation may be reduced and consumers may suffer.
- Innovation can come from nowhere: it does not need to be protected; it doesn’t have to come from the ‘big guy’ in the market.
- The media is generally more interested in ‘beating up’ branded goods; it is a bigger story than that with private labels. Perhaps people are embarrassed to complain about private labels as they may be perceived as being ‘cheaper’.

³ NCA: National Competition Authority

ANNEXES

ANNEX I: BIOGRAPHIES OF SPEAKERS⁴

Jonathan Banks is a Sales and Marketing enthusiast with 30 years experience working with the UK's top grocery manufacturers and retailers. His impressive record of achievement comprises senior Sales and Marketing roles with several multi-national manufacturers and a retailer. Jonathan joined A C Nielsen in 2003 and is a Business Insight Director for Europe. In this role he helps major Fast Moving Consumer Goods manufacturers and retailers interpret today's trends and develop winning strategies. He can often be found chairing or presenting to conferences around the world.

Dick Bell has been a member of the Institute of Retail Management at Templeton College, Oxford since 1996. He joined as a Senior Research Associate specialising in retailer relations contributing many articles to the *Oxford European Retail Digest* and notably to the *Journal of Long Range Planning* and to the book *Retail Strategy* published in 2004. In 1999 he became an Associate Fellow of Templeton College. During his time at Templeton he has advised the British Brands Group, the European Brands Association, and Planet Retail. Prior to joining Templeton College he was a Vice President at Mars Inc, with responsibility for European sales strategy and global consumer research programmes. During this time he was Vice President of AIM and a member of the marketing committee of CIES.

Ulf Bernitz is Professor of European Law at Stockholm University and Director of the Oxford/Stockholm Wallenberg Venture in European Law at the Institute of European and Comparative Law, Oxford. He is the author of many books and articles in competition law, marketing law, IP law and general European law.

Marcel Corstjens is the Unilever Chaired Professor of Marketing at INSEAD. He is the creator and director of their Storewars programme for senior executives in the consumer goods industries. After his studies in Belgium, Marcel received his PhD

⁴ These biographies are taken from the profiles handed out at the symposium itself by the organisers of the event.

from the University of California, Berkeley, where his doctoral dissertation won 1st prize from the American Marketing Association. He taught at Berkeley before joining INSEAD in 1978, and has since been visiting professor at Cornell and Stanford.

Ariel Ezrachi is the director and founder of the Centre for Competition Law and Policy (CCLP) at the University of Oxford. He is the Slaughter and May University Lecturer in Competition Law and a Fellow at Pembroke College, Oxford. In addition to his teaching within the University of Oxford he also develops and instructs training programmes for European national judges through the CCLP and teaches in other forums. His publications focus, among others, on European competition law, private and public enforcement, passive investments, abuse and excessive pricing. He has also written widely on cross border merger control and the international dimension of competition enforcement.

Alena Kozakova is a principal economist at Which? (the UK's independent consumer organisation) responsible for driving forward Which?'s economic analysis of consumer markets and managing its competition policy work. Most recently, Alena led Which?'s investigation into credit cards interest calculation methods using Which?'s special legal powers to make 'super-complaints' to the UK competition authorities. Alena is responsible for developing Which?'s economic policy in various consumer markets. Prior to joining Which?, Alena worked for NCC (National Consumer Council) as a senior economist where she managed competition policy work. Prior to joining NCC, Alena worked for the European Commission's Competition Directorate General in its Energy and Water Unit. Alena completed an MSc (Hons) in economics at the Prague School of Economics. She then pursued her studies at the Institute of Political Studies in Paris and completed a Master's Degree in Public Administration at France's Ecole nationale d'administration, the training school for senior French civil servants. She is currently studying for an MSc in Economic Regulation and Competition at City University.

Pieter Kuipers is Deputy General Counsel – Europe of Unilever NV. He obtained his Netherlands law masters degree in 1982 and joined Dutch law firm (now named) De Brauw Blackstone Westbroek in The Hague, where he predominantly handled

cases at the Supreme Court ('Hoge Raad') of the Netherlands. In 1988 he joined Unilever's Legal Department in Rotterdam and practiced in the general commercial law and banking law areas. From 1993 to 1997 he was seconded to London with responsibility for legal services (including M&A) for Unilever's Africa and Middle East regional management. In 1997 he returned to Rotterdam to head up Unilever Netherlands' national legal department. Early 2001 he was appointed Deputy General Counsel – Europe, as part of which role he is Unilever's European Competition Counsel. Over the years he has written articles and has spoken on a variety of civil law subjects (banking law, contract law, general tort and environmental liability law, product liability law) and more recently on competition law. In 2000 he was appointed honorary member (deputy judge) of the Court of Appeal in The Hague. In June 2005 he became chairman of the competition committee of VNO-NCW (Confederation of Netherlands Industry and Employers). He is also a member of the committees dealing with competition law and policy matters of AIM (the European Brand Association, based in Brussels) and ERT (European Round Table of Industrialists, also based in Brussels).

Philip Lowe has been the Director General of the Commission's Directorate General for Competition, since 1 September 2002. As such, he is the most senior Commission official responsible for competition matters, and reports to the European Commissioner for Competition, Neelie Kroes. He is responsible for a Directorate General of over 700 staff, charged with enforcing the competition rules in the fields of antitrust, mergers and state aids throughout the European Union's 25 (soon to be 27) Member States. He was born in Leeds in 1947 and attended schools there and in Reading before going to St. John's College, Oxford where he read Politics, Philosophy and Economics. In 1968, he started his professional career in the manufacturing industry. He also completed the two-year M.Sc. Programme at London Business School. At the end of 1973, he joined the European Commission where he worked in the fields of loans and borrowings, steel restructuring and regional development before becoming Chef de Cabinet of Bruce Millan, European Commissioner for Regional Policies in 1989. In 1991, he was appointed Director of Rural Development in the Directorate General for Agriculture. From 1993 to 1995, he was Director of the Merger Task Force in the Directorate General for Competition. In January 1995, he was seconded to be Chef de Cabinet of Neil Kinnock, European Commissioner for

Transport and Transeuropean Networks. In December 1997, he was appointed Director General for Development. In this post, he was responsible in particular for the negotiation of the EU-ACP Cotonou Partnership Agreement and the EU-South Africa Trade, Development and Cooperation Agreement. In June 2000, he was again appointed Chef de Cabinet to Neil Kinnock, who was, as Vice President of the Commission, then responsible for the administrative reform of the Commission. From 1st February 2002, he was seconded to the Secretariat General and appointed acting Deputy Secretary General responsible for relations with the Council, until taking up his appointment as Director General of Competition on 1st September 2002.

John Ratliff is co-chair of the European Antitrust and Competition Department at WilmerHale. Mr. Ratliff has practised EC competition law for more than 20 years. He has been in Brussels since 1986 engaged in advocacy, advice and representation on a wide range of competition issues in all types of proceedings. Mr. Ratliff's practice concentrates on European merger control, cartel defence cases and competition remedies through complaints and other representations. While his primary focus is on the European Commission, Mr. Ratliff also has assisted in competition proceedings before various other European jurisdictions and has represented companies on appeal to the European Court. Additionally, he practises EU regulatory law and has represented companies before the European Commission, national courts and the European Court on issues such as State aid, 'Sunday trading' free movement of goods and EC GATT quota issues. Mr. Ratliff regularly advises companies on all sorts of competition issues and has assisted several dominant companies in reviewing their compliance with Article 82 EC and in implementing related changes to their commercial practices. Over the years, Mr. Ratliff has been involved in various leading cases including: the *Delta Air Lines/PanAm* acquisition, the *Boeing/McDonnell Douglas* and *Volvo/Scania "Phase 2"* merger cases, the *BT/MCI (Concert)* joint venture, the *EUDIM* information exchange case, the *London European/SABENA* computer reservations case, complaint proceedings to reinstate *The English Football League* in the UEFA Cup, and actions based on Article 86 of the EC Treaty to obtain compensation for *Sydskraft*, when the Swedish Government ruled that one of Sydkraft's nuclear reactors should be closed. Mr. Ratliff has a wide European experience. He studied at University College, Oxford and qualified as a Barrister in the United Kingdom in 1980. He was a trainee in the European

Commission's Legal Service (as a Middle Temple Bristow Scholar) and studied first in Germany (as a participant in the Young Lawyers Programme to Germany) and then in the Netherlands (at the Europa Instituut in Amsterdam). Mr. Ratliff then practised EC competition and commercial law in Paris and as a litigator in London before moving to Brussels in 1986.