Purchasing Agreements

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Outline

- Background
- Benefits and potential harm
- Guidelines and case
Background
What are they?

- An agreement for the joint purchasing of products
- Range from loosely structured cooperatives of atomistic buyers to joint ventures amongst buyers

Structure

- Can have open or closed membership
- Can have symmetric or asymmetric terms for members
- Can be ‘passive’ or ‘active’
Intermediate market

Suppliers

Upstream: Suppliers sell input to ‘buyers’

Buyer Group

Downstream: Input sold on to end consumer (either directly or as part of a new product)

Rival buyers

End Consumers
Benefits and potential harm
Benefits?

- Why is there a general presumption of benefits?

- Purchasing agreements used to increase bargaining power or obtain economies of scale in purchasing.

- Lower input costs result in lower prices to consumers downstream – provided agreement doesn’t change downstream competition.
Benefits

- **Buyer groups established to obtain better terms of supply**
  - Improved supply chain efficiencies
  - Intensify competition between suppliers
  - Intensify competition between downstream competitors
  - Potential to increase innovation/investment

- **But benefit must pass through to final consumers. If purchasing agreement leads to:**
  - lowers input price (\(\downarrow MC\)) expect lower consumer prices
  - efficiencies which expand output or improve quality expect increased output or higher quality downstream, but
  - lower fixed costs benefits less likely to be passed on – especially in short term
“Substantial buyer power” ability of the group to materially influence competition between suppliers

Requires:

- Firms in purchasing agreement must by able to credibly resist attempts by suppliers to increase price
  - Switching
  - Sponsor new entry
  - Self-supply

- Firms in purchasing agreement must be a ‘gateway’
  - Firms control access to a downstream market or a key sales channel
  - Supplier would forgo substantial economies of scale
Direct harm

● **Façade to hide explicit collusion**
  - E.g. Spanish Tobacco case – Used purchasing agreements to fix relative downstream quantities and segment the market.

● **Increased risk of tacit coordination**
  - Increased contact
  - Information exchanges
  - Symmetry of terms of supply
  - Symmetry of costs
  - Standardisation
Direct harm

- **Reduction in rivalry:**
  - Obtaining lower costs via a purchasing agreement is the ‘easy option’, pursuit of efficiencies through organic growth would have been better.
  - Purchasing agreements ‘rigidify’ the market – e.g. damaging innovation in buying practices.
Indirect harm

- **Input foreclosure**: striking a (near) exclusive supply deal with a supplier of a key input

- **Raising rivals costs**: bid up the price of an input which is more important to the rivals than the buyer group

- **Reduce rivals benefits**: induce a supplier to adopt a technology, quality level or means of delivery which is more favourable to the group
Indirect harm

- Strategies weaken downstream rivals and may result in exit

- But:
  - **Incentive:**
    - Buyer groups generally do not want to harm upstream competition
  - **Ability:**
    - Does the group have substantial buyer power?
    - Groups may face problems coordinating divergent demands of members.
Indirect harm

- Increased bargaining power for the buyer group may lead to higher prices for rival retailers – Waterbed effect

- Difficult to argue:
  - If suppliers could charge a higher price to the rival buyers why are they not already be doing so?

- But could be credible where:
  - Rival buyers offer suppliers less scope to benefit from scale economies
  - Better terms for group gives them a competitive advantage downstream the fall in input demanded by rivals, weakens their ability to credibly threaten to switch supplier

- Even if the waterbed is credible consumers could still benefit!
‘Rent sharing’ agreements

- Coordination on upstream purchases may spillover into anticompetitive vertical agreements

- Powerful groups may induce suppliers to facilitate downstream collusion via RPM or exclusivity agreements

- Usually suppliers would have no incentive to join a collusive agreement that restricts supplier but could be induced by non linear contracts enabling rent sharing
Guidelines and OFT case
Agreements exempt if members have a combined market share of:
- <15% of the upstream purchasing (i.e. supplier’s) market, and
- <15% of the downstream market

Hard to imagine buyer group as a ‘gatekeeper’ with only 15% market share

Merger analogy – if merger would not be anti-competitive, why would a purchasing agreement
- Not a perfect analogy as purchasing agreement does not involve coordination downstream so likely to be less harmful, but also to produce less downstream efficiencies

Suggests a more tolerant view than the 15% block exemption
Makro and P&H Retail case

- **Two food retailers/wholesalers**
  - Makro – business to business wholesaler
  - P&H – wholesale supplier to independents

- **Agreement to jointly purchase and negotiate discounts and promotional contributions**
  - Implemented through jointly owned service company (PalMak)
  - PalMak negotiates contributions to promotional activities on behalf of both parties, but they individually negotiate how they will be used
  - Each party free to negotiate outside the agreement, with outcomes of outside negotiations kept secret
Market definition and market shares

- **Upstream market** consists of purchases of daily consumer goods from producers
  - Combined market share <15%

- **Downstream market** (narrowest) comprises the wholesale supply by independent wholesalers to independent and convenience retailers
  - Combined market share between 15-20% (above the block exemption)

- In the absence of parallel networks of similar purchasing agreements, OFT indicated agreements are unlikely to cause harm when the parties have no downstream market power
Exclusion of economically dependent suppliers from agreement:

- Parties initially proposed to exclude any supplier who relied on parties for more than 22% turnover

- Heavy dependence need not raise competition concerns

- Use of specific threshold may in fact chill parties incentives to expand their business

Information Exchanges

- Parties only exchange aggregated information on promotional contributions, making coordination less likely

- Payments between parties calculated by independent auditor