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

by

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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 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, food retailing 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 development in retail distribution in the European Commission's Green Paper on Vertical Restraints, released in January 1997 and from which the Commission has subsequently amended policy with the introduction of new block exemption rules and the issuing of new policy guidelines. It has arisen in the context of Commission investigations into merger proposals, for example the proposed consolidation of two of Finland's

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 (which has subsequently been acquired by Wal-Mart).

largest food retail groups (*Kesko/Tuko*) and the proposed merger between two of the largest grocery operators in Austria (*Rewe/Meinl*). 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 and concern over market practices including vertical arrangements with suppliers.

Although all European countries have experienced considerable changes in the food retail 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. However, 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 has a turnover which 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. However, 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 although this may have led to 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 offsetting 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 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 of buyer-power. The present paper is specifically concerned with the buyer power of retailers. Here we seek to draw on recent 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. The policy approach adopted has also been employed to serve as a general framework of reference for an accompanying detailed empirical study of the food retailing sector in the European Union – see Dobson Consulting (1999) for full details.

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 leading retail firms to obtain from suppliers more favourable terms than those available to other buyers, or which would otherwise be expected under normal competitive conditions.[4] 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.

In principle, 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 – see Borgesani, de la Cruz and Berry (1997). 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

4 This definition of buyer power is, it should be noted, somewhat more general than that proposed by the Secretariat of OECD which focuses on the differences in underlying negotiating power among contracting parties:

> ….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).

taken different stances. Nevertheless, the continued consolidation of the retailing sector has brought the issue to the fore. 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.

However, 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 that 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. In the context of retail grocery markets the effects may be to force manufacturers to reduce investment in new products, product improvements, advertising and/or brand building. It may also affect competition by eliminating secondary brands and weakening 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 is an exclusively short run trade-off between increased retailer buyer power and increased retailer seller 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 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 the next two sections of the paper. We begin in the next section by briefly reviewing and analyzing the economic theory of buyer power. From this analysis we put forward, in section 3, a set of buyer power propositions and a structured framework for considering the net welfare effects of buyer power.

We then move from theoretical considerations to consider the actual structure and nature of food retail distribution in Europe. Section 4 presents a summary statistical analysis of retailing across the European Union, focussing on the extent of seller and buyer concentration measures at the aggregate EU and national levels. Section 5 then draws on our theoretical framework to comment on case analysis from four countries - France, Germany, Spain and the United Kingdom. Consideration is given to 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. In addition, specific observations are made in regard to 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. Section 6 concludes the paper with some general remarks and observations about the state of competition and the extent and effects of buyer power in the food retail distribution sector of the European Union.

2. THE ECONOMICS OF MONOPSONY AND BUYER BARGAINING POWER

The analysis of monopsony and bilateral monopoly 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 that does extensively deal with these issues is Blair and Harrison (1993) which 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 this paper's theme, we draw directly on this analysis to illustrate the key arguments. While much of the analysis and the simple models here may be viewed as all too familiar, the purpose of this section is to draw together established theory on buyer power to highlight the economic conditions that give rise to welfare concern for different market circumstances and different market characteristics. Thus the overview of the theory is intended to provide general insights which will serve as a basis for our specific buyer power propositions, which are set out in the next section.

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).

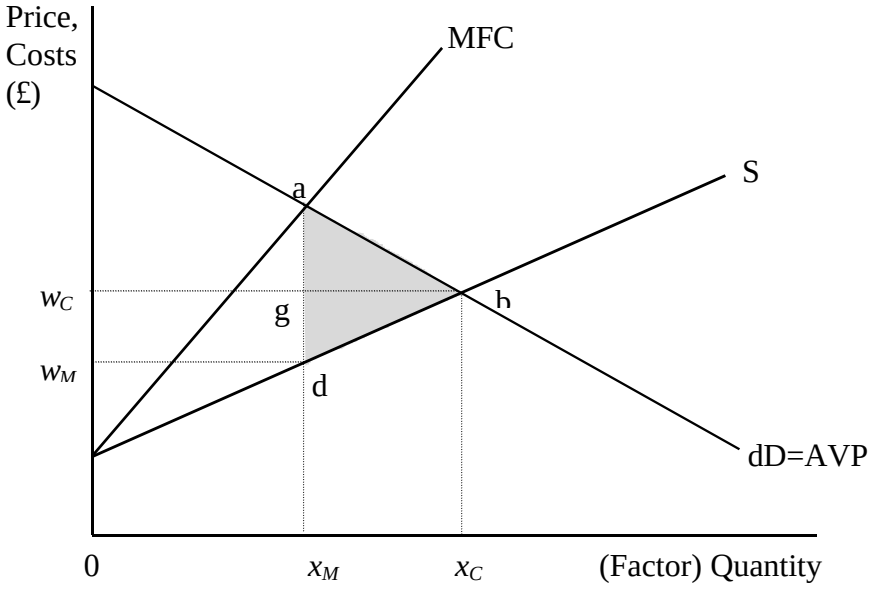

Figure 2.1 - Monopsony Welfare Losses

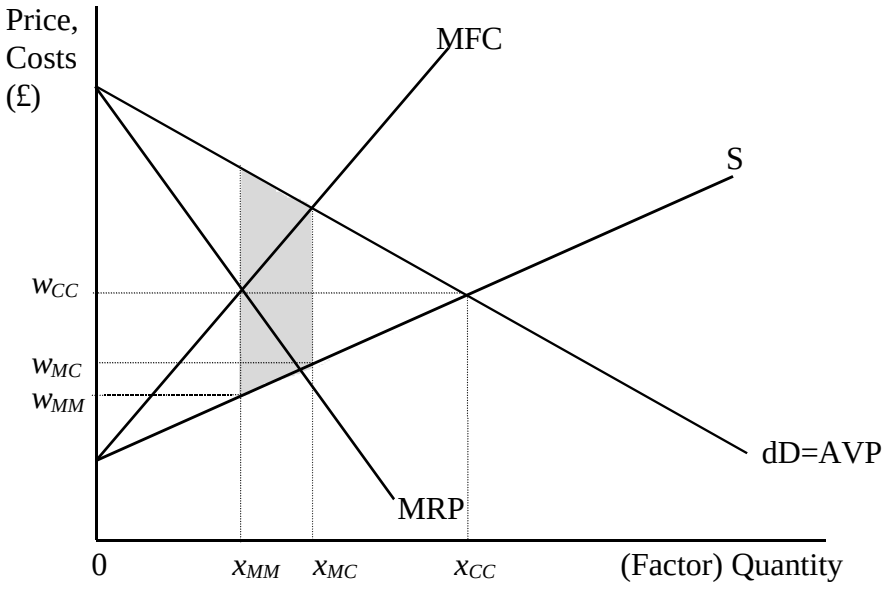

Figure 2.2
Additional Welfare Losses From Monopsonist Possessing Monopoly Power

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).

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 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*.

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 $w_C bdw_M$, while purchaser (consumer) surplus rises by the difference between the rectangle $w_C gdw_M$ 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

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.

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

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]

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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 $(p - MC)/p = 1/\eta$, 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 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

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 upward sloping supply. However, an important empirical study which has some bearing in this regard is that

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

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 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 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

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.

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.

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

14. For example, this latter point was made, for example, 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.

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

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.

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 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,

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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.

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.

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.

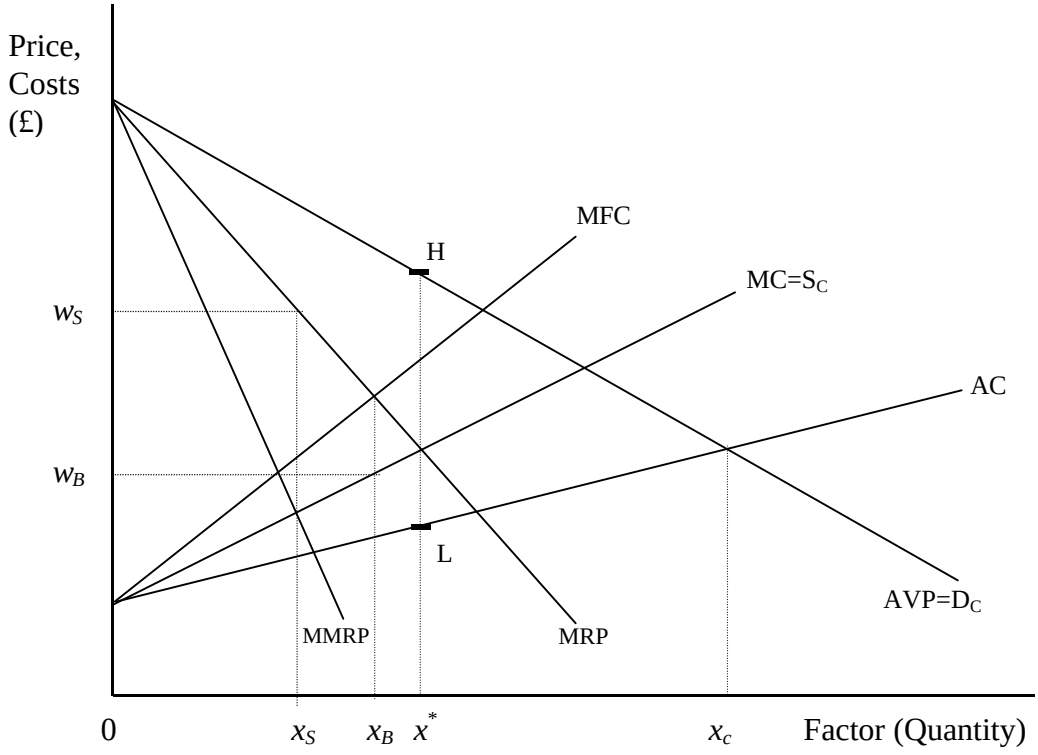

Figure 2.3 - Bilateral Monopoly

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, as the number of retailers declines 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 ("countervailing power") effect is stronger when competition is intense as a consequence of retail services being seen by consumers as highly substitutable, otherwise the latter ("successive market power") effect dominates and consolidation leads to higher prices for consumers.

3. BUYER POWER PROPOSITIONS

Flowing from our analysis of models of the effects of buyer power and following the standard welfare economic practice in section 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 proposition 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 UK's 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 and which may appear particularly relevant in the context of countries such as France, Germany, Greece, Portugal and Spain where laws apply concerned with economic dependency in trading relationships – see Vogel (1998) and Dobson Consulting (1999, ch.4).

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.

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.

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 or the goods specified.*

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

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).

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 anti-competitive effects may take three forms: raise barriers to entry or mobility, relax (dampen) competition between existing rivals, or facilitate collusion. However, there may well be potential efficiency benefits arising from such restraints meaning that two opposing sets of effects need to be weighed in order to determine the overall welfare effect.

As Dobson, Waterson and Chu (1998) indicate, there may be numerous forms of buyer-induced restraints, each serving a different purpose and having potentially different welfare effects depending on market circumstances. Here it is worth listing a few practices that may be particularly relevant to food retailing (with an indication of possible anti-competitive effects shown in brackets):

- Insistence on exclusive supply (barrier to entry; dampening competition)
- Buyer-induced resale price maintenance (dampening competition; facilitating collusion)
- Listing charges, slotting allowances and other up-front fees paid by suppliers (dampening competition)
- Buyer forced application of most favoured nation (MFN) clauses (dampening competition)
- Predatory buying of key goods/inputs (barrier to entry)

In each of these cases it should be apparent that there may be efficiency benefits associated with, for example, reaping economies of scale and/or scope, reducing transaction costs and optimising investments (say by avoiding free-rider and/or hold-up problems).

The prime role for the procedure set out in table 3.1 is essentially for investigation of specific cases involving alleged or potential exploitation of buyer power in a given market. However, the framework might also serve a more general use for guiding assessment of general empirical findings across a sector or making comparisons between different markets. Indeed it is this aspect which we turn to next by presenting a summary of developments in the structure of food retailing across the European Union prior to applying the framework to summarise our case study findings relating to France, Germany, Spain and the United Kingdom.

4. THE STRUCTURE OF EU FOOD RETAILING

The rapid development of food retailing as an industry over the last decade or so has been widely documented – see Dobson Consulting (1999, ch.6). From a once largely fragmented sector, large retail corporations have come to dominate or at least capture significant share of their respective domestic markets, pursuing retail brand building through controlling extensive chains of stores and taking increasing control of the products they stock, particularly with the promotion of private label products. At the same time, many of these corporations have sought to extend their operations internationally with a number of them now operating across several member states of the EU. This section seeks to quantify some of these aspects to put the general structure of food retailing in Europe into perspective, while highlighting key differences between the experience in individual member states.

From our research of the performance and position of food retailers across 14 member states of the EU, quantifying the market shares and scale of operation for the leading firms for 1993 and 1996, six "headline" facts stand out.

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 estimated by Davies et al (1998) 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.[18] 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. Table 4.1 shows our estimates of five firm national concentration ratios for the different member states. While highlighting the differences between countries, it is apparent that even over a three time horizon concentration has increased rapidly for some states, notably Spain, Portugal and Greece, while remaining extremely high for the Nordic countries of Finland and Sweden. It is also the case that disparities appear in the breakdown of the shares of each of the leading five firms across the countries and accordingly the markets may be designated differently as indicated in Table 4.2.

18 The top 10 food retails firms for 1996 ranked by sales in the EU were, in descending order, Rewe (25.3bn ecus), Metro (24.0), Aldi (23.6), Promedes (23.4), Edeka (20.6), Carrefour (20.4), Intermarche (19.7), Auchan

Table 4.1: 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

Source: Dobson Consulting (1999)

(19.4), Tesco (17.2), Leclearc (15.9), with total sales for the whole EU estimated at 764bn ecus.

Table 4.2 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	weak 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	weak 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%						

Source: Dobson Consulting (1999)

III. With the notable exception of the UK, **buyer concentration is even higher** - on average, by about 10% points than seller concentration. Concentration ratios when adjusted for buying groups, as shown by Table 4.3, are noticeably higher for Belgium, Denmark, France, Germany, Italy, Netherlands, Portugal and Spain.

Table 4.3 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	

Source: Dobson Consulting (1999)

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 very recent entry of Wal-Mart through acquisitions in Germany and the UK) 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[19] as a force for intense competition**, particularly in Germany. We see an important potential force for changes in the market generally arising out of

19 These are retailers which operate with a relatively limited product range (typically between 3,000 and 6,000 lines) and offer a very basic retail service with discounted prices to consumers, in comparison to the more broad based hypermarket operators offering around 20,000 product lines in fully serviced large store formats. The leading four discounters (Aldi, Lidl, Tangelmann and Rewe) are all German in origin but now operate widely across

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.

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, while a final decision is awaited on the proposed merger between Promodes and Carrefour of France.

There is also a seventh observation that can be made - perhaps better referred to as a "stylised fact":

VII. Currently, there appears to be a **dual structure apparent in food retailing within member states**. Figure 5.1 has been constructed to depict the relationship between concentration and market size. (Admittedly, this focuses 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.

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, and compares to C5 of 15% for food retailing in the EU. In some sectors, e.g. Tobacco, Chocolate and Household Chemicals, it exceeds 40%. Broadly speaking, manufacturing concentration tends to be higher where products are typically advertising intensive with pronounced brand loyalty.

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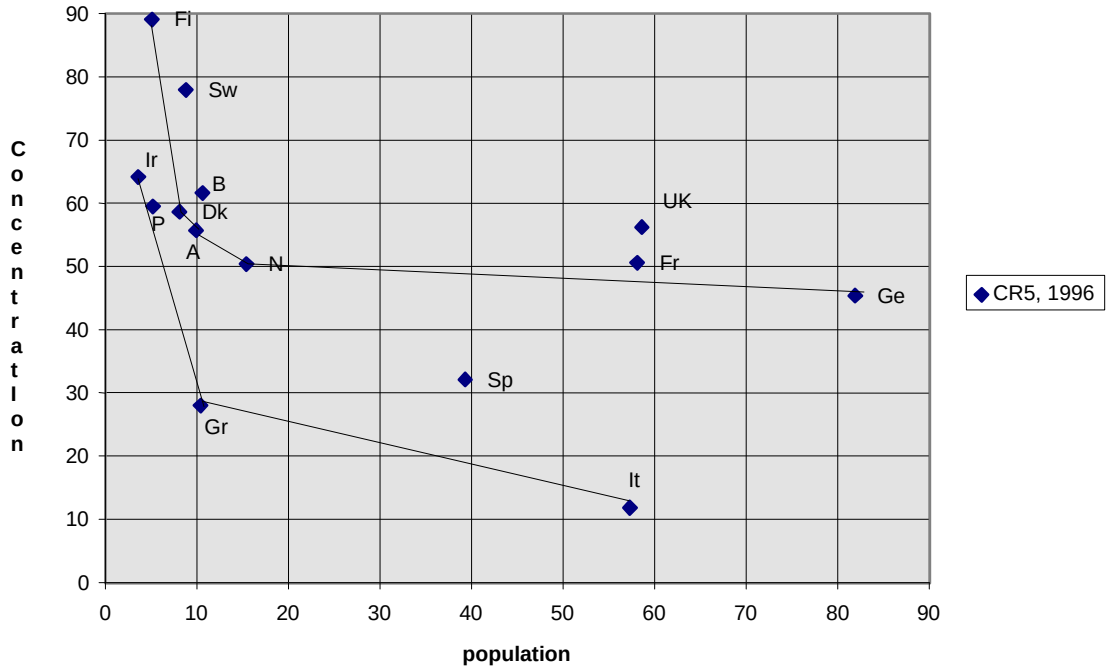
the Union.

Figure 4.1 Concentration in European Food



IX. There is an **increasing importance of the world's largest food MNEs**. Over half of the world's largest manufacturers have a leading top 5 presence in at least one manufacturing industry in the EU. Moreover, four firms - Unilever, Nestle, Philip Morris and Danone (BSN) - appear frequently as the leaders in many individual markets.

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. However, there are important differences between member states and between different types of foodstuff. In addition, both sectors are also clearly in a state of noticeable structural change. But is apparent that the rate of change and consolidation is moving more rapidly in retailing, if somewhat from a generally lower base than much of manufacturing associated with many food items and related daily goods.

5. CASE STUDY ANALYSIS

The general background on retail structure as set out in the previous section alluded to potentially significant differences between member states. As shown in tables 4.1 and 4.2 there are clear differences in the market structure of food retailing in different member states. It might be expected that different approaches to conduct are also apparent, in part arising from the different market structures but also from the individual character of national markets associated with culture, history and institutional involvement.

To gain some insights in to these differences and to allow for comparisons to be made, we conducted detailed case analysis for four countries – France, Germany, Spain and the UK – with the intention of commenting generally on grocery retailing. In addition to examining food retailing at a broad level we wanted to give consideration as to how competition and buyer behaviour might vary across products. For this purpose, we sought to draw specific insights on three representative product groups - washing powders/detergents, coffee and butter/margarine. In this section we summarise our findings. Full details of the analysis are contained in our report to the European Commission – see Dobson Consulting (1999, part III).[20]

In all four countries selected for investigation 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. 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

20 The research for these case studies draws on published information in each of the countries (e.g. company reports, trade journals, published papers, and so on). In addition, a total of 47 structured interviews took place with companies and other organisations and industry bodies, conducted by local researchers, to supplement the published information and gain further insights.

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 4.3 above). 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 4.1 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.

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.

As a means of organising and summarising our findings from the case studies we utilise the framework set out above in table 3.1. 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.

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 4.3, 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.[21] 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).[22] 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,

21. 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.

22. 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 in a more competitive market.

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.

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 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 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 sections 2 and 3 above, 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 4.1. 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%. Germany and France are classified as symmetric oligopolies in table 4.2 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 late-

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.

Other issues - trade-offs between short-run and long-run effects

The interviews conducted in preparation for the case studies raised a number of issues beyond the immediate effects of buyer power. In particular, it should be apparent 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 section by pointing to one specific example which 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.

6. CONCLUSION

At the heart of this paper lie the "buyer power propositions" and the framework set out in table 3.1. 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 paper, they also provide an obvious framework and identify some of the key concepts and perspectives to be pursued in undertaking broad empirical and case analysis. 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 food 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.

As highlighted by section 4, 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 (private label items), 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 section 4 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 Carrefour and Promodes in France.

Building on this final point, we can suggest that, at the aggregate EU level, as the market becomes more integrated, more countries will move towards the position represented by the first set of players in Figure 4.1. It is worth pointing out 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.

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