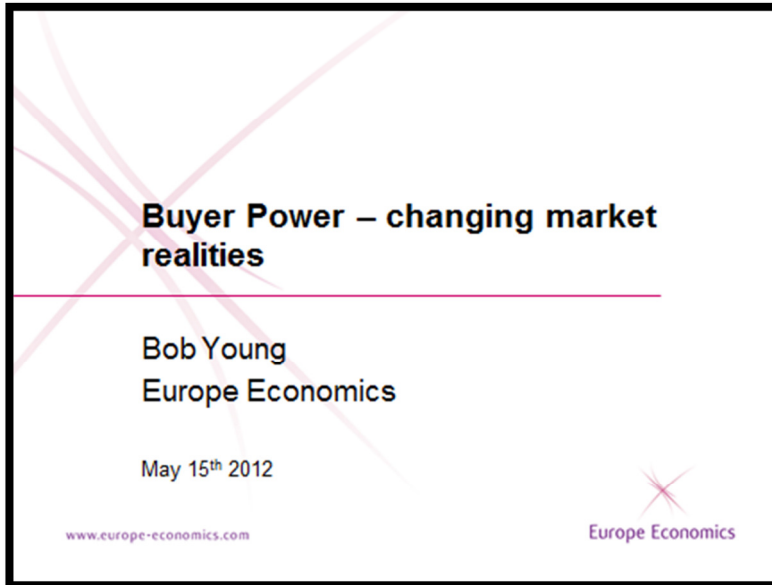


Buyer Power in Competition Law
St Catherine's College, Oxford
15 May 2012

Presentation by Bob Young
Europe Economics

Slide 1



Buyer Power – changing market realities

Bob Young
Europe Economics

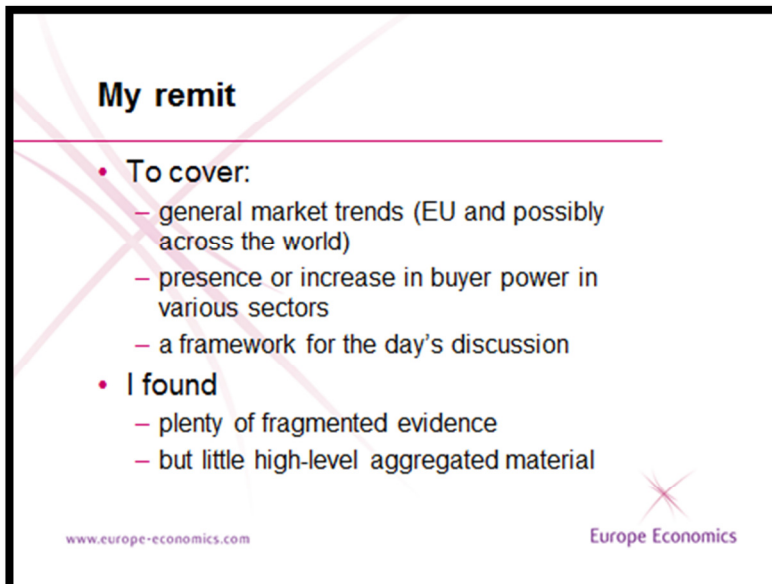
May 15th 2012

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Thank you, Ariel, and good morning, ladies and gentlemen. I have one small point to mention at the outset, and that is that I am now retired from Europe Economics. I wasn't when Ariel invited me to make this presentation, but I am now, and this may well be the last public presentation I make, on this or any other subject.

Slide 2



My remit

- To cover:
 - general market trends (EU and possibly across the world)
 - presence or increase in buyer power in various sectors
 - a framework for the day's discussion
- I found
 - plenty of fragmented evidence
 - but little high-level aggregated material

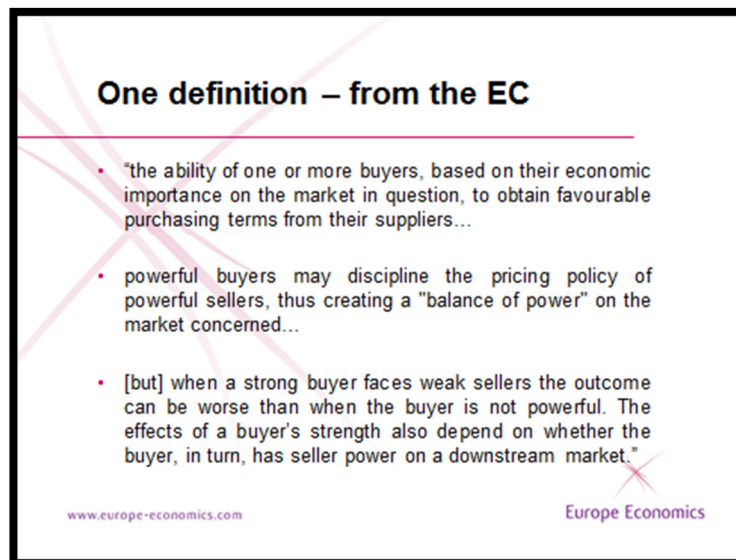
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I was asked to cover these topics – a tall order in a short space of time, and it turned out to be more challenging than I had expected, solely because of the problems I had in getting suitably aggregated, up-to-date data. In fact, it is the difficulties I

encountered in data gathering which have shaped the framework I suggest for our discussions today.

Slide 3



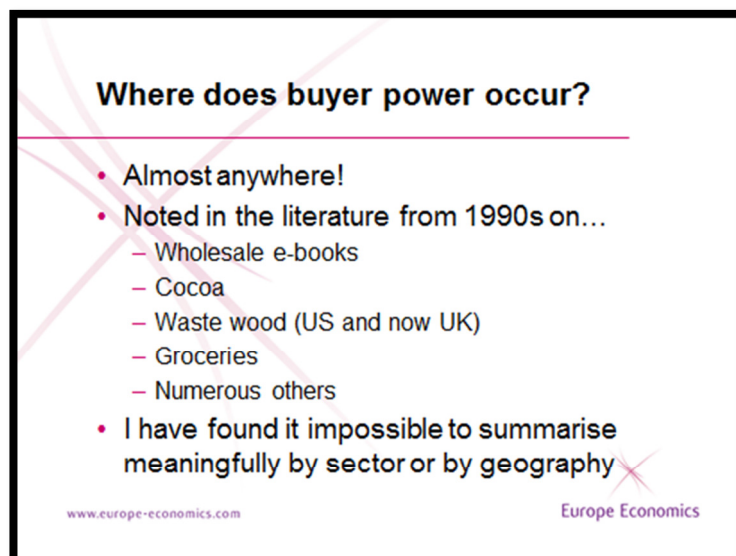
One definition – from the EC

- "the ability of one or more buyers, based on their economic importance on the market in question, to obtain favourable purchasing terms from their suppliers..."
- powerful buyers may discipline the pricing policy of powerful sellers, thus creating a "balance of power" on the market concerned...
- [but] when a strong buyer faces weak sellers the outcome can be worse than when the buyer is not powerful. The effects of a buyer's strength also depend on whether the buyer, in turn, has seller power on a downstream market."

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I suppose somebody has to offer up a definition of buyer power, so I volunteer this one, from the European Commission. I chose it because it seems OK to me as a simple, straightforward form of words but also because it hints at the things that might matter in consequence of buyer power – its capacity to deliver consumer and even supplier benefit on the one hand, and detriment to both groups on the other.

Slide 4



Where does buyer power occur?

- Almost anywhere!
- Noted in the literature from 1990s on...
 - Wholesale e-books
 - Cocoa
 - Waste wood (US and now UK)
 - Groceries
 - Numerous others
- I have found it impossible to summarise meaningfully by sector or by geography

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One of the things Ariel asked me to do was to examine where buyer power occurs, and, on the back of that, to portray the trends in it. From all that I read, buyer power can arise in just about any jurisdiction and in just about any sector. I have no basis for saying that buyer power is more prevalent in one region than another, or in one sector rather than another.

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Buyer power and seller power

- The grocery sector bears out the EC's assertion that buyer power and seller power can be pernicious when combined
- Across the EU, supermarket seller power has increased remorselessly for at least three decades – longer in most Member States
- In such cases, buyer power probably increases in step with seller power
- Why "probably"? Measurement of buyer power has been at best inconsistent

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One thing that is clear, however, is that organisations that exert buyer power often exert retail power too, and that buyer and retailer power are mutually reinforcing. There are some examples, which I will deal with briefly towards the end of my presentation, where an organisation has buyer power but not seller power, but these are a category of exceptions that we may not wish to bother with very much today.

We saw a moment ago the EC's assertion that buyer power when combined with seller power can be pernicious. "When a strong buyer faces weak sellers the outcome can be worse than when the buyer is not powerful. The effects of a buyer's strength also depend on whether the buyer, in turn, has seller power on a downstream market."

The supermarket sector, possibly to a greater extent than all others, bears this out. Over decades, supermarkets in the developed industrial world have taken retail market share from smaller stores, independent or otherwise, to an extent where we now see more than 70 per cent of a national grocery market held by four or so players – sometimes five but also, sometimes, three.

And with such retail power comes buyer power, inevitably so. While the largest supermarket groups, or the buying groups that they contact with, deal daily with the largest branded good suppliers, the supply side is, as a robust generality much more fragmented than the distribution sector. The UK Competition Commission, in its two recent studies of supermarkets, estimated that there were over 7,000 suppliers of

food or food products in the UK – and although the number is steadily going down, it is still a number in the thousands rather than the hundreds. The imbalance of bargaining power is thus colossal.

However, I cannot say to you that buyer power has increased in step with seller power, although intuitively one would think that it has. The problem is that down the years we – that is the collective we: competition authorities, economists, academics, and, at the bottom of the heap, consultants like myself – have not developed a consistent and systematic analysis of buyer power.

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Measurement of buyer power

- UK Competition Commission in 2000 found that buyer power occurs when a single buyer achieves 8% of the relevant product market
 - abuse had persisted over at least a decade
- Same Commission ducked the measurement issue in 2008
 - established a “satisfactory” correlation between volume and price
 - same abuses still going on

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To come back to the grocery sector, the UK Competition Commission determined in 2000 that buyer power existed when a buyer (in this case a supermarket buyer) held 8 per cent or more of a given supply market. When the same Commission – albeit with different panel members – considered the grocery market between 2006 and 2008, it ignored the 8 per cent judgment of its predecessors and settled for a correlation that it found satisfactory between buying volume and terms of trade. As an aside, both panels found sustained abuse of suppliers by supermarkets with buyer power, but did not attempt to relate the scale of abuse with the scale of buyer power – and in fact very little has been done (as I shall go on to say later) about the abuse.

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Another view on measurement

“Enforcers need to develop a deeper understanding of the unique characteristics of the buying side of the market place...A mindless transposition of seller side criteria for market shares or competitive effects can result in a deeply flawed analysis of the buyer power implications of mergers....

It is my earnest hope that both the FTC and the Antitrust Division will make sustained efforts to understand the different aspects of buyer markets and buyer market power.”

Peter Carstensen for the DoJ:
<http://www.justice.gov/atr/public/workshops/docs/202606.htm>

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To get a wider view on all this, I reviewed US and EU literature, and came across two US pieces that I thought might reverberate today. The first is a memorable few sentences written by a US academic for the DoJ. In all innocence I appropriated this quotation before I realised that the author is none other than Professor Peter Carstensen, who is speaking here later today. I just hope Peter hasn't changed his mind since I lifted his quotation into my slide.

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And yet another

“Recent scholarship does not indicate that competitive concerns relating to buyer power in distribution warrant either broad limitations on the purchasing practices of large retailers or any sort of presumption that a particular practice by a large retailer is anticompetitive....

Yet there is ample reason to believe that errors in imposing liability or in formulating remedies could undermine price competition.”

FTC submission to an OECD Round Table on Monopsony and Buyer Power (2008)

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On the other hand, there are other views. Take a look at this quotation, which is part of an FTC submission in 2008 to an OECD Round Table. I agree entirely that finding solutions is easier than identifying problems, but my own experience is that competition authorities have allied themselves with the thinking expressed by the

FTC – not that the FTC is the only body to have voiced it, of course. Far from it, especially in the EU.

Slide 9

The slide is titled "What do suppliers do?" and contains a bulleted list of points. A large, faint red 'X' is drawn across the entire slide content. The text is as follows:

- In the main, put up with it
 - even large brand-owners fear to speak out against major buyers/sellers
 - UK Competition Commission ducked this too
- In the grocery sector, some produce supermarket private labels alongside their own brands
- Building up countervailing power does not show up as a motive for consolidation
 - (e.g.) Kraft/Cadbury makes no reference to building better defences against supermarkets

At the bottom left is the URL www.europe-economics.com. At the bottom right is the logo for "Europe Economics", which consists of a stylized red 'X' above the text.

One might ask what the biggest brand owners do about the exploitation of buyer power, and the answer appears to be: not very much. They put up with it, and in the main they are reluctant to speak out against it: the UK Competition Commission in its 2008 report had identified a climate of fear during its draft stages, then, astonishingly, airbrushed all that out of the final report. I have no idea why. Other suppliers have thrown in half the towel and produce private label products for supermarkets – though I acknowledge that others refuse to do this. There is not much evidence, either, that buyer power, in the grocery sector at least, has provoked consolidation that otherwise would not have occurred. I cite the Kraft-Cadbury merger here but this deal is not alone in confirming the point.

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What do the authorities do?

- Duck detailed analysis
 - (e.g.) no studies that consider when economies of scale become exhausted
- Consider only the short-term interests of consumers and suppliers
- Go for weak remedies
 - for example, Codes of Practice (UK)
- Play it long (UK and EC)

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What have the regulatory authorities done? Not much either. By and large the evidence suggests that they duck the issue – fearing that solutions could be worse than the problems – or play it long.

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Examples

- UK Codes of Practice
 - First UK code of practice in groceries followed 2000 supermarkets inquiry, and was little used
 - Second code of practice followed 2006-2008 groceries market inquiry, and promised enforcement through an Ombudsman
 - Code is in force (unused) but no Ombudsman yet
- EC dilatoriness
 - interest in buyer power goes back to at least 2005
 - studies and discussion gained momentum in 2008
 - but still no action

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Where remedies are attempted, as in UK groceries, weak remedies have been attempted, and even then pretty slowly. We have in this country buyer power abuses that have persisted for over 20 years. The EU too is adept at playing matters long.

Slide 12

Governments as monopsonists (1)...

"MoD and contractors have to reach agreements on efficient cost estimates, on cost sharing arrangements, on a maximum price and on an agreed profit rate. Such bargaining offers extensive opportunities for playing games involving bluff, tit-for-tat and brinksmanship. Questions arise as to whether such behaviour will deliver good value for money for the UK Armed Forces and taxpayers." (Prof. Keith Hartley, Economics of the UK Defence Industry, 2007)

<http://www.securitychallenges.org.au/ArticlePDFs/vol3no2Hartley.pdf>

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I said earlier that there were some instances where buyer power exists but is not exploited, and I will deal just briefly with a couple of these. As the cynics among you will no doubt have worked out, the only organisations that enjoy monopsony power without retail power, and without apparent recognition of what they could do with their buyer power, and get away with it year in year out – are Governments.

In the UK, doubt is frequently cast on the ability of the Ministry of Defence to exploit its buyer power intelligently. Here's an academic view, from Professor Keith Hartley. His wording is quite restrained, but the underlining is mine.

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Governments as monopsonists (2)...

"...it seems that the NHS does not use its power to extract maximum, short-term advantages, but tries to keep a longer-term, strategic view on the supply chain...the NHS Purchasing and Supply Agency may recommend hospitals to buy from certain suppliers, even though they might not be the cheapest, in order to keep them in business and to ensure future competition within the market"

(Chatzaslian, Breen and Webster, Bradford University, 2005)

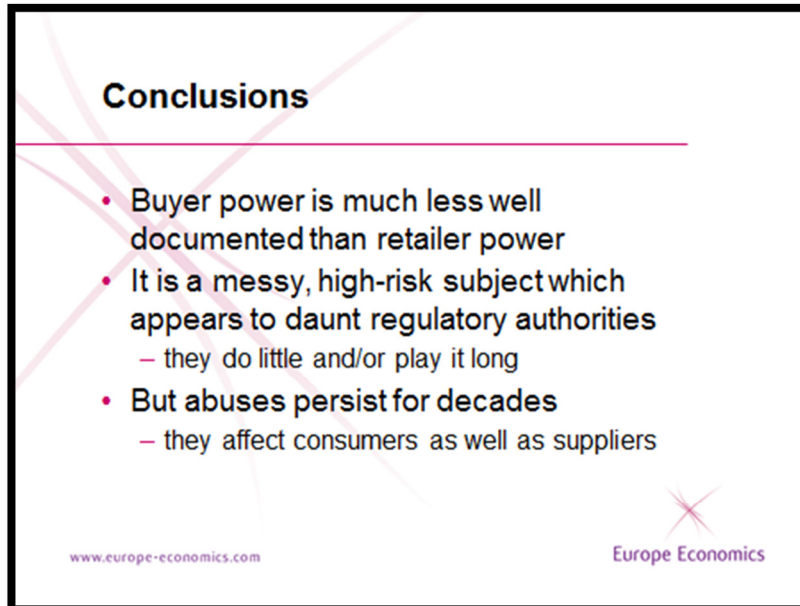
http://www.brad.ac.uk/acad/management/external/pdf/workingpapers/2005/Booklet_05-22.pdf

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The Department of Health fares a little better, though only a little. This is from the Management School at the University of Bradford.

In summary, one might say that when buyer power is exploited the consumer loses, and when it is not the taxpayer loses. What a life! Perhaps one might swap Tesco for the MoD to see if matters improve.

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Conclusions


- Buyer power is much less well documented than retailer power
- It is a messy, high-risk subject which appears to daunt regulatory authorities
 - they do little and/or play it long
- But abuses persist for decades
 - they affect consumers as well as suppliers

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To sum up, I would say that in the commercial world buyer power is not well documented but that regulatory authorities find it difficult to deal with, so the detriments that spring from it, whether for suppliers or consumers, tend to be virulent and to live long.

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Some subjects for the day

- Can we develop a better framework for the analysis of buyer power?
- If yes, would competition authorities apply it?
- How to get disadvantaged parties to speak out and supply the evidence?
- How can the interests of consumers and suppliers be safeguarded over the long term?

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So far as today is concerned, here are my suggestions for matters that we might tackle. Can we develop a better analytical framework? Can we make it such that competition authorities might apply it? Can we get disadvantaged suppliers to speak out? And how does one safeguard the long term rather than settle for the expedience of settling for the short term?

Slide 16



Ladies and gentlemen, thank you very much.

[end]