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Market entry conditions affecting competitiveness and exports of goods and services of developing countries: large distribution networks, taking into account the special needs of LDCs

Note by the UNCTAD secretariat

Executive summary

Apart from government regulations that determine market access conditions, the ability to enter a market is a function both of the competitiveness of the exporter, which is determined by the relative cost and quality of the product, and of the characteristics of supply chains and the structure of markets. The growing internationalization and globalization of production and trade have led to large distribution networks becoming the core of the logistic chain of domestic commerce and international trade for both developed and developing countries. Such networks are becoming increasingly important for many products and services in which developing countries have comparative advantages, including food, textiles and clothing, and tourism. The market entry conditions posed by the large distribution networks relate to product characteristics, including (a) quality, appearance, cleanliness or taste; (b) safety (e.g. pesticide or artificial hormone residue, microbial presence); and (c) authenticity (guarantee of geographical origin or use of a traditional process). Other conditions relate to the nature of the production process (e.g. with respect to worker health and safety, or to environmental impact), prices and speed of delivery. The effort to meet such market entry conditions may have positive results for the efficiency and competitiveness of developing country enterprises. However, where producers are unable to meet the requirements, they may face acute problems in entering prospective export markets. This is the case for LDC producers in particular. The large distribution networks, and the possible responses to them by developing country producers, also raise specific concerns with respect to competition policy.

Introduction

1. The Commission on Trade in Goods and Services, and Commodities, convened this Expert Meeting at its seventh session to clarify the impact of international supply chains, in particular large distribution networks, on the competitiveness of developing country enterprises in domestic and Export Markets. Also, the Expert Meeting would review opportunities provided to developing country enterprises by subcontracting arrangements with international distribution networks and the effects of dealing with monopsonistic or oligopsonistic partners. Market entry conditions studied were to include quality and volume requirements, payment conditions and environmental considerations.

2. The present report focuses accordingly on the implications of the market entry conditions posed by large distribution networks for the competitiveness of developing country exports, particularly those originating in least developed countries (LDCs). For the purposes of this report, large distribution networks are defined as geographically diversified networks with many components that handle large volumes of products and that are, usually, vertically integrated. Such networks are becoming increasingly important for many products and services, including food, textiles and clothing, and tourism. These are all sectors in which developing countries have comparative advantages, based on their natural resource endowments and relatively low labour costs.

3. Market entry conditions may be defined as the parameters that exporting firms in developing countries have to meet in order to enter such distribution networks for goods and services in the market of developed countries. Such parameters may relate to product characteristics, including (a) quality, appearance, cleanliness or taste; (b) safety (e.g. pesticide or artificial hormone residue, microbial presence); and (c) authenticity (guarantee of geographical origin or use of a traditional process). Other parameters may relate to the nature of the production process (e.g with respect to worker health and safety, or to environmental impact), prices and speed of delivery. Compliance with such market entry conditions is a prerequisite for participation in entry modes such as direct exportation, joint ventures, partnerships, franchising, licensing or trade fairs, and for the use of a sales representative, distributor or consolidator.

4. Such market entry conditions, which are dealt with in this report, are distinct from market access conditions. As explained in an earlier UNCTAD report dealing with market access,[1] while the *possibility* of entering foreign markets depends on market access conditions (determined by the legal and administrative conditions imposed by the importing countries under internationally agreed trade rules), the *ability* to enter a market is a function both of the competitiveness of the exporter (determined by the relative cost and quality of the product), and of the characteristics of supply chains and the structure of markets. That report also made an important conceptual distinction between competitiveness, on the one hand, and market access and entry, on the other; while the exporting side can do much *by itself* to improve its competitiveness, market access conditions, market exigencies and the characteristics of supply chains are to a large extent exogenous to developing country exporters, which are often small and wield little power. Thus, market access would be a prerequisite for market entry to occur, but would not be sufficient; developing country exporters (especially those

[1] See UNCTAD, "Export diversification, market access and competitiveness," TD/B/COM.1/54, 26 November 2002.

from LDCs), as well as their Governments, need to go beyond market access concerns and also focus upon the conditions governing actual market entry.

5. The effort to meet such market entry conditions may have positive results for the efficiency and competitiveness of developing country enterprises. For these results to be achieved, however, it would be necessary for the developing country Governments concerned to provide adequate opportunities for capacity-building and to develop appropriate industrial strategies and policies; such policies would concern areas such as standardization, quality control, access to market information, investment facilitation, technology promotion, small and medium-size enterprise development and upgrading and/or diversification of agro-related industries. Failure to satisfy market entry conditions would result in market exclusion: in the absence of a solid technological and skill base, including availability of specialized knowledge, techniques and good equipment for research, metrology and certification, suppliers from developing countries, particularly from LDCs, would face acute problems in entering prospective export markets. A complicating factor is that market entry conditions requiring excessively low prices could reduce the resources available to improve supply capacity and competitiveness. As a result, adverse terms of trade arising from market entry conditions would impact upon both developing countries' short-term balance-of-payments situation and their long-term supply capacity.

6. However, large distribution networks with their nodal points, as well as large commercial customers for small and medium-size enterprises' products, can contribute to achieving a supportive marketing environment and can assist with infrastructure and support services. They can also provide a stimulus for enterprise-level reforms leading to a modernization of business practices. The advantage of support by distribution networks is that it is specific to the needs of the sectors concerned, and may thus be particularly useful in eliminating supply constraints and enhancing efficiency. Compared with generalized sector support, specific output targeting and organizational efficiency benchmarking can significantly improve competitiveness.

7. The present report deals mainly with market entry conditions affecting agro-food exports (such as meat, dairy products, cereals, fresh fruit, vegetables, fisheries or processed foods). However, other sectors of interest to developing countries such as textiles and clothing and tourism are also considered; brief descriptions of the role of large distribution networks in these sectors are provided in boxes 1 and 2 respectively. The bulk of the report, contained in chapter II, is devoted to a review of the implications of the growth of such networks for the market entry conditions facing exporters from developing countries, including LDCs, in one particularly representative sector, namely the agro-food sector. Chapter III discusses issues of market concentration and the commercial practices of large distribution networks, particularly from the point of view of competition law and policy. The report concludes with a number of questions for consideration by the experts.

Box 1. Inter-firm strategic alliances in the textiles and clothing industry of developing countries

Since the early 1960s the textiles and clothing industry has remained outside the normal rules of the international trading system and has been subject to quota restrictions targeting exports from developing countries. The integration of trade in textiles and clothing into the WTO rules was agreed in the Uruguay Round, and a phase-out programme for the quota restrictions was established in the Agreement on Textiles and Clothing (ATC). The implementation period is 10 years, until the end of 2004, when the ATC expires. So far, however, only one fifth of the total restricted products have been liberalized, and on the final day of the ATC implementation, namely 31 December 2004, the remaining quotas will be lifted.

Large international companies seeking competitive textile products have responded to the discriminatory and restrictive trade regime by developing supply chain networks, taking advantage of differing competitive advantages between countries and regions. Most developing country producers have, however, remained contract manufacturers, often on the basis of inputs and designs provided by large retailers and brand companies. The expiration of the ATC will offer new market opportunities for developing countries that export textiles and clothing. However, competition will intensify and this may adversely affect small suppliers lacking the capacity to adjust to the rigours of the post-ATC regime.

The key challenge for developing country exporters wising to increase international market shares is to enter into strategic alliances with internationally operating apparel companies, retailers and brand companies to expand the capability to include high-value-added activities such as marketing and design. In this way, the customer base of the exporting firms can be expanded, reducing dependence on a few large customers. From the point of view of competitiveness, this shifts the emphasis from competitive advantage in material resources to immaterial assets, the latter being far more difficult to obtain or to imitate. In the future, it is widely expected that lead time (short responses), product quality (including environmental and health parameters) and small order acceptance will become more important factors for major buyers than price. This will require changes in the management of exporting enterprises with respect to products, markets, production organization and marketing. Developing such capabilities requires companies in developing countries to create networks both with downstream suppliers, who can provide the materials needed to put the package together, and with upstream customers looking to place orders for apparel. Development of networks will be crucial for effecting the transition to full service production. To start the development systematically, companies could focus on developing national networks first.

In Bangladesh, for instance, there are some alliances between textile mills and garment manufacturers to jointly develop fabric design, facilitate participation in overseas trade fairs, and coordinate production plans so as to cut delivery time. Some of these networks with downstream suppliers involve close relationships with textile mills in China, India, Indonesia, Thailand and Malaysia.

This adjustment and learning process is likely to succeed in the larger and established textiles and clothing-exporting developing countries. Even in these cases, however, the vertical and horizontal integration among the downstream sub-sectors of the textile and clothing industry is not well developed and national or regional schemes that can provide goods and related services are not guaranteed. In the other countries, apart from poor infrastructure and communication, necessary skills are often unavailable and key inputs, including ancillaries such as buttons, zippers and elastics, have to be imported. In order to compete on international markets, these countries will have to rely on the exploitation of local skills in stitching, lace work and embroidery. Locally available skills, which form part of the national culture, could be incorporated into the process of contract manufacturing. This will, however, require substantial training and assistance so as to transform the national skills into exportable products.

Source: The information in this box is largely drawn from a series of country-case studies by the International Trade Centre on adding value – building value-addition alliances in the textiles and clothing sector, accessible at: www.intracen.org/mds/sectors/textiles/atcpaper.htm.

Box 2. The international distribution of tourism services

As a general rule, in the realm of services, as opposed to that of commodities, the spheres of production and distribution cannot be separated in a clear-cut fashion. However, in an approximate and ad hoc fashion framed from an international trade vantage point, a difference can be established also in many services sectors between "core" services activities which are directly aimed at producing the service as a product, on the one hand, and other activities which facilitate the contact and the transactions between the "core" producers of the service and the customers, on the other. The former can be likened to "production" activities, and the latter to "distribution" activities. By this token, for instance, in the domain of tourism services, "core" service activities such as hotels, restaurants, local travel agents and national travel services (such as bus and railway connections inside the national boundaries and domestic flights) can be considered "production" activities, while others, such as large transnational tour operator services and international air transport services, can be seen as "distribution" activities.

Local tourist firms in developing countries often enjoy a comparative advantage in the "production" stage of the value chain, but this advantage is nullified to a large extent by the severely oligopolistic/oligopsonistic structure of the "distribution" stage in international markets dominated by a few large transnational operators from developed countries (see P. Evans, "Recent developments in trade and competition issues in the service sector: A review of practices in travel and tourism", UNCTAD Series on Issues in Competition Law and Policy, 1999). The top five tour operators control around 75 per cent of the European market, establishing the conditions for other participants (SIAM FUTURE DEVELOPMENT PLC, Sunday, 27 July 2003). Even in more open markets, domestic tour operators may be unwilling to market offers of other tour operators in their retail outlets. Such problems are just beginning to be mitigated by the increasing popularity of the Internet-based reservation system, which allows service providers from developing countries to establish direct contacts with customers. However, difficulties for developing countries' tourist operators are compounded by restricted access to computerized airline and hotel reservation systems. Such market-driven handicaps are often magnified by policy-induced distortions deriving from a variety of non-tariff barriers put in place by developed countries' Governments. Taking into account that large transnational tour operators are few and concentrated, while firms active in the tourism business in developing countries are usually numerous, small and fragmented, an uneven business cooperation mechanism results, in which bargaining power rests firmly in the hands of the former. The non-existence, or weakness, of national airline carriers in most developing countries has a similar impact on bargaining power and, ultimately, on the distribution of benefits in the international value-added chain of the tourist sector. These phenomena add to the "leakage" effect, that is the overall low retention within the country of the revenue generated by total sales to foreign tourists, which is also caused by other factors such as the import of materials, inputs and consumer goods for the tourist industry and the repatriation of income and profits earned by foreigners operating in the country. As a result, even developing countries enjoying tourism booms often derive limited benefits in terms of foreign exchange earnings, employment, income generation, and long-run contribution to economic and social development.

I. Impact of large supermarket chains on developing countries' agro-food exports

A. Global market trends and large distribution networks

8. The importance of distribution services for food products can be appreciated through their contribution to total value added. For instance, in the United States, in the marketing of domestic farm products, according to 1996 data, 77 per cent of the estimated total bill of $544 billion accrues to the logistic chain, mostly distribution, packaging and transport, and only the remaining 23 per cent represents the gross return to farmers. Meanwhile, in the case of an imported commodity such as bananas, the producers' gross return is only 5 per cent of the retail price, while distribution and retailing costs account for 34 per cent of the price and distribution profits 17 per cent, the rest being explained by transport, taxes, ripening costs and other fees.[2] In this case, as with almost all commodities produced in developing countries, more than 90 per cent of the price paid by consumers remains in the importing country.

9. Large distribution networks dominate the market place of wholesaling and retailing in both developing and developing countries. The rapid diffusion and incorporation of new technologies as well as profound institutional and organizational changes are reshaping the industry worldwide. The share of the top 100 retailers in the worldwide retail business is estimated at around 25 per cent, with the leading 30 retailers accounting for 10 per cent.[3] Of the world's top 100 largest retailers, ranked according to 2001 sales, 41 are from the United States, 12 from Japan, 11 from the United Kingdom, 9 from Germany and 7 from France. Only two developing countries, Mexico and Singapore, appear in the list with one retailer each among the largest 100. In the case of Mexico, the retailer is Wal-Mart Mexico, a foreign-owned corporation.[4] One of every three retailers in the top 100 operates primarily in the supermarket business, with groceries being their main sale item. From 1997 to 2000, the total number of food-related outlets developed by the 30 top international operators increased by 23 per cent, from 98,723 to 122,000.

10. Food sector retailing and wholesaling are mature industries in developed economies, although highly saturated and concentrated with a dominance of large retailing conglomerates. Both in the European Union and the United States large retailers' share of the market is above 59 per cent. In the United States, the top four grocery retailers account for 22 per cent of annual grocery sales and have 18.5 per cent of individual supermarket stores.[5] Table 1 shows the sales of the top 10 global grocery retailers; together with table 2, it illustrates the degree of globalization in this sector.

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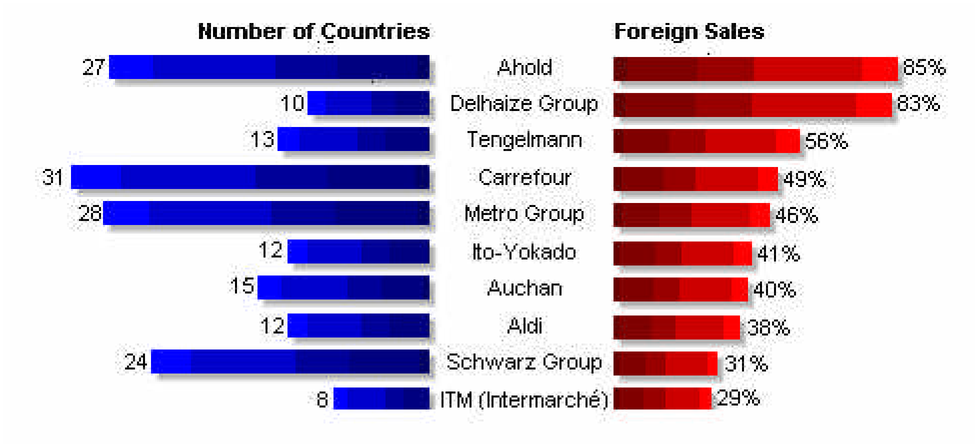
[2] *"Bananas: The Facts"*, New Internationalist, issue 317, October 1999.
[3] M+M Planet Retail, Press release, 10 May 2001.
[4] Only 10 companies of developing countries are listed in the top 200 retail stores worldwide. Four come from Mexico, two from The Republic of Korea, and one from Brazil, Singapore, Hong Kong (China), and South Africa. OECD TD/TC/WP/(2003)23/PART 1, 3 June 2003.
[5] J. Kinsey, "Concentration of ownership in food retailing: A review of evidence about consumer impact", Retail Food Industry Center, University of Minnesota, Working Paper 98-04.

Table 1. Number of stores, sales in billions United States dollars and countries of operation of the top 10 grocery retailers in 2002

Rank	Company	No. of stores	Sales in billions	Countries of operation
1	Wal-Mart Stores United States	5,164 (1)	$244.50	Argentina, Brazil, Canada, China, Germany, Japan, Mexico, Singapore, Republic of Korea, United Kingdom, United States, Viet Nam
2	Carrefour France	10,704	$64.70	Argentina, Belgium, Brazil, Chile, China, Colombia, Czech Republic, Dominican Republic, Egypt, France, Greece, Indonesia, Italy, Japan, Malaysia, Mexico, Oman, Poland, Portugal, Qatar, Romania, Singapore, Slovakia, Republic of Korea, Spain, Switzerland, Taiwan Province of China, Thailand, Tunisia, Turkey, United States
3	Ahold Netherlands	9,407	$59.20	Argentina, Brazil, Chile, Costa Rica, Czech Republic, Denmark, Ecuador, El Salvador, Estonia, Guatemala, Honduras, Indonesia, Latvia, Lithuania, Malaysia, Netherlands, Nicaragua, Norway, Paraguay, Peru, Poland, Portugal, Slovakia, Spain, Sweden, Thailand, United States (2)
4	Kroger United States	3,667	$51.80	United States
5	Metro Germany	2,411	$48.50	Austria, Belgium, Bulgaria, China, Croatia, Czech Republic, Denmark, France, Germany, Greece, Hungary, India, Italy, Japan, Luxembourg, Morocco, Netherlands, Poland, Portugal, Romania, Russian Federation, Slovakia, Spain, Switzerland, Turkey, United Kingdom, Ukraine, Viet Nam
6	Tesco United Kingdom	2,294	$39.50	Czech Republic, Hungary, Ireland, Malaysia, Poland, Slovakia, Republic of Korea, Taiwan Province of China, Thailand, United Kingdom, United States
7	Costco United States	400	$38.00	Canada, Japan, Mexico, Republic of Korea, Taiwan Province of China, United Kingdom, United States
8	Albertsons United States	1,688	$35.60	United States
9	Rewe Zentrale Germany	12,077	$35.20	Austria, Bulgaria, Croatia, Czech Republic, France, Germany, Hungary, Italy, Poland, Romania, Slovakia, Ukraine
10	Aldi Germany	6,609	$33.7e	Australia, Austria, Belgium, Denmark, France, Germany, Ireland, Luxembourg, Netherlands, Spain, United Kingdom, United States

e=estimate; (1) Store numbers include Seiyu; (2) Ahold is currently in the process of disposing of several operations in South America and South-East Asia; (3) Ito-Yokado also has franchise operations in Denmark, Norway, Singapore, Republic of Korea and Sweden; *Source*: Planet Retail – www.planetretail.net; SN research.

Table 2. The ten most internationalized large grocery retailers in 2002 (based on per cent foreign sales)



Source: Planet Retail – www.planetretail.net

11. The buyer power wielded by supermarket chains is such that they are able to negotiate favourable terms and prices in a variety of ways. A report on supermarket pricing policies in

the United Kingdom cited 52 ways in which supermarkets exploit their dominant power over suppliers.[6] Supermarkets were found to habitually refuse to enter into binding contractual agreements, leaving their suppliers without redress. Other practices included delaying payments by 15 days more than the terms agreed; changing quality standards agreed without adequate notice; requiring buyback of unsold goods and making deductions from returns to cover wastage (failure fees); insisting on non-cost-related payments or discounts, sometimes retrospectively; and imposing charges or making changes to agreements without adequate notice. Buyers may also seek to impose a variety of restraints upwards along the chain of supply, such as exclusivity contracts.

12. Suppliers pay distributors slotting allowances for product placement on store shelves. Sometimes these are requested by distributors, and sometimes they are offered by suppliers. However, well-tested, innovative products can and do reach consumers without slotting allowances. Many supermarkets also waive such allowances for small producers and for suppliers in their community. The most common allowances are for new products – so-called new product introduction allowances. These may also cover premium product placements, such as on eye-level shelves or special displays, and the cost to have products remain on shelves, also known as "staying fees" (pay-to-stay) allowances.

13. The amounts paid vary depending on numerous factors, such as whether the supplier has a proven track record, whether consumer testing has been performed, whether the product is carried by competitors in the same market, and whether the supplier has a well-conceived advertising programme. The amount can be from several hundred dollars to have a new product introduced in a single store to many thousands of dollars for a chain-wide promotion. However, since each product introduction is unique, these allowances are typically negotiated individually and no industry-wide numbers are available.

14. The practice of slotting allowances may be best understood in the broader context of a major shift in how manufacturers spend their promotional dollars. In 1968, they spent 72 per cent on direct consumer advertising and marketing, largely using the mass media of television, daily newspapers and general interest magazines. At that time, only 28 per cent of these funds were spent on trade promotions to help retailers influence consumers once they are in the store. Since then, the ratios have changed dramatically: by 1998, manufacturers were spending 50 per cent of their money on the latter type of promotions. The reasons for this shift in promotional spending are clear. It has become much harder to reach consumers through the mass media with the decline in the market share of network television and the proliferation of cable channels, special interest magazines and millions of websites. Instead, consumers can be reached most effectively in the stores where they actually buy groceries. That process begins by having products placed on the shelf.

15. The reasons for slotting practices are to cover the considerable costs involved in introducing a product, to remove the item that previously occupied the shelf space and to recover some of the investment in the likely event that the new product fails. Suppliers do not place products in supermarkets on consignment, as they do in many other industries. Supermarkets pay for products and assume the risk as to whether consumers will buy them. When a new product fails, the cost includes the dollars lost from the item that had to be dropped to make room for the new product. Many small suppliers hold the view that slotting allowances are unfair and prevent them from introducing their products into supermarkets.

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[6] See Corporate Watch, "What's wrong with supermarkets?", www.corporatewatch.co.uk, 2002.

Most of these small farmers cannot afford slotting allowances and consider that large suppliers pay large allowances to keep their products off supermarket shelves.

16. In the grocery business, there has been an impressive expansion of supermarket chains in many developing countries. Latin America has led the way among developing countries in the growth of the supermarket sector, with store numbers growing by 237 per cent since 1997. As a result of the recent restructuring of the retail business in the region, supermarkets account for 50 to 60 per cent of the total national food retail in many countries of the region, compared with 20 per cent in 1990. In Argentina, this share has risen to 80 per cent and in Brazil to 72 per cent. The development of supermarket chains in Asia and Africa has followed a pattern similar to that in Latin America, but with a lag. The share of supermarket chains in grocery retail is around 33 per cent in Indonesia, Malaysia and Thailand, 63 per cent in the Republic of Korea, Taiwan Province of China and the Philippines, and in urban China it has reached almost 50 per cent. In contrast, supermarket penetration in India is only 5 per cent. The most recent venue for supermarket take-off is Africa, especially Eastern and Southern Africa. In the case of South Africa, supermarket chains represent 55 per cent of total national groceries sales, while in Nigeria the figure is still only 5 per cent.[7]

17. The development of the retail grocery market in developing countries has been characterized by growing concentration at the firm level and by internationalization. The top supermarket chains are progressively taking over a larger segment of the total grocery retail market, and the share of global retailers in domestic markets has increased. In Chile, for example, the top four chains represent 46 per cent of total national grocery retailing, and for Latin America as a whole the top five chains represent 65 per cent of total sales on average. In Indonesia the top five chains have 60 per cent of the market. Mergers and acquisitions have played an important role in the growing concentration of the grocery retailing industry, together with the displacement of traditional retailing networks. The multi-nationalization of the sector is illustrated in Latin America, where global multinationals constitute 70–80 per cent of the top five chains in most countries. Carrefour is today the biggest retailer in South America with its two main markets in Brazil and Argentina, which have 96 of its 120 stores in the region. The company leads the market in both countries. Wal-Mart is the major retailer in Mexico with 40 per cent of the retail business.[8] In Thailand, global retailers control 36 per cent of the grocery market. Nevertheless, in some developing countries domestically owned chains play an important role in the market, as in China or Peru, where the largest retailers are wholly domestically owned. In some cases, domestically owned firms from developing countries have also ventured abroad, mostly to neighbouring countries, as in the case of Shoprite of South Africa, or Dairy Farm international, a Hong Kong (China), firm.

18. A case in point is supermarkets in China that have introduced modern store management and purchasing methods. While most retail procurement in China tends to be localized, supermarkets have sought to establish national distribution networks. Supermarkets have also been able to keep prices low by supplementing their sales revenues with high slotting fees paid by suppliers eager to place their products in these fashionable stores. Consequently, China's retail food sector has matured rapidly, as consumer demand for convenience and quality in food products has increased. A highly competitive food retail sector has emerged, featuring modern supermarket chains, wider choice of products and

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[7] See Reardon, et al., op.cit. Agribusiness Management Review.

[8] In Mexico Wal-Mart operates 500 Wal Mart-CIFRA stores, and also operates Almacenes Aurrera stores and supermarkets, Bodega Aurrera discount warehouse stores, Superama Supermarkets, Grand Bazar Hypermarkets, Suburbia Clothing stores and Vips restaurants.

branded items. The maturing of the retail sector in China is also beginning to affect the way food is produced at the farm level. Foreign retailers, processors and chain restaurants have sourced most of their produce and other raw materials in China, but they have had difficulty in obtaining reliable suppliers of standardized quality products from China's traditional system of small farmers geared towards producing food for home consumption. To keep pace with the demands of supermarkets, farms tend to adjust their activities by specializing in a particular commodity, consolidating fragmented land holdings to achieve scale economies, and forging stronger links with processors and retailers. Closer relationships between firms at different stages of production and marketing are emerging as larger commercialized farm operations grow produce and raise animals under contract for processors, retailers or exporters. This trend is likely to continue and may profoundly alter the way food is produced in China.[9]

19. Important developments taking place in the retail industry in developed economies – also impacting on business format in developing countries – are noteworthy in three main areas: (a) *Procurement, inventory control and on-store new technologies and management methods*, including through B2B procurement networks, such as the World Wide Retail Exchange (WWRE) formed by 59 retail industry leaders from North America, Europe, Latin America, Africa and Asia with combined sales of over US$ 845 billion[10]; (b*) online-retailing:* although this mode of retailing is at an introductory stage, grocery online sales in the United States are growing at 50 per cent rate annually; and (c) i*ntroduction of novel payment and credit systems supported by new technologies*. Retailers have become one of the major sources of consumer credit.

B. Impact on developing countries' agri-food exports

20. The effects of supermarkets on developing countries' agri-food exports are not uniformly positive or negative. On the one hand, they can increase the market size for a product, reducing barriers to entry so as to allow the participation of more suppliers and the expansion of trade, thereby increasing transaction efficiency and lowering transaction costs. On the other hand, the characteristics that the product is expected to have (e.g. safety, quality requirements, and authenticity of the production process) can decrease market size or can limit the number of suppliers participating by increasing entry barriers through raising investment requirements for participation.[11] A milder but still effective barrier is a certification requirement for an input supplier. As a result, those who are included may have a higher profit rate due to efficiency gains imposed by meeting the standards[12] and because barriers limit competition from new entrants. Investments in quality requirements can range from upgrading management skills to new equipment purchase and establishment of quality control and coordination systems.

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[9] For further information see *China Food and Agricultural Services: People's Republic of China Food Processing Sector Report 2001*, report prepared for U.S. Department of Agriculture, Foreign Agricultural Service, ATO-Shanghai, December 2001; or P. Moustakerski and L. Brabant, *People's Republic of China Retail Food Sector Report*, U.S. Department of Agriculture, Foreign Agricultural Service, GAIN Report CH1810, November 2001, *http://www.fas.usda.gov/gainfiles/200111/*.

[10] www.wwre.org for more information.

[11] See Reardon, T.J.M. Cordon, L. Busch, J. Bingen and C. Harris, "Griffon grades and standards in developing countries: Issues of inclusion and exclusion", Food and Agribusiness Management Review (in press).

[12] See M.A. Mazzocco, "HACCP as a business management tool", *American Journal of Agricultural Economics, 78* (August 1996) pp.770-4.

21. Changes in agrifood quality and safety standards will in general not be neutral in their effects on the profitability of a given sub-sector or on the relative market shares and incomes of different types of producers. For those suppliers that survive or are included, the standards can increase profits, thanks to (a) greater inter-firm efficiency in the agrifood system due to coordination benefits; (b) the greater efficiency of resource use; (c) lower transactions costs; and (d) economies of scales resulting from larger markets.

22. However, it is also recognized that these systems introduce new costs through new practices, coordination costs and investment requirements in new or modified equipment and acquisition of skills and information. The investments required might include specialized and specific assets, creating sunk costs and increasing transaction costs. There is growing evidence that the burden will be hardest to bear for small actors in the agrifood supply chains, and it can be a catalyst for concentration. Meeting standards tends to be harder for small farmers in LDCs.

23. It has been reported that in Argentina and Brazil thousands of small dairy producers were forced to exit in the past decade because of logistical and equipment requirements related to the quality and safety standards imposed by downstream actors. A similar development occurred in the Brazilian wheat products and coconut product sectors.

24. The converse of the above story of the exclusion of the small players is that the large players also sometimes suffer inefficiencies because of the necessity of internalizing phases of production due to lack of sufficient numbers of farmers with whom they can contract to supply their intermediate inputs in a way that allows them to meet standards. This was the case with supplies of fresh cuts to fast food stores in Brazil.[13] Hence, adoption and dissemination of standards as the basis for market entry conditions have unclear consequences. Independent economic studies of large distribution networks such as supermarkets divide into two schools of thought about the effects that these distribution channels can have on the competitiveness of developing countries' food exports. One sees them as a tool for improving distribution efficiency and stimulating competition and the other sees them as a tool for enhancing market power and damaging competition.[14] Box 3 contains a review of private standards.

[13] See E.M.M.Q. Farina and E.L. Machado, "Government regulation and business strategies in the Brazilian fresh fruit and vegetable market", University of São Paulo, Brazil, 1999. Also see E.M.M.Q. Farina, M.K. Marino and T.M. Guedes, "Nestlé Sucôco: Private certification in quality management", case study presented at the Maple Leaf Conference, Chicago, 2000.

[14] For further information see Food Marketing Institute, "The Journal of Marketing: Slotting allowances and fees: Schools of thought and the views of practising managers", by Paul N. Bloom, Gregory T. Gundlach and Joseph P. Cannon; Washington DC, 2002. See also "Fresh fruit and vegetable marketing: Emerging trade practices, trends and issues", Economic Research Service Report, U.S. Department of Agriculture, 2001.

Box 3. Environment and health standards

Environment- and health-related government regulations, but even more so industry standards and guidelines set by the private sector, as well as buyers' requirements, are becoming more frequent and more stringent, especially in certain key sectors of export interest to developing countries, such as food products, timber products and textiles. Examples of standards developed by large European supermarkets in the food sector are provided elsewhere in this report. In the case of certified timber products, growing demand is generated primarily from bulk buyers and retailers seeking to “green” their image and thereby gain a competitive edge. In the textiles sector, the use of private-sector eco-labels, based on life cycle analysis, and buyer’s requirements also seem to be growing. In Switzerland, MIGROS, the largest retail group, observes codes concerning social responsibility, environment and industrial safety in the textiles and clothing market. MIGROS uses eco-criteria for its 150 suppliers worldwide.

At the Expert Meeting on Environmental Requirements and International Trade (October 2002) many experts pointed out that in practice importers and buyers were often setting the standards in the market. The question was also raised about how to deal, in an intergovernmental setting, with the proliferation of voluntary, private sector standards. For voluntary standards and buyers' requirements large information gaps remained and no comprehensive clearing house mechanisms existed, at national, regional or international level.

Private sector standards and industry codes may have the effect of crowding out small and medium-sized enterprises and smallholders. In the case of certified timber products, for example, chain-of-custody monitoring obliges certified companies to adopt a tracking system that enables certifiers to trace each forest product through the process of harvesting, processing, storage and sale. Such systems have up to now clearly favoured large-scale industrial forest holdings.[1]

The Commission, at its seventh session in February 2003, recommended to "explore the possibility of the creation of a consultative group on environmental requirements and international trade”. In the preceding discussions it had been suggested that the group would place particular emphasis on voluntary environmental requirements set by the private sector and buyers. Exploratory work is being carried under a project funded by the Government of the Netherlands, which includes studies on the feasibility of covering private sector standards in early warning systems.

[1] UNECE/FAO (2002), Forest products Annual Market Review, 2001-2002.

II. Competition policy issues

A. Buyer power, oligopsony and effects upon suppliers

25. Only a minority of the rural population is connected to the global agrifood economy through contracts with agribusiness and even directly with supermarkets. At the other extreme is a world marked by the struggle for food security and survival, of livelihoods fractured into diverse mixtures of off-farm work and subsistence agriculture against a backdrop of depleting human and natural resources. In between are family farmers and landed peasants producing undifferentiated commodities with low and declining returns.

26. The position of farmers in developing countries may be made even worse by the fact that food processing industries are also undergoing rapid consolidation. The economic power of the top eight food multinationals has been compared to that of half of Africa. By 2000, Nestlé, Philip Morris and Unilever had emerged as the Big Three on global food markets. One key reason given by analysts for this accumulation of market power by food processors is the need to have more clout in the consolidating retailing environment.[15] Similarly, in the farming inputs sector, it was estimated in 1997 that 10 companies already controlled 40 per cent of global sales in commercial seed; in Asia, three multinationals controlled 70 per cent of the seed market and as a result of mergers and acquisitions the continent had effectively two competitors in the commercial corn seed market.[16] Commodity trading houses are now fewer, bigger, more diversified across the range of commodities, and more vertically integrated upstream to farmers' level and downstream into transport and processing.[17] Such dominant market leaders may make it very difficult for developing country firms to penetrate developed country markets, not only because of the inequality in strength and financial capacity for marketing, trade financing and publicity support for distributors, but also because of the much greater capacity to offer rebates and fidelity premiums to distributors, and indeed to vertically integrate distribution networks into their company. Some food processors are able to extract greater value from the food industry by controlling the seed market, and industry analysts are predicting a growth in networks and cross-ownership between food processing, retailers and the seed sector.[18] In this connection, it may be noted that the OECD secretariat has stated that there could well be situations, most likely outside the retail domain, where the notion of monopsony power would provide a good framework for investigating possible economic welfare losses occasioned by a firm enjoying a dominant position as a buyer, and that this is especially likely in cases arising in the agricultural sector where something close to monopsony power could produce a deadweight loss in producers' surplus and perhaps even, if downstream markets are insufficiently competitive, some deadweight loss as well in consumer surplus.[19]

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[15] See International Institute for Environment and Development, "The chains of agriculture: Sustainability and restructuring of agri-food markets", IIED/RING, 2001.

[16] See S. Murphy, "Market power in agricultural markets: Some issues for developing countries", South Centre, Geneva, 1999.

[17] See UNCTAD, "The impact of changing supply-and-demand structures on commodity prices and exports of major interest to developing countries", TD/B/COM.1/EM.10/2, 1999.

[18] See International Institute for Environment and Development, op. cit.

[19] See OECD, "Buying power of multiproduct retailers", DAFE/CLP(99)21, Paris 1999. Monopsony refers to situations where an enterprise is the sole buyer of a given product (as opposed to a monopoly, an equivalent situation on the seller side of the market). Monopsony power would be measured by the ability to profitably set price below competitive levels. Similar power could be enjoyed on a smaller scale by each of a small number of large buyers, namely oligopsonists.

B. Treatment of buyer power under competition policies of OECD countries

27. There is a growing list of complaints that competition authorities in OECD countries are hearing concerning the alleged abuse of retail buyer power, including demands for "unjustified" discounts or for discrimination against rival retailers, loss-leading, and shelf allowances/slotting fees/listing fees.[20] Some manufacturers say they are being forced to cave in to retailer demands because they fear being de-listed or finding their products relegated to the lowest of the low shelves in important retail chains. But such situations are not easy to tackle through competition policy, since (a) it is mainly concerned with economic efficiency and consumer welfare (although fairness issues are also taken into account in many jurisdictions); (b) the gains that retailers may make at the expense of suppliers would often be passed on to final consumers, vis-à-vis whom there may be no market power; and (c) buyer power does not necessarily result from monopsony (or even oligopsony) power and may indeed be used to counter the market power of suppliers – because of many consumers' preference for infrequent one-stop shopping, large multi-product retailers can enjoy substantial buyer power despite having retail market shares (and hence shares of manufacture sales) falling well below levels which might be considered as necessary to constitute dominant positions of market power on either the selling or the buying side.

28. There has therefore been considerable debate in developed countries over the design of appropriate competition law and policy towards buyer power, and this remains a contentious area. While United States antitrust law imposes an outright ban on the grant of preferential terms by suppliers to selected buyers,[21] many other OECD countries' laws apply an economic analysis to determine whether to prohibit such discriminatory terms in individual cases. Apart from the practice of discrimination, however, most OECD countries exercise stricter controls over buyer power than does the United States, and apply for this purpose their competition provisions relating to abuse of dominance or (in a few countries) abuse of economic dependence;[22] specific contractual terms may also be prohibited.[23] All OECD countries would have concerns where buyer power goes hand in hand with increased selling power, and thus potentially has adverse effects on consumer welfare. Some countries are also concerned that the buying power of retailers may have adverse long-term economic effects by eroding the viability and efficiency of suppliers, forcing them to reduce investment in innovation, advertising or brand building, and fostering greater concentration among them – thus reducing consumer choice. There are also concerns that unequal abilities among buyers to exercise power may distort competition and lead to the withdrawal of smaller buyers from the market. In practice, however, competition laws in OECD countries have been used to discipline abusive buyer power relatively infrequently, largely because suppliers are reluctant to complain for fear of reprisals. Some OECD countries have also shown some

[20] See OECD, op. cit.

[21] This has received considerable criticism for impeding the competition process and the development of efficient forms of distribution.

[22] Abuse of dominance may take the form of exclusionary behaviour aimed at hindering market entry or forcing the exit of actual or potential competitors through various kinds of anti-competitive conduct, or it may involve exploitative behaviour such as excessive pricing (or pricing below competitive levels). Abuse of economic dependence may arise even if there is no dominant position, where there is an unfair taking of advantage of such economic dependence.

[23] Thus, for example, in the enforcement of competition law relating to unfair trading practices, the Korean Fair Trade Commission has sanctioned Walmart Korea for unfair refusals to receive goods, unfair return of products, coercive demands for suppliers to buy its goods, reduction of prices after purchase of products, and imputing of advertising fees to suppliers. Korea Carrefour has also been sanctioned for unreasonably reducing prices for products bought from suppliers.

tolerance towards purchasing agreements among small retailers designed to match the buyer power of their large competitors, such as through co-operatives, although possible anti-competitive effects are also evaluated. One approach to the problem of buyer power has been to require supermarket chains and similar distribution networks to enter into a code of practice to be negotiated with the national competition authority.[24]

29. In the context of an OECD round table on buyer power of multiproduct retailers, it was suggested that countries concerned by buyer power should (a) use merger review to attack its roots, that is, to maintain sufficient competition both upstream and downstream, since reducing retail seller power would make buyer power lose much of its significance; (b) judiciously apply competition laws against discrimination, horizontal agreements among competitors, and resale price maintenance (taking into account that these practices may sometimes be used to counteract buyer power); and (c) take procedural steps to protect complainants.[25] On the other hand, it has been suggested that it may be inefficient and anti-competitive to try to reduce buyer power by, for example, restricting loss-leading or making it more difficult for retailers to change suppliers; criticism has also been expressed of prohibitions on abuse of economic dependence on such grounds.

III. Some indicative questions for the experts

30. The following are some of the questions that arise from the preceding discussion and that the experts may wish to address:

Retailing and distribution issues

(a) What has been and could be the impact of the spread of global retailers upon national and international distribution networks and upon the agrifood industry, textile industries and tourism?

(b) Could the growing reliance on centralized procurement systems, fewer suppliers, long-term contracts and global procurement impact on particular developing country exports, potentially marginalizing them from important markets?

(c) What are the relationships between the internationalization of major retailers and trade flows? Is there a link between the commercial presence of distribution services and the opening of markets for goods and services?

(d) Could segmentation and market niches represent a good opportunity for these producers and what are the concrete effects of the different fair-trade initiatives (such as the fair-trade principles of Max Havelaar) for developing country producers?

(e) What are the potential effects of the development of business-to-business (B2B) networks incorporating suppliers and retailers on market entry for developing country exporters?

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[24] This is the approach taken by the UK Competition Commission to address supermarket chain practices having a negative impact on the competitiveness of suppliers and considered to be against the public interest.

[25] See OECD, op. cit.

(f) How do supermarkets and producers in developing countries cooperate in supply chain management and what strategies are domestic retailers following to confront increasing competition from global retailers?

Quality, safety and environmental standards issues

(a) How could private grading and standards be used to facilitate market entry by developing countries' producers and help them retain a larger share of the total value-added generated?

(b) How significant are environmental requirements in the context of purchasing policies of supermarkets? Which sectors are targeted? What kind of environmental aspects are highlighted? Are requirements more stringent than in the case of government regulations?

Competition law and policy issues

(a) Could competition law and policy be used by developing countries to tackle problems associated with large distribution networks and, if so, (a) in which areas and (b) how should it be adapted and applied, taking into account the specific circumstances of developing countries?

(b) Is there any risk that cooperative arrangements or mergers among developing country producers aimed at boosting their bargaining power, so as to counter-balance oligopsony or buyer power of developed country enterprises, may be subjected to extraterritorial competition enforcement action by developed country competition authorities?

(c) Could enhanced cooperation among competition authorities of developed and developing countries assist in tackling problems and, if so, what could be its objectives, content and mechanisms? Would exchange of information relating to oligopsony or buyer power be feasible or useful?

Other policy issues

(a) What might be appropriate roles for Governments in this area? Could they, for example, include (a) provision to small farmers (cooperatives or firms) of adequate instruments for improving human resources and financing investment; (b) basic quality and safety standard systems; (c) encouragement of cooperation among small and medium-sized farmers and firms to overcome scale and scope barriers and human resource requirements; (d) allowing strengthening of seller power of developing country enterprises through mergers or other means; or (e) promoting group negotiations by developing country enterprises relating to supply contract terms?

(b) Are there any measures (taking into account Article IV (b) of the GATS)[26] that might be undertaken by developing and/or developed country Governments and/or private stakeholders to maximize options and benefits in terms of available export outlets and/or to promote direct contact with ultimate consumers?

(c) Should industry standards and standard-setting procedures and supermarket purchasing practices be the subject of international discussions?

(d) Where can development assistance contribute most to building up local capacities and stimulate action in these areas? What might be the appropriate roles for Governments?

[26] The paragraph provides that increasing participation of developing country Members in world trade shall be facilitated through negotiated specific commitments, by different Members pursuant to Parts III and IV of this Agreement, relating *inter alia* to the improvement of their access to distribution channels and information networks.