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**Competition Issues in the Food Chain:  
Possible Measures to Address Buyer Power in the Retail Sector  
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*I. INTRODUCTION*

Amongst all areas of retailing, food retailing stands out as having experienced the most significant changes in market structure in the last 20-30 years: supermarkets have emerged as the grocery retail channel of choice for consumers, as grocery demand has evolved towards a one-stop-shop model.

Furthermore, supermarkets' pre-eminence over traditional and specialized grocery shops has radically altered the balance of power in the grocery supply chain and it is likely to impact significantly both suppliers and consumers.

It is widely recognized that this new economic paradigm is one characterized by supermarket domination up to a point where supermarkets' listing decisions may affect the financial viability of their suppliers. Even those suppliers who are fortunate enough to be listed must adhere to the supermarkets' terms and live under the "Damocles sword" of a delisting with immediate effect. Furthermore, large supermarkets have become the fiercest competitors of their suppliers and often misuse the business secrets of their suppliers in favor of their own brands up to the point of copycatting the same packaging and presentation. In other words, supermarkets' terms force independent suppliers to 'feed' competing supermarket brands in a slow but fatal *hara-kiri* process. However, legal complaints are almost non-existent, as suppliers are afraid of upsetting their largest customers.

Traditionally, supermarkets have been portrayed as neutral traders who simply channeled consumers' demand to suppliers. Economic power and related competition problems have been considered to be abstract concepts created by businesses and economists concerned about profits and economic efficiency, respectively.

Conventional competition analysis of supermarkets' dealings with suppliers remain anchored in an old-fashioned view of supermarkets as merchants. This conventional analysis presents supermarkets as buyers of grocery products and equates buyer power with lower purchase prices. Not surprisingly, in EU competition law guidelines identify buyers/retailers as consumers. Therefore, competition policy has been designed to protect and increase retailers' business freedom and buyer power at the expense of their suppliers. Most notably, competition rules on vertical restraints are generally designed to increase intra-brand competition, a term coined to limit suppliers' business freedom (bargaining power) at the expense of distributors downstream, without much regard to the status of inter-brand competition between suppliers.

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\* This draft text is not an official final version and is being circulated unedited.

## ***II. THE NEW ECONOMIC PARADIGM: SUPERMARKET PLATFORMS***

In recent years supermarkets have emerged as powerful platforms/networks, whose listing and category management decisions influence and condition how suppliers and consumers interact with each other. Indeed, independent sources estimate that over 70% of consumers' purchase decisions of specific brands take place once they are in the store. As a consequence, supermarkets are no longer neutral traders that convey consumers' demand to suppliers and make sure that this demand is satisfied in the most efficient way. Supermarkets have realized that they hold the power to influence and even prescribe what consumers demand and how suppliers reach consumers. The retailing literature has extensively analyzed this new economic paradigm and described the extent of supermarkets' power and reflected the common wisdom in a self-explanatory war cry: "whoever owns the shelf, owns the market".

Supermarkets now provide services to both consumers and suppliers. In their dealings with suppliers, supermarkets have managed to transfer more and more of the risks of their retailing operations to them by means of remunerated service agreements, manifestly unbalanced product supply agreements and unilateral practices that disregard contractual terms and legal provisions. For example, supermarkets and their alliances may impose access fees for the right to enter or be part of the supermarkets' product listing or request distinct sizes/packages that prevent customers' price comparisons across retailers.

On top of that, independent grocery brands may be contractually forced to bear the cost of:

- Delivery to the individual stores or the provision by the supermarket of centralized delivery & warehousing services;
- In-store replenishment;
- In-store promotions and marketing activities;
- Product shrinkage;
- Consumer complaints;
- Guaranteed margins or wrong margin forecasts;
- Return of unsold items; and
- Positive credit terms enjoyed by supermarkets.

If, despite all the risk-transferring activities put in place contractually, supermarkets do not meet internal profit forecasts or want to exceed them, there is always scope for unilateral practices that extract rents from suppliers under threat of delisting. Basically, supermarkets have transformed themselves into service providers to independent grocery brands and they seek to maximize profits from access to and competition within their platforms.

In addition, it's necessary to consider that the retail grocery sector deals with the most basic human need (i.e., food) and its social implications are huge. Indeed, social concerns have led different social groups, including NGOs, to call actively for the control of the supermarkets' power and abuses, a social uprising hardly seen in any other economic sector. Without a doubt, it's critical for the economy and society to assess whether the emerging power of grocery retail giants is improving consumer welfare or rather deteriorate it by harming competition.

## ***III. MARKET STRUCTURE AND COMPETITION***

Supermarkets' power is four-fold and self-reinforcing:

- a) Food retail sector tends to be oligopolistic (few players, high market shares, transparency and full acknowledgment of their mutual interdependence), reinforced by local strongholds.
- b) Consumers tend to develop strong links with individual supermarkets (“the power of habit” according to Nielsen) and information asymmetries and switching costs ease the competitive pressure on these platforms.
- c) The business model of independent brands relies on access to as many consumers as possible in order to sustain the virtuous R+D+innovation- sales growth model and this model places them at the mercy of supermarkets: as a rule, a supermarket can easily substitute a supplier, whereas the loss of a supplier may turn around the virtuous growth cycle into a decline and market-exit spiral.
- d) Supermarkets have been vertically integrated into the food chain by producing and selling their own brands, therefore have become fierce competitors of independent grocery brands. Therefore they have a strong incentive to exploit suppliers of independent brands and expel them from the market.

Supermarkets’ anticompetitive practices have a profound impact on producers of agricultural products and the agrofood industry. Agricultural products can be impacted by such practices in different ways. If producers supply branded or unbranded goods directly to supermarkets, they can be subject to abuses regarding access fees and terms. If producers integrate vertically into industrial processing and develop commercial brands, they may also be prey to the practices described herewith. Producers will also suffer indirectly as input suppliers of the agrofood industry. The Imitation and Price Discounting model mostly adopted by supermarkets, however profitable may be for them, would not foster innovation and productivity growth by producer/suppliers, thereby leading to zero sum competition, since the latter may not make sufficient profits. This situation would eventually lead to supply of homogeneous products at infra-competitive wholesale prices. The Imitation and Price Discounting Model impedes the development of economic value in agricultural chain.

In many countries, particularly in developing countries, agriculture constitutes a crucial pillar of the economy. However, competition law and policy usually does not include provisions to tackle competition problems in the agricultural and agrofood sectors. In most, if not all, countries, the scope of competition legislation is limited to handling market concentration and seller power at the production level under abuse of dominance provisions; and does not address competition problems arising from buyer power. This prevents authorities from addressing competition problems in the food retail sector, where supermarkets engage in abusive and/or exclusionary practices using their market power vis-à-vis their suppliers. This situation will ultimately result in the suppression of the Competitive Rivalry model in favour of the Imitation and Price Discounting model. To achieve a sustainable and competitive agricultural sector, countries must address the competitive bottleneck in the food retail sector.

#### ***IV. COMPETITIVE BOTTLENECKS***

The ever-increasing power of large supermarkets has transformed them into competitive bottlenecks, as described in economic theory. Indeed, Mark Armstrong, the economist who developed the theory of competitive bottlenecks, had supermarkets in mind, as well as other sectors that have seen proactive competition/regulatory intervention (e.g., credit-card networks, computer reservation systems and mobile telephony). This theory shows that the exploitation of suppliers by supermarkets will always outweigh any potential benefit transferred to consumers from a social (producer + consumer) welfare perspective. Moreover, if consumer welfare is not only measured in terms of price but as a complex bundle of innovation, quality, variety and price, the unavoidable conclusion is that supermarkets’ abuses against suppliers of independent brands undermine both social and consumer welfare.

These practices distort access of independent brands to supermarket platforms as well as competition within these platforms. These practices have a horizontal dimension, as they not only unfairly exploit a

business partner but also, and more importantly, foreclose a competitor from the market. Access foreclosure takes place through the following practices:

- The misuse of the business secrets provided by independent brands to supermarkets in favor of the supermarket brands;
- Access fees that prevent distribution of independent brands;
- An abrupt termination of access that undermines the economic viability of the operations of independent brands; and
- An upfront access refusal of the independent brands' products and innovations that compete with supermarket brands.

Market foreclosure may also take place through pricing and non-pricing practices that distort in-store competition between supermarket brands and independent brands. Even though supermarkets are able to transfer most, if not all, retail risks to suppliers and often operate de facto as providers of remunerated services to them, they have not formally foregone their "retailer" or "merchant" role (i.e., purchase for resale to consumers bearing all the associated risks), as far as it affords them competitive advantages such as the control of the retail price of independent grocery brands.

1. Pricing power may undermine an independent brand's value proposition to consumers through:

- An artificial price gap between the targeted independent brand and the supermarket brand;
- A loss-leading price of the independent brand that undermines its quality perception;
- A refusal to pass-through promotional wholesale prices of independent brands to their retail prices; and
- A prohibition of the on-package promotions carried out by the independent brands.

2. Non-pricing practices may also be used to distort the consumer's in-store choice through:

- degradation of the in-store services provided to independent brands;
- switch marketing techniques in favor of supermarket brands;
- better shelf-positioning of the supermarket brands or disproportionate space allocation; and
- copycat packaging by supermarket brands of targeted competitors.

In order to address these unfair and exclusionary commercial practices, competition law and regulatory remedies may be adopted as necessary.

## ***V. SOME RECOMMENDATIONS TO ADDRESS COMPETITION PROBLEMS IN THE FOOD RETAIL SECTOR***

### ***A. COMPETITION LAW REMEDIES***

Several factors point towards the need to supplement competition law and policy with economic regulation of the food retail sector:

1. In developed economies, the retail market structure is not likely to become more competitive in the foreseeable future. On the contrary, retail market concentration is growing and the possibility for new entry or growth of small players is vanishing.

2. Competition bottlenecks may be better dealt with under an ex ante regulatory regime than under competition rules.
3. Supermarkets' anticompetitive practices are widespread, simultaneous and multifaceted, pointing to a structural market failure.
4. Supermarkets' vertical integration and foreclosure practices place the old vertical relationships between grocery brands and supermarkets in a new horizontal dimension: a non-reciprocal commercialization agreement with a competitor, whose brand competes head-on with independent brands in the store.
5. For many years, competition law and policy enforcement has been biased against manufacturers (sellers) and in favour of retailers. Supermarkets have benefited from an asymmetric competition regime (e.g., prohibition of resale price maintenance) for many years. It would only be fair that their anticompetitive practices are banned upfront and expeditiously through economic regulation.
6. Public intervention in other sectors witnessing competitive bottlenecks suggests that economic regulation is a necessary complement to competition rules. Indeed, preventive regulatory intervention against the threat of anticompetitive practices, despite the absence of single-firm dominance, has been the remedy chosen in other sectors, including computer reservation systems (CRSs), interconnection between mobile telecommunications networks, provision of Internet access, and Internet domain name registration.
7. Supermarkets' power has enabled them to bundle two business models in order to benefit from their respective advantages: they de facto behave as service providers vis-à-vis independent grocery brands whilst controlling retail competition through their formal role of merchants.

For instance, the current EU competition law, under Articles 101 and 102 of the TFEU, does not take into consideration competitive bottleneck issues in the food chain. Commission's Guidelines on vertical agreements (Vertical Guidelines) have dealt with access fees, category captains and foreclosure of independent brands but have not come up with any practical solution and yet consider that supermarkets are not competitors of independent brands when they source their own brands. Intervention under Article 102 TFEU has also failed since intervention is only considered if single-firm dominance is found, based on very high market shares and a significant market share gap with competitors.

In light of the specific features of the grocery retailing and its economic and social importance, it is necessary to do a holistic supervision of the supermarket practices governing access to the store and in-store competition. This may be accomplished by a sector-specific block exemption regulation and/or Guidelines. This solution would facilitate the definition of hard-core practices between manufacturers and retailers that are anti-competitive per se irrespective of the market share of the companies involved (e.g., misuse of sensitive commercial information) and would provide guidelines regarding competition analysis of most common practices.

Furthermore, the interpretation of "abuse of dominance" provisions of competition laws should take into account the particularities of competitive bottlenecks, which have prompted competition authorities to

(a) protect business customers of the bottlenecks as much as the end-consumers (e.g., advertisers in media platforms; merchants in card payment networks ; content providers in network neutrality issues);

(b) apply narrower market definitions (e.g., call termination on each operator's network in mobile communication networks or aftermarket in the motor-vehicle sector); and/or

(c) show greater readiness to find market power/dominance. One suggestion is the possibility for relevant authorities to propose different options, including narrower market-definitions of dominance; lower dominance thresholds (e.g., 20%, as in the Rewe/Meinl Decision of the European Commission) and the application of remedies in local/regional markets where dominance is found.

## ***B. REGULATORY REMEDIES***

The need to supplement competition law and policy enforcement with regulation in the grocery retailing in order to tackle unfair/exclusionary practices is becoming increasingly evident. Authorities have acknowledged that buyer power and competition bottlenecks are better dealt with under an ex ante regulatory regime; competition law and policy enforcement has been biased against manufacturers/sellers and in favour of retailers (e.g., prohibition of resale price maintenance); and economic regulation may also take into account other policies worth of protection such as agricultural policy.

The regulatory remedies may be directed:

- to ban unfair/exclusionary practices regarding access to supermarkets and in-store competition with supermarket brands;
- to order the separation of supermarket and supermarket brand activities; and
- to be enforced by an independent authority with sufficient powers to investigate and impose fines .

For instance, the EU regulatory experience with competitive bottlenecks in other sectors such as CRSs could serve as an example. The EU Regulation 2299/89 puts in place regulatory remedies regarding access to CRSs; competition within each CRS; legal and functional separation between CRSs and their parent airline carriers; and effective guidance and enforcement by the Commission with the help of independent auditors.

In this context, the following suggestions for regulation of food retail sector might be considered to deal with anti-competitive practices in this sector:

### 1. Access to supermarkets and in-store competition

i. Access to the supermarkets should be granted on "fair, reasonable, and non-discriminatory" (FRAND) terms. The principle of fairness requires that the supply agreements:

- are written;
- cover at least the most important elements of the contractual relationship; and
- provide for balanced rights and obligations on both sides.

ii. Furthermore, the terms of delivery should be regulated (e.g., a fair dispute resolution mechanism and proportionate penalties).

iii. Supermarkets must not transfer to independent brands the risks of activities falling within their retailer function. For example, supermarkets should bear the cost of shrinkage, wastage and customer complaints (unless the supermarket is legally entitled to a compensatory action before the supplier).

iv. Public authorities should also evaluate whether access fees should be regulated, i.e., subject to a test of proportionality and due consideration, or prohibited altogether. Several arguments favor an upfront prohibition or limitation of access fees in the retail business model (experts have referred to supermarkets' shelf space as "the most expensive real estate in the world"). Experience shows that the prohibition of unjustified/disproportionate fees for services rendered is useless.

v. The principle of non-discriminatory access might come to play once the supermarket has decided its assortment strategy ("light non-discrimination") or it may be extended to the listing criteria used to select the listed grocery brand(s) ("pure non-discrimination). The light non-discrimination obligation would simply ensure that the listed independent brands are not discriminated in terms of access (e.g., access fees levied only on independent brands). Public authorities might impose the light non-discrimination obligation or the pure non-discrimination one according to the market-size of the supermarket concerned

(e.g., leading supermarkets would be subject to the pure non-discrimination obligation). In certain sectors such as CRSs, regulations have even mandated open access to a facility, subject to capacity/technical constraints. Certainly, an unrestricted access obligation would be more difficult to enforce in the grocery retail business, in light of the ever-changing features of the grocery categories and segments. However, this difficulty may be overcome by fixing a minimum number of competing brands in specified categories (e.g.: The European Commission has accepted this kind of remedy in the Microsoft case and seems inclined to accept it in the Google case).

vi. In-store competition between supermarket brands and independent brands should be governed by FRAND principles to ensure access of independent brands to supermarket platforms on equitable terms.

vii. In the field of non-pricing competition, the enforcement of these principles should be straightforward in respect of practices such as degradation of in-store services, switch marketing and allocation of preferential shelf-space. Furthermore, it may be necessary to introduce a specific provision against copycats in this sector, in light of the dual role played by supermarkets.

viii. In the field of pricing competition, a fair dealing and non-discrimination obligation may apply to wholesale promotional prices and retail promotions (which should be reflected accordingly in the retail prices of the independent brands). Competition authorities have also identified artificial retail price gaps between leading independent brands and supermarket brands (i.e., higher retail margins on the former cross-subsidize the latter) in recent market investigations in Spain, France and Finland.

A regulatory remedy against this practice could provide that supermarkets may not earn higher retail margins on independent grocery brands than they do on their own brands. Finally, even though brand-destruction through loss-leading retail prices has never been a concern for competition authorities, which were more focused on static intra-brand price competition than on dynamic inter-brand competition, it should now be treated as an exclusionary practice.

Considering the implications for competition of supermarkets' unfair pricing practices vis-à-vis independent brands, especially in cases where supermarkets are vertically integrated and have an incentive to force competitors to exit the market, authorities may consider the option of not prohibiting resale price maintenance in certain cases.

FRAND principles regarding access to supermarkets and in-store competition may be applied more easily if the boundaries between different roles of supermarkets, that is, as service providers where they charge access fees and provide all sorts of remunerated services and as retailers (merchants) who purchase goods and control all aspects of their resale, could be separated. This could be done by prohibition of access fees if supermarkets retain their retailer role. Currently, leading supermarkets essentially forego their role of retailers by contractually and/or unilaterally transfer retail risks to suppliers (including guaranteed margins and retroactive payments/deductions to meet margin forecasts). In order to respond to this market failure, public authorities could consider confining the role of supermarkets to that of a service provider, similar to a market-place/shopping mall where grocery brands pay upfront and/or variable fees to gain access to the distribution services and can interact with shoppers directly or through agency agreements with supermarkets. Supermarkets as service providers may auction their shelf-space and associated in-store services.

## 2. Separation of independent brands from supermarkets' sales activities

In order to ensure equitable access by independent brands to supermarkets and fair in-store competition with supermarket brands, there is need for supermarkets to keep separate accounts for sales of their own brands and independent brands. Moreover, in order to protect and maintain innovative efforts of

independent brands, appropriate mechanisms should be put in place for supermarkets not to misuse confidential information received from independent brands.

### 3. Independent regulatory authority

Regulation of food retail sector should be done by an independent authority with ex officio investigatory and fining powers. This responsibility could be given either to a newly created public authority vested with sufficient regulatory powers or to an existing body such as the competition authority. In case this sector will be regulated by a newly created authority, the latter should be given sufficient powers to issue interpretative guidelines and regulations; settle/arbitrate bilateral disputes; open infringement proceedings either ex officio or following complaints received from affected parties or their representative associations; and impose remedies and fines. The Groceries Code Adjudicator in the United Kingdom is a good example. It is an independent adjudicator which oversees the relationship between supermarkets and their suppliers to ensure that large supermarkets treat their direct suppliers lawfully and fairly; investigates complaints and arbitrates in disputes.<sup>1</sup> Another useful example is the new law Spanish Law on Measures to Improve the Functioning of the Food Chain (*Ley 12/2013, de 2 de agosto, de medidas para mejorar el funcionamiento de la cadena alimentaria*). Furthermore, since vertical integration of supermarket and grocery brand activities and the supermarkets' control over in-store competition under the retail business model raises significant competition problems, public authorities could also consider establishing an audit mechanism such as the one put in place by the EU Regulation 2299/89. This Regulation aims at ensuring fair competition between air carriers and between computerized reservation systems, in order to protect the interests of consumers.

## VI. CONCLUSION

The retail sector is an important part of the food chain industry. Considering the dominant role of supermarkets in the distribution of food products to final consumers, fair competition in the food retail sector is crucial to ensure producers'/suppliers' equitable access to the distribution chain. The current situation where supermarkets impose unfair sales prices and/or terms to suppliers, adversely affects not only suppliers but also consumers with respect to product prices and choice. Regulation of food retail sector could remedy this situation and promote fair competition in the market to the eventual benefit of consumers. Such a solution might also contribute to agricultural policy by ensuring fair commercial terms for agricultural producers.

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<sup>1</sup> <https://www.gov.uk/government/organisations/groceries-code-adjudicator>

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