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# LATIN AMERICAN COMPETITION FORUM

## Session I - Structural Issues in the Groceries Sector: Merger and Regulatory Issues

## -- Background paper by the OECD Secretariat --

**23-24 September 2015, Montego Bay, Jamaica**

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*The opinions expressed and arguments employed herein do not necessarily reflect the official views of the Organisation or of the governments of its member countries.*

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**LATIN AMERICAN** COMPETITION FORUM

23-24 September 2015 • Montego Bay • Jamaica

**Session I – Structural Issues in the Groceries Sector: Mergers and Regulatory Issues**

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# RETAIL STRUCTURE AND COMPETITION ASSESSMENT WITH APPLICATION TO LATIN AMERICA AND THE CARIBBEAN

**-- BACKGROUND PAPER BY THE OECD SECRETARIAT[*] --**

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# 1. Introduction

## *1.1 Retail innovation and efficiency*

1. Retailing is central to economic activity, as the source from which consumers buy the goods they need and the route by which producers distribute their goods to these consumers. The sector's economic importance has grown over time as disposable incomes have risen and consumers' appetite to spend more on goods has grown. This increased demand has spurred considerable innovation and structural change in the sector, as new forms of retailers have emerged. In particular, the retail landscape has been transformed in many countries by the rise of large format "big-box" stores and hypermarkets in retail parks and locations away from town and city centres and the increasing domination of large multiple chain-stores promoting a common retail brand identity as a challenge to traditional, independent retailers. At the same time, improved information technology and sophisticated logistics systems allowing for continuous replenishment and re-stocking have provided the opportunity to revolutionise efficiency in the industry with quick-response and just-in-time systems promoting much greater integration and connectivity across supply chains. Certainly, different countries and regions have proceeded at different paces in terms of seeing such changes take place, but the spread and diffusion of these innovations and efficiency enhancements is taking place on a global scale.

## *1.2 Retailing in the public eye*

2. Perhaps nowhere more has the profound changes in retailing been witnessed than in the retail grocery sector, where large format supermarkets and hypermarkets have emerged in most countries to provide a "one-stop-shopping" service catering for all (or most of) consumers' food purchasing needs as well as increasingly providing wide selections of non-food items, and as a consequence taking an increase share of consumers' total expenditure on retail goods. Not surprisingly then, for consumers, the levels of prices, choice, quality and innovation they face, in respect of the goods and service provided by these supermarkets and the other retailers they rely upon for most of their other retail purchases, take on considerable importance. Weak or ineffective competition in the sector has the potential for causing significant consumer welfare loss in absolute terms. As such, this is then a sector constantly in the public eye and in which any industry-led developments or regulation-led impediments that might lessen competition or consumer welfare should be subject to close scrutiny.

## *1.3 Emerging oligopoly structures*

3. In grocery retailing, along with many other areas of retailing, chain-store retailers (known as "multiples") operating a number of stores under a common retailer banner have become increasingly prevalent and have grown at the expense of a diminishing, if still important, independent retail sector. As the retail sector has consolidated then typically a limited number of major retailers have emerged to lead if not dominate key retail segments. Hence, over time, oligopoly structures have then emerged in retailing to replace once highly fragmented structures. In the process, these retailers may not just have gained *seller power* over consumers but also *buyer power* over suppliers. This means that any competitive assessment of retailing will need to consider how these two forms of power can interact and how they may individually and in combination affect competition at successive stages of supply chains. It is this relationship between retailer buyer and seller power that is the main theme of this paper in seeking to understand the dynamic process through which retailing is going and the direction it is heading and how it might be affected by regulation. This dynamic aspect is important because of the rapid pace through which retailing can develop and how competition policy and regulatory decisions today can affect the path the industry will be taking and how this will affect market outcomes and the economic welfare of consumers and the firms involved in all stages of supply chains.

### *1.4 Paper outline and organisation*

4. As with any short summary paper, it is not possible to cover in detail the myriad of competition issues thrown up by the rapid developments taking place in retailing in terms of the changing market structure and conduct of the firms involved. Instead, this paper will begin by considering how retail developments are taking place in Latin America and the Caribbean and how they might shape the future of competition in the retail sector. This will provide important context for addressing competition assessment in retailing, whether it is the context of a merger inquiry, an inquest about specific actions or forms of behaviour, or a full-blown market investigation, and also consider how competition can be affected by regulation.

### *1.5 Key questions to be addressed*

5. As a way of organising the material for this paper, the paper proceeds by addressing five questions, building on each other to examine different aspects of structural and regulatory issues in retailing:

1. What is the composition and structure of retailing in Latin America and the Caribbean?
2. How should retail markets be defined?
3. Is higher retail concentration inevitable and is that good or bad for consumers?
4. Is retailer dominance over suppliers good or bad for economic welfare?
5. How can regulation work to promote rather than impede effective competition in retailing?

6. In addressing these questions, insights and details will be drawn from across a variety of retail sectors, but the key insights will relate to the retail grocery sector, because it both the largest and therefore most economically important retail segment and also it is the one that has received the greatest attention from competition authorities so there is now a growing body of case insights and lessons to draw on.

7. Necessarily, the discussion will be limited to the key points, but there will be suggestions for further reading for both the relevant academic literature as well as the different market studies, commentaries and guidance that has emerged from competition authorities and international agencies in the last few years to help competition authority officials undertake economic assessments applied to the retail sector.[1]

[1] In particular, Kobel et al. (2015) provide a detailed multi-country perspective on antitrust issues in the groceries sector, with separate chapters covering individual countries, including a chapter on Brazil, and a useful introduction chapter to provide a thorough overview across all the countries studied. In addition, in respect of Latin America, Basker and Noel (2013) provide a very useful summary of the key developments taking place in grocery retailing and the relevant antitrust and competition assessment issues.

## 2. What is the composition and structure of retailing in Latin America and the Caribbean?

### *2.1 Retail diversity*

8. As a large continent and major world region, made up of many differently sized countries at different stages economic development, it is not surprising that the structure and character of retailing is diverse across Latin America and the Caribbean. In some countries, modern grocery distribution has advanced and commands a large share of the retail grocery trade. Yet, in most countries in the region, the traditional, independent retail sector is still prevalent and accounts for a large share of retail sales.

### *2.2 Retail sales at country level*

9. To give some indication of the diversity in retailing across the continent, Table 1 provides details of the retail sales at country level in respect of all formats of retailers, compared with sales for food retailers in general along with that designated as being through modern grocery distributors.[2] As the sizes of the populations for each of these countries vary very considerably across the region, the table also provides the same sales figures expressed on a per capita basis (measured in US Dollars) to allow for comparisons to be made in terms of consumer spend from one country to another. However, the figures are estimated values and might be dependent on the manner in which sales are defined and recorded in different countries, and so making reliable inter-country comparisons difficult. Nonetheless, the table does indicate that for many countries, modern grocery distribution still only accounts for around one-quarter to one-third of all retail sales and to about half to two-thirds of food retailer sales, but with significant variation around these averages across the countries listed in the table. Furthermore, it is noticeable that the Caribbean countries on average have higher per capita sales, especially through modern grocery distribution, than on average for continental Latin American countries, which is strongly reflected in differences of GDP per capita (as shown in the last column) but could also be attributable to different consumer spending patterns on food and also the availability and diffusion of modern grocery distributors in each of the listed countries.[3]

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2 Planet Retail, as the source of the data for Table 1, defines MGD sales to cover sales (including VAT or sales tax) for modern grocery distribution retailers and wholesale enterprises. In respect of grocery sales, these relate to total sales of edible grocery, household and pet care, health and beauty and foodservice.

3 The correlation coefficient between GDP per capita and MGD total sales and grocery sales per capita across all these countries is respectively 0.976 and 0.977, while the correlation coefficient between GDP per capita and total and food retail format sales per capita is respectively 0.955 and 0.841, indicating that modern grocery distribution sales and total retail format sales are very closely aligned with GDP but that there is slightly more variation when it comes to food retail format sales and GDP.

**Table 1. Retail Sales in Latin America and the Caribbean**

| Country | Total retail format national sales (US $m) | Food retail format national sales (US $m) | MGD total sales (US $m) | MGD grocery sales (US $m) | Total retail format sales /capita (US$) | Food retail format sales/capita (US$) | MGD total sales/capita (US$) | MGD grocery sales/capita (US$) | GDP per capita (US$) |
|---|---|---|---|---|---|---|---|---|---|
| Antigua and Barbuda | 311 | 139 | 137 | 106 | 3,494 | 1,560 | 1,538 | 1,190 | 14,462 |
| Argentina | 121,383 | 50,564 | 31,678 | 25,474 | 2,861 | 1,192 | 747 | 600 | 13,115 |
| Aruba | 600 | 225 | 307 | 226 | 8,098 | 3,030 | 4,138 | 3,049 | 49,876 |
| Bahamas | 2,131 | 809 | 667 | 579 | 5,854 | 2,222 | 1,831 | 1,590 | 25,350 |
| Barbados | 1,367 | 570 | 641 | 487 | 4,883 | 2,037 | 2,288 | 1,739 | 15,866 |
| Belize | 612 | 315 | 225 | 178 | 1,682 | 865 | 617 | 490 | 4,920 |
| Bermuda | 1,794 | 538 | 1,034 | 714 | 26,113 | 7,834 | 15,045 | 10,390 | 145,548 |
| Bolivia | 14,243 | 8,506 | 2,369 | 2,112 | 1,243 | 742 | 207 | 184 | 3,110 |
| Brazil | 487,882 | 245,975 | 213,910 | 173,685 | 2,386 | 1,203 | 1,046 | 850 | 9,349 |
| Chile | 87,293 | 41,201 | 44,460 | 30,637 | 4,848 | 2,288 | 2,469 | 1,702 | 13,737 |
| Colombia | 97,431 | 47,459 | 23,020 | 18,879 | 2,021 | 984 | 478 | 392 | 6,504 |
| Costa Rica | 16,579 | 7,844 | 5,073 | 4,205 | 3,428 | 1,622 | 1,049 | 869 | 11,562 |
| Cuba | 30,570 | 17,542 | 10,100 | 8,017 | 2,631 | 1,510 | 869 | 690 | 8,471 |
| Dominica | 167 | 82 | 65 | 52 | 2,349 | 1,159 | 918 | 729 | 7,560 |
| Dominican Republic | 30,178 | 15,569 | 10,688 | 8,036 | 2,796 | 1,443 | 990 | 745 | 6,187 |
| Ecuador | 40,282 | 24,027 | 11,793 | 9,361 | 2,474 | 1,476 | 724 | 575 | 6,306 |
| El Salvador | 12,278 | 6,468 | 4,153 | 3,326 | 1,925 | 1,014 | 651 | 522 | 4,101 |
| French Guiana | 940 | 419 | 396 | 305 | 4,102 | 1,831 | 1,728 | 1,330 | 20,894 |
| Grenada | 344 | 163 | 134 | 105 | 3,242 | 1,539 | 1,268 | 990 | 8,359 |
| Guadeloupe | 3,030 | 1,257 | 1,012 | 869 | 6,257 | 2,596 | 2,090 | 1,794 | 26,039 |
| Guatemala | 30,539 | 16,830 | 9,437 | 7,482 | 1,877 | 1,035 | 580 | 460 | 4,104 |
| Guyana | 1,813 | 1,021 | 526 | 418 | 2,261 | 1,273 | 656 | 521 | 4,307 |
| Haiti | 6,638 | 4,388 | 1,327 | 1,081 | 626 | 414 | 125 | 102 | 865 |
| Honduras | 10,064 | 5,984 | 1,863 | 1,615 | 1,193 | 710 | 221 | 192 | 2,443 |
| Jamaica | 6,061 | 2,916 | 2,229 | 1,698 | 2,154 | 1,036 | 792 | 603 | 5,148 |
| Martinique | 3,240 | 1,327 | 2,439 | 1,762 | 7,054 | 2,890 | 5,311 | 3,836 | 29,949 |
| Mexico | 382,173 | 178,138 | 201,490 | 154,787 | 3,156 | 1,471 | 1,664 | 1,278 | 9,651 |
| Netherlands Antilles | 1,101 | 465 | 500 | 380 | 4,661 | 1,969 | 2,119 | 1,610 | 21,100 |
| Nicaragua | 4,867 | 3,042 | 1,210 | 973 | 772 | 483 | 192 | 154 | 2,025 |
| Panama | 11,222 | 5,618 | 3,207 | 2,793 | 2,801 | 1,402 | 800 | 697 | 11,852 |
| Paraguay | 11,484 | 6,578 | 3,135 | 2,490 | 1,637 | 937 | 447 | 355 | 4,112 |
| Peru | 70,779 | 41,162 | 21,539 | 17,210 | 2,218 | 1,290 | 675 | 539 | 6,117 |
| Puerto Rico | 26,782 | 12,102 | 10,578 | 8,257 | 6,628 | 2,995 | 2,618 | 2,044 | 25,815 |
| St Kitts and Nevis | 285 | 134 | 128 | 97 | 4,677 | 2,191 | 2,100 | 1,586 | 14,648 |
| St Lucia | 437 | 224 | 168 | 133 | 2,558 | 1,312 | 983 | 777 | 8,284 |
| St Vincent and the Grenadines | 343 | 177 | 132 | 103 | 3,115 | 1,607 | 1,201 | 938 | 6,926 |
| Suriname | 1,356 | 878 | 459 | 358 | 2,430 | 1,573 | 823 | 642 | 10,133 |
| Trinidad and Tobago | 8,598 | 4,252 | 3,361 | 2,566 | 6,331 | 3,131 | 2,475 | 1,890 | 22,154 |
| Uruguay | 21,737 | 9,697 | 6,564 | 5,337 | 6,363 | 2,839 | 1,921 | 1,562 | 15,763 |
| Venezuela | 367,725 | 194,568 | 61,118 | 49,935 | 11,888 | 6,290 | 1,976 | 1,614 | 23,870 |
| TOTAL | 1,916,659 | 959,173 | 693,272 | 546,828 | - | - | - | - | - |
| AVERAGE (unweighted) | 47,916 | 23,979 | 17,332 | 13,671 | 4,177 | 1,875 | 1,709 | 1,296 | 15,765 |

Source: Author's analysis based on data sourced from Planet Retail (http://www.planetretail.net)

### *2.3 Retail channels' share of trade*

10. In terms of how sales vary across the retail channels in Latin America compared to other world regions, Table 2 provides a breakdown by the key retail channels for retail grocery sales in percentage terms.[4] Here, it is noticeable that traditional retailing still maintains a substantial share of sales, holding almost a quarter of sales which matches the combined share held by large supermarkets and hypermarkets. Moreover, with bars and kiosks also being important, in holding 11% of sales, it is evident that small outlets predominate in the region. All five world regions illustrated in the table display differences, but the contrast with the domination of large format stores in North America and Europe is very distinct from Latin America, and different again from the Africa/Middle East and Asia-Pacific regions.

**Table 2. Percent Share of Trade by Retail Channel for World Regions**

| | Latin America | North America | Europe | Asia/Pacific | Africa & Middle East |
|---|---|---|---|---|---|
| Large Supermarket | 13 | 41 | 25 | 11 | 33 |
| Hypermarket | 11 | 32 | 24 | 18 | 1 |
| Traditional | 24 | - | 8 | 38 | 42 |
| Convenience | 1 | 20 | 6 | 7 | 4 |
| Small Supermarket | 18 | - | 17 | 12 | 5 |
| Drug Store | 9 | 7 | 4 | 5 | 6 |
| Hard Discounter | - | 1 | 11 | - | - |
| Bar | 5 | - | - | 2 | 4 |
| Kiosk | 6 | - | 1 | 1 | 1 |
| Specialty | - | - | 1 | - | - |
| Other | 4 | - | 4 | 7 | 4 |

Source: Based on information adapted from Nielsen (2015)

### *2.4 Leading grocery retailers in Latin America*

11. On a continental basis, the retail grocery sector remains quite fragmented, even though at the country level market concentration can be significant. At present, the leading grocery retailers only command a small share of the total grocery sales across the entire region when put into the context that total food retail sales are close to US$960 billion and modern grocery distribution sales are around US$690 billion (based on the totals given in Table 1). However, as Table 3 shows in terms of the leading grocery retailers in Latin America, five retailers are now generating annual sales in excess of $15bn across all their different store formats and seem set to grow quickly over the next few years. For all twenty retailers, their sales are forecast to rise from $225bn to $300bn over that period, and currently they appear to be near to accounting for a quarter of all food retail format sales and a third of all modern grocery distribution sales across the entire region.

4 Latin America sales in Table 2 relate to sales in Argentina, Brazil, Chile, Columbia, Mexico, Peru and Venezuela.

**Table 3. Top 20 Grocery Retailers in Latin America**

| Rank | Retail Company (nationality) | Company Outlets 2013 (estimates) | Banner Sales 2013 (estimates) (US$m) | Banner Sales 2018 (forecast) (US$m) |
|---|---|---|---|---|
| 1 | Walmart (USA) | 4,284 | 60,428 | 78,502 |
| 2 | Casino (France) | 2,395 | 37,687 | 54,224 |
| 3 | Cencosud (Chile) | 1,325 | 24,403 | 28,256 |
| 4 | Carrefour (France) | 763 | 21,127 | 28,566 |
| 5 | Falabella (Chile) | 531 | 15,521 | 22,655 |
| 6 | Soriana (Mexico) | 815 | 8,648 | 10,432 |
| 7 | OXXO (Mexico) | 12,528 | 7,762 | 11,973 |
| 8 | Lojas Americanas (Brazil) | 856 | 7,173 | 12,246 |
| 9 | SHV Makro (Germany) | 186 | 6,838 | 9,246 |
| 10 | SMU (Chile) | 737 | 5,288 | 4,616 |
| 11 | Chedraui (Mexico) | 211 | 4,252 | 5,414 |
| 12 | Dia (Spain) | 1,310 | 3,919 | 6,877 |
| 13 | Comercial Mexicana (Mexico) | 268 | 3,909 | 5,078 |
| 14 | Costco (USA) | 37 | 3,569 | 4,314 |
| 15 | Coto (Argentina) | 117 | 3,384 | 2,729 |
| 16 | Safeway (USA) | 206 | 2,618 | 3,273 |
| 17 | La Anónima (Argentina) | 141 | 2,410 | 2,000 |
| 18 | Olimpica (Columbia) | 334 | 2,403 | 3,108 |
| 19 | PriceSmart (USA) | 30 | 2,287 | 3,568 |
| 20 | Corporación Favorita (Ecuador) | 145 | 1,888 | 2,788 |
| | *Top 20 TOTAL* | *27,219* | *225,514* | *299,865* |

Source: Based on information adapted from Planet Retail (2014) and http://www.planetretail.net

## *2.5 Range of leading retail banners*

12. Taking a broader look at all retail sectors, it is evident that a mix of domestic and international retailers have been growing sales in different sub-sectors of retailing, and related retail service areas including food service and fast food chains. To give an indication of this broad mix, Table 4 provides a ranking of the top 50 retail banners (i.e. retail names) covering the entire region of Latin America and the Caribbean. This shows the total sales for the retail banner as well as the banner's grocery sales (if appropriate to that retailer). In addition, the share of sales for each of these banners is shown (expressed in percentage terms from all 441 retail banners recorded by *Planet Ret*ail as having sales for this world region). Spanning the entire region, it is not uncommon for the larger international retailers to use different retail banners for different countries or combinations of countries, as well as for different retail formats.[5] Accordingly, the influence of these retailers extends beyond individual banners and it is the combination of the banners that represents the true scale of the retailer and the potential to exert market power over both consumers, through the choice of different outlets available, and suppliers, through the alternative routes to final consumers for their goods.

5 For instance, in reference to the different leading retailers listed in Table 3, Walmart has operated with 16 distinct banners and formats, Carrefour with 7, Casino with 19, Cencosud with 10, Soriana with 5, OXXO with 2 and SHV Makro with 3 across Latin America – see details in Agriculture and Agri-Food Canada (2012).

**Table 4. Top 50 Retail Banners in Latin America and the Caribbean (2015f)**

| Rank by Total Banner Sales | Retail Banner | Total Banner Sales (US$m) | MGD grocery banner sales (US$m) | Share of Total Banner Sales % | Share of MGD Grocery Banner Sales % | MGD total market share % |
|---|---|---|---|---|---|---|
| 1 | Walmart Supercenter | 14,682 | 10,183 | 4.69 | 6.22 | 2.12 |
| 2 | Carrefour | 8,870 | 6,159 | 2.83 | 3.76 | 1.26 |
| 3 | Sam's Club | 8,576 | 4,859 | 2.74 | 2.97 | 1.24 |
| 4 | Atacadão | 8,013 | 5,713 | 2.56 | 3.49 | 1.16 |
| 5 | Bodega Aurrerá | 7,869 | 2,556 | 2.51 | 1.56 | 1.13 |
| 6 | OXXO | 7,516 | 7,115 | 2.40 | 4.35 | 1.08 |
| 7 | Coppel | 7,004 | - | 2.24 | - | - |
| 8 | Casas Bahia | 6,886 | - | 2.20 | - | - |
| 9 | Makro | 5,961 | 4,229 | 1.90 | 2.58 | 0.86 |
| 10 | Jumbo | 5,063 | 3,445 | 1.62 | 2.10 | 0.73 |
| 11 | Liverpool | 4,954 | - | 1.58 | - | - |
| 12 | Extra Hipermercado | 4,801 | 3,685 | 1.53 | 2.25 | 0.69 |
| 13 | Dia | 4,452 | 4,022 | 1.42 | 2.46 | 0.64 |
| 14 | Soriana Hiper | 4,286 | 2,992 | 1.37 | 1.83 | 0.62 |
| 15 | Homecenter Sodimac | 4,250 | - | 1.36 | - | - |
| 16 | McDonald's | 4,226 | - | 1.35 | - | - |
| 17 | Costco | 4,213 | 2,431 | 1.35 | 1.48 | 0.61 |
| 18 | Lider | 4,118 | 2,622 | 1.32 | 1.60 | 0.59 |
| 19 | O Boticário | 4,009 | 3,739 | 1.28 | 2.28 | 0.58 |
| 20 | Falabella | 3,865 | - | 1.23 | - | - |
| 21 | Assai | 3,659 | 2,609 | 1.17 | 1.59 | 0.53 |
| 22 | Disco | 3,645 | 3,312 | 1.16 | 2.02 | 0.53 |
| 23 | B2W Digital | 3,603 | - | 1.15 | - | - |
| 24 | Chedraui | 3,380 | 2,360 | 1.08 | 1.44 | 0.49 |
| 25 | Exito | 3,348 | 2,103 | 1.07 | 1.28 | 0.48 |
| 26 | Magazine Luiza | 3,330 | - | 1.06 | - | - |
| 27 | Casa Ley | 2,968 | 2,121 | 0.95 | 1.30 | 0.43 |
| 28 | PriceSmart | 2,962 | 1,646 | 0.95 | 1.01 | 0.43 |
| 29 | Cnova | 2,862 | - | 0.91 | - | - |
| 30 | Lojas Americanas | 2,807 | 1,022 | 0.90 | 0.62 | 0.40 |
| 31 | Home Depot (The) | 2,800 | - | 0.89 | - | - |
| 32 | Pernambucanas | 2,668 | - | 0.85 | - | - |
| 33 | Santa Isabel | 2,530 | 2,316 | 0.81 | 1.41 | 0.36 |
| 34 | Drogasil | 2,488 | 2,258 | 0.79 | 1.38 | 0.36 |
| 35 | Unimarc | 2,484 | 2,483 | 0.79 | 1.52 | 0.36 |
| 36 | SuperFarmacia | 2,452 | 2,079 | 0.78 | 1.27 | 0.35 |
| 37 | Easy | 2,403 | - | 0.77 | - | - |
| 38 | Pão de Açúcar | 2,372 | 2,200 | 0.76 | 1.34 | 0.34 |

| Rank by Total Banner Sales | Retail Banner | Total Banner Sales (US$m) | MGD grocery banner sales (US$m) | Share of Total Banner Sales % | Share of MGD Grocery Banner Sales % | MGD total market share % |
|---|---|---|---|---|---|---|
| 39 | Tottus | 2,325 | 1,705 | 0.74 | 1.04 | 0.34 |
| 40 | Subway | 2,015 | - | 0.64 | - | - |
| 41 | Fast Shop | 1,950 | - | 0.62 | - | - |
| 42 | Bodega Aurrera Express | 1,945 | 1,757 | 0.62 | 1.07 | 0.28 |
| 43 | Ponto Frio | 1,909 | - | 0.61 | - | - |
| 44 | Sears | 1,869 | - | 0.60 | - | - |
| 45 | La Anónima | 1,833 | 1,661 | 0.59 | 1.01 | 0.26 |
| 46 | H-E-B | 1,820 | 1,271 | 0.58 | 0.78 | 0.26 |
| 47 | Super Central Madeirense | 1,697 | 1,573 | 0.54 | 0.96 | 0.24 |
| 48 | Metro | 1,648 | 1,399 | 0.53 | 0.85 | 0.24 |
| 49 | Extra Supermercado | 1,643 | 1,524 | 0.53 | 0.93 | 0.24 |
| 50 | Paris | 1,635 | - | 0.52 | - | - |
| | *SECTOR TOTAL (out of 441 banners)* | *312,983* | *163,744* | | | |

Source: Author's analysis based on 2015 forecast sales data from Planet Retail (http://www.planetretail.net)

### *2.6 Leading retailers in individual countries*

13. At the individual country level with this continent and region there appears to be significant variation in respect of the mix of leading retailers and also the market shares that they hold. In some Latin American countries, the leading retailers seem to hold quite substantial shares while in other countries the retail sector appears to be highly fragmented and the leading retailers only hold small market shares. To give some indication of the extent of this variation, Table 5 provides a list of the leading grocery retailers and distributors for a selected range of different countries across the region.[6] The selection of countries is based on available retailer data from *Planet Retail* and the sales and other figures relate to their forecasts for 2015. In some of these countries, the leading retailers' market shares appear to be very small (e.g. in Brazil, Dominican Republic and Peru where even the top retailer is shown as holding less than a 4% grocery market share). In some other countries, notably Costa Rica but also to a less extreme in Columbia, Ecuador, Guatemala, Honduras and Mexico, there is one leading retailer that appears to have a sizeable market share advantage over its rivals. However, in the other countries, notably Argentina, Chile, Puerto Rico and Uruguay, there is a mix of leading retailers where the market share differences are more limited or there are at least a leading pair of retailers that are close in market share terms with each vying for the top position.

14. A further feature, which is very evident from Table 5, is the range of average of store sizes both across the leading retailers as well as across the different countries. In some cases, the average outlet sizes represent very large hypermarket or warehouse club proportions (exceeding 5,000 $m^2$ of sales area), and in

6 The list of retailers, all the figures and the rankings are drawn from country level data provided by Planet Retail, and while the quoted market shares are for the grocery market it might be the case that some of the retailers' sales relate to non-grocery sales, especially where the retailers' primary retail businesses are operating as department stores, warehouse clubs and other mixed goods retailers. Accordingly, the reported figures in the table, especially in respect of market shares, should be treated cautiously as should the classification of the retailers as representing grocery retailers when in fact they might be more appropriately designated as other forms of retailers and distributors. Indeed, a number of the retailers are multi-format retailers selling very different types of goods (e.g. Cencosud, Falabella, Centro Cuesta Nacional, Corporación Favorita, and Tia).

other cases more standard size hypermarkets and superstores (2,500-5,000 $m^2$), as well as large supermarkets (1,500-2,500 $m^2$), then mid-size and smaller supermarkets (around 500-1,500 $m^2$), and the smallest sizes (less than 500 $m^2$) represent convenience stores and other very small outlets.

15. Another feature highlighted by Table 5 is the extent to which domestic and international retailers are competing for the top positions. It is noticeable that European-based or US-based retailers hold top positions in most of these countries (French-based Carrefour and Casino holding the top positions respectively in Argentina and Brazil and Columbia and Uruguay, and US-based Walmart number one in Chile, Costa Rica, Guatemala, Honduras, and Mexico), but there are also regional-based leaders.

**Table 5. Leading Grocery Retailers in Selected Latin American Countries (2015f)**

| Country | Company | Total Sales Area m2 ('000s) | Average Sales Area m2 | Number of Outlets | Total Grocery banner sales (US $m) | Grocery Market Share % |
|---|---|---|---|---|---|---|
| Argentina | Carrefour | 678 | 1,086 | 624 | 3,880 | 6.65 |
| | Cencosud | 896 | 2,588 | 346 | 3,758 | 6.57 |
| | Dia | 236 | 295 | 800 | 1,966 | 3.44 |
| | Coto | 333 | 2,708 | 123 | 1,777 | 3.11 |
| | La Anónima | 174 | 1,273 | 137 | 1,636 | 2.86 |
| Brazil | Carrefour | 1,588 | 5,630 | 282 | 10,314 | 2.98 |
| | Casino | 1,734 | 1,753 | 989 | 10,232 | 3.56 |
| | Walmart | 2,324 | 4,288 | 542 | 6,445 | 2.39 |
| | Cencosud | 565 | 1,936 | 292 | 2,515 | 0.99 |
| Chile | Walmart | 945 | 2,368 | 399 | 4,845 | 11.37 |
| | Cencosud | 1,345 | 3,645 | 369 | 4,508 | 10.66 |
| | Olimpica | 323 | 1,192 | 271 | 1,243 | 2.46 |
| | SHV Makro | 104 | 5,792 | 18 | 371 | 0.08 |
| | Alkosto | 66 | 6,000 | 11 | 362 | 0.72 |
| Costa Rica | Walmart | 251 | 1,133 | 222 | 1,933 | 23.13 |
| | Auto Mercado | 33 | 1,022 | 32 | 368 | 4.40 |
| | Gessa | 86 | 1,323 | 65 | 305 | 3.65 |
| | PriceSmart | 29 | 4,768 | 6 | 302 | 2.89 |
| | Olimpica | 77 | 895 | 86 | 278 | 3.33 |
| Dominican Rep. | Ramos | 160 | 3,075 | 52 | 626 | 3.93 |
| | Centro Cuesta Nacional | 153 | 3,252 | 47 | 415 | 2.61 |
| | PriceSmart | 11 | 3,810 | 3 | 141 | 0.71 |
| | Carrefour | 9 | 9,000 | 1 | 52 | 0.33 |
| Ecuador | Corporación Favorita | 276 | 2,071 | 133 | 1,503 | 6.23 |
| | El Rosado | 237 | 1,631 | 145 | 906 | 3.76 |
| | Tia | 101 | 579 | 175 | 594 | 2.46 |
| Guatemala | Walmart | 238 | 1,078 | 221 | 1,279 | 7.29 |
| | PriceSmart | 14 | 4,650 | 3 | 130 | 0.59 |
| Honduras | Walmart | 62 | 752 | 83 | 498 | 7.96 |
| | PriceSmart | 14 | 4,701 | 3 | 159 | 2.04 |

| Country | Company | Total Sales Area m2 ('000s) | Average Sales Area m2 | Number of Outlets | Total Grocery banner sales (US $m) | Grocery Market Share % |
|---|---|---|---|---|---|---|
| Mexico | Walmart | 6,346 | 2,732 | 2,323 | 15,632 | 8.03 |
| | OXXO | 1,723 | 117 | 14,707 | 7,193 | 3.87 |
| | Soriana | 4,533 | 4,461 | 1,016 | 6,611 | 3.54 |
| | Chedraui | 1,297 | 5,591 | 232 | 2,746 | 1.48 |
| | Safeway (USA) | 1,108 | 4,990 | 222 | 2,065 | 1.11 |
| Peru | Falabella | 946 | 5,471 | 173 | 1,292 | 3.09 |
| | Cencosud | 358 | 3,286 | 109 | 1,281 | 3.07 |
| | Supermercados Peruanos | 293 | 2,595 | 113 | 1,266 | 3.03 |
| | SHV Makro | 64 | 5,800 | 11 | 261 | 0.06 |
| Puerto Rico | Supermercados Econo | 103 | 1,580 | 65 | 1,190 | 10.17 |
| | Walmart | 476 | 8,504 | 56 | 1,088 | 8.79 |
| | Costco | 76 | 19,000 | 4 | 309 | 2.11 |
| | Pueblo | 66 | 3,495 | 19 | 239 | 2.04 |
| Uruguay | Casino | 82 | 1,287 | 64 | 705 | 7.25 |
| | Ta-Ta | 69 | 639 | 108 | 601 | 6.17 |
| | Tienda Inglesa | 14 | 1,350 | 10 | 482 | 4.95 |

Source: Author's analysis based on data sourced from Planet Retail (http://www.planetretail.net)

### *2.7 Consumer store choice*

16. While Table 5 indicates that at the national level the leading retailers do not appear to be holding individually dominant positions, nonetheless what matters for consumers is store choice at the local level. In this regard, the range of different types of retail outlets and variety of retail banners and formats available to local consumers is a critical aspect of competition. However, competition between different retailers is only likely to be intense if consumers are very active in respect of their willingness to search out the best value for money and be prepared to switch stores to obtain best value, assuming there is choice available on a local basis. Accordingly, it is interesting to note then which the main drivers for consumers to switch stores are, in terms of the “push” and “pull” factors that work to push consumers away from one retailer and instead encourage them to shop at another retailer. Clearly, local and national differences are likely to exist, but Table 6 provides a perspective of the differences across the major global regions. Here, it can be noted that for Latin America, compared to the other world regions, consumers are very much driven in their consideration of switching stores by prices and special promotions, indicating a high degree of price consciousness, but also there are quality factors that appear to be important to consumers in terms of product quality, store cleanliness, the product selection/assortment, and the staff. Indeed, it is only in respect of convenience that Latin American shoppers appear to rate as less important than the other listed factors compared to the other world regions, which might be an indication that convenience is something that already exists, given the prevalence of independent retailers and small supermarkets, and perhaps it is the other elements that might be less in evidence, so seen as highly important.

**Table 6. Grocery Store Switching Drivers across World Regions (Percent of consumers who say attribute drives them to switch stores)**

| | Global Average | Latin America | North America | Europe | Asia/ Pacific | Africa & Middle East |
|---|---|---|---|---|---|---|
| Prices | 68 | 77 | 72 | 70 | 63 | 69 |
| Product Quality | 55 | 61 | 43 | 49 | 59 | 62 |
| Convenience | 46 | 28 | 45 | 39 | 54 | 34 |
| Special Promotions | 45 | 55 | 35 | 40 | 49 | 49 |
| Store Cleanliness | 39 | 52 | 28 | 35 | 40 | 50 |
| Selection/Assortment | 36 | 52 | 34 | 43 | 30 | 26 |
| Staff | 27 | 44 | 21 | 29 | 24 | 34 |

Source: Adapted from Nielsen "The Future of Grocery: E-Commerce, Digital Technology and Changing Shopper Preferences Around the World" (April 2015)

### *2.8 Conclusion on retail sector structure*

17. The structure and composition of retailing in Latin America and the Caribbean is a mix of traditional and modern retailing. Multiple chain-store retailers have been growing both domestically and internationally and it is evident that there is a broad range of different retail formats in operation serving different consumer needs.[7] However, what is less evident from this brief overview of retailing across the continent is the extent to which there is local choice for consumers in terms of different retailer banners and formats to enable consumers to have an effective choice over *where* to shop and *what* to buy. Indeed, it is these two elements that determine the nature and character of retail markets and the choices that consumers face, and it is this matter that is addressed next in terms of how to define retail markets.

7 For further insights and analysis on the key retail trends that are shaping retailing in Latin America, see Capizzani et al. (2012) which looks at trends related to the shopping experience, including store size, store format, location, product mix, private labels, and consumer preferences as well as online trends. See also Agriculture and Agri-Food Canada (2012) for a summary of the different strategies and market positions being pursued by the leading retailers operating in Latin America. In addition, Basker and Noel (2013) put into context the development taking place in grocery retailing in this world region and its relevance to antitrust and competition assessment issues in respect of both structural and behavioural aspects. Kobel et al. (2015, chapter 5) provides summary grocery retail sector details and cases in respect of Brazil. Also, on Brazil, see OECD (2014) and de Barcellos et al. (2014) on the structure and sales levels of leading food retailers, where the top 10 retail chains account for an estimated 65 per cent of supermarket sales (http://thebrazilbusiness.com/article/the-10-largest-supermarket-chains-in-brazil).

## 3. How should retail markets be defined?

*Market definition challenges*

18. In some situations, defining relevant economic markets can be a straightforward activity. However, market definition in retailing is complicated by the multiple contexts in which retailers operate – dealing with both procurement and retailing while often being national operators but with individual stores selling to local consumers – and the continuous spectrum of market positions that can be taken in respect of differentiation through a plethora of variables including service characteristics, general pricing policy, product range, store sizes, and location, amongst others. Ultimately, competition authorities need to decide on market definition in two dimensions: the product dimension and the geographic dimension.[8] Each of these dimensions are considered in turn in this section of the paper.

### *3.1 Product dimension*

#### *3.1.1 Retail proposition as a price-quality-range-service combination*

19. Because retailers are service providers, the product dimension does not just relate to the type of goods sold (e.g. grocery, clothing, furniture, electrical, jewellery, toys, books, hardware, etc.) but it also relates to the service that retailers provide consumers and in this sense market definition needs to distinguish between how the retailers cater for the different shopping needs of consumers. Retailers will often talk about their own competition in terms of their proposition to consumers in terms of "PQRS" as a "Price-Quality-Range-Service" combination making up the ingredients of the retailer's offer.

#### *3.1.2 Price position*

20. Thus, for example, retailers might differ in terms of their "price" position – some high, some low, others with a high-low mix – but this difference is underscored by the value that consumers attach to the retail proposition by the quality offered, the range of goods stocked, and the service level provided. For instance, the grocery retail sector might support a range of price positions, with some retailers operating at the high end of the market with "premium pricing" in providing superior products or a valued service like convenience, others at the low end of the market, as "EDLP" ("Every Day Low Price") or discount retailers focused more on high turnover with a low margin, and others adopting a mid-market position perhaps using "High-Low" ("Hi-Lo") promotional pricing (where higher regular prices are punctuated with frequent short-term price promotion discounts).

#### *3.1.3 Quality, range and service*

21. As for the other elements of the PQRS combination, "quality" can refer to both to the quality of the goods stocked or the level of service provided, such as the accessibility, convenience, ambience and facilities of the store as well as the helpfulness and customer service provided by the store's staff. "Range" refers to the number of different items stocked but also the depth and breadth of the assortment, so the number of product lines in any give product category as well as the spectrum of brands and different varieties, qualities and sizes on offer. "Service" refers to a multitude aspects including the store's location (e.g. city-centre or sub-urban), accessibility (including its opening times), convenience (in a location sense of being near to where consumers live or work as well as how quickly they can shop for their needs),

8 For a discussion of the different ways of determining market definition, see Bishop and Walker (Ch. 4, 2010). For more specific focus on defining relevant markets in retailing, see CC/OFT (2011) and Hosken and Tenn (2015).

facilities (e.g. car parking, crèche, home delivery, online ordering, and other product services like an in-store café, pharmacy, dry cleaning, etc.) and also the sales service provided by the store's staff.

### *3.1.4 Consumers' shopping needs*

22. In terms of the products and service offered and whether the different retailers providing these should be viewed as being in the same or different economic markets, what matters is the extent to which consumers are prepared to substitute amongst alternative retailers to make their required purchases. Often this can be simply down to the products sold when they all retailers might offer a very similar retail proposition to consumers, e.g. one newspaper-magazine retailer against another. However, more often than not there are differences in the PQRS combination which mean that consumers might have a more restrictive substitute set than simply all retailers selling the particular products they are seeking to buy. For example, in purchasing groceries it is possible that consumer needs might be significantly different in using large stores as opposed to small stores, where large stores might be able to provide a complete "one-stop-shopping" service with an extensive product range for all consumer's main or primary needs, while small stores with necessarily a more limited range can only cater for specialist or secondary needs, such as "top-up shopping" but provide for "convenience", and so each size serves very different consumer needs at different times.[9]

### *3.1.5 Retail types appealing to different consumer segments*

23. The foregoing example is where consumers have two needs but which arise at different times. An alternative case is where different retailers appeal to distinctly different clienteles which self-select and segment by their retailer choice. For example, one consumer group might only consider shopping in "upmarket" premium-price retailers while another group only considers shopping in "budget" discount-price retailers. There might even be a suitable sub-division in types which suggest the possibility of even narrower markets. For instance, premium-price retailers might cater for different sub-groups of consumers, such as focusing on particular products like grocery wholefood retailers who might specialise in selling organic produce or gluten free, plant based, raw, or vegan healthy foods or, alternatively, they could be differentiated by their service quality like upmarket grocery retailers that sell superior quality products and provide a high level of sales service. Similarly, discount retailers might also be sub-divided. For example, discount general merchandise "variety" stores could be divided into "single price point" (SPP) retailers (e.g. dollar stores or pound shops) as opposed to "value general merchandise" retailers (VGMs) operating a multi-price point business model,[10] which in turn might be distinct from "limited assortment discounters" selling predominantly food but also some general merchandise as well as "off-price discounters" specialising in discounting major-label brands (often in clothing but also homeware goods and some limited food lines), as again distinct from "warehouse clubs" where discount benefits arise from bulk buying across a wide range of goods.

9 For example, this was the distinction used by the UK Competition Commission (2000) in its investigation of the UK supermarkets sector between those stores greater or less than those stores with sales areas of at least 1,400 square metres).

10 For instance, this has been under consideration in a case being considered by the UK's Consumer Markets Authority (2015a) in its assessment regarding the anticipated acquisition by Poundland Group plc of 99p Stores Limited.

### *3.1.6 Specialist and generalist retailers*

24. Similarly, consumers might in some instances, but not in other instances, regard specialist retailers and general retailers selling related products as being substitutes. For example, specialist clothing boutiques and department stores might have very different customer bases even though they sell clothes and perhaps even sell some of the same brands. Similarly, an increasingly common issue is about the extent to which supermarkets selling non-food product ranges compete with specialist retailers. While the staple product range of supermarkets is in selling "groceries", taken as food, drinks (including alcohol when permitted), cleaning products, toiletries, and household goods, it is not uncommon for the largest store operators (like "hypermarket" and "superstore" grocery retailers) to sell broad non-food ranges including clothing, books, toys, electrical appliances, hardware products, and pharmacy products as well as operating gasoline stations at the same location as their stores. Even though these additional product ranges might not be core to these supermarkets, it might often be the case that the size, scale and reach of the network of their stores mean that they are major sellers of such products and might form part of the same competitor set in the eyes of consumers as specialist retailers.

### *3.1.7 Asymmetric competitor sets*

25. However, this last point raises a further important aspect in that market definition might not be symmetric in the sense of different sets of competitors belonging uniquely to different economic markets. Instead, asymmetric relationships can exist where in the same market there might be one set of retailers limited to operate in that market but another set also competing in other markets. For instance, large supermarkets might compete in selling domestic electrical goods with electrical goods specialists but the latter do not compete with supermarkets in selling groceries. Moreover, this asymmetry might not only exist between product market specialists and general merchandise retailers but also even when only focusing on the same types of products. For example, large format supermarket operators might compete with small format convenience stores for secondary top-up (small basket) grocery shopping but these convenience stores might not compete with the large supermarkets for the primary main (large trolley or cart) grocery shopping. In this sense, small or specialist stores might be limited to operating in one product/service market, while it is possible that large general retailers might operate across several product/service markets.[11]

### *3.1.8 Applying the hypothetical monopolist test*

26. The general approach for competition authorities making a market definition assessment on the product/service dimension is to begin by looking at the overlapping products of retailers in the narrowest plausible candidate product market and then to consider whether this can be widened primarily on the basis of demand-side considerations. For example, consumer surveys or household panel data (such as that collected by market research agencies) might show the extent to which consumers shop around and compare different retailers which they might regard as providing substitute services and how they might respond to price adjustments by the different retailers. By starting with a narrow set of substitutes as a candidate market, then a competition authority might seek to apply the "hypothetical monopolist test" by identifying if a hypothetical firm that was the only present and future seller of the products in the candidate market would find it profitable to raise prices. Under this approach, a candidate market will fail the hypothetical monopolist test, and will be too narrow to comprise the relevant market, if customers would respond to the price rise by switching to products outside the set to such an extent that the price increase by the hypothetical monopolist would not be profitable. The critical issue is whether the firm could profitably raise the price of at least one of the products in the candidate market by at least a small but significant

11 See, for example, the discussion on this aspect in the UK Competition Commission (2008) grocery markets inquiry.

amount over a non-transitory period of time (i.e. by a 'SSNIP'—a small but significant and non-transitory increase in price – usually taken to be about 5 percent).[12]

### *3.1.9 Defining retail markets and procurement markets*

27. In conducting such an analysis, it is usual to focus almost entirely on demand-side considerations in market definition analysis. However, supply-side considerations should not be completely put aside because the response of suppliers to relative changes in prices might be important. For instance, suppliers might be view a broader set of retailers as re-sellers of their goods as constituting a broad market for their goods, even if consumers might view markets more narrowly in respect of their purchasing behaviour, and it could be that this broader retail base affords consideration of aggregating seemingly very narrow markets to cater for the potential for substituting across retailers. More generally, though, it is not unusual to see market definition as applying differently to *retail markets*, which is inherently about consumer behaviour and the group of retailers whose *services* are seen as substitutes and which serve to constrain each other on their retail pricing, as opposed to *procurement markets,* which are more naturally about the group of retailers that compete to buy particular *products* from the same pool of available suppliers. In practice, defining both aspects is important if a competition assessment is going to take into account both retailer *seller power* over consumers (relating to the retail market definition) and retailer *buyer power* over suppliers (relating to the procurement market definition).

## ***3.2 Geographic dimension***

### *3.2.1 Consumer willingness to travel to shop*

28. Historically, retailing has been a highly fragmented sector where single (owner-run) independent store operators, and this still remains the predominant channel for many consumers across different countries in Latin America and the Caribbean. Increasingly, though, for most countries, it is common to find that chain-store retailers operating a network of stores under single ownership or through a franchise relationship dominate retailing for specific or general goods, including groceries. These "multiple" retailers typically operate with common format stores using the same store fascia (i.e. retail brand name) and applying common stocking, pricing and marketing policies in multiple locations, where the combined geographical reach of the store network serves to give them a large regional or even national presence. Despite using the same store configurations with an essentially common retail proposition across their network of outlets, what primarily matters when considering the geographic extent of retail markets is consumers' shopping behaviour. In this respect, it is how far consumers are prepared to travel when considering the set of retailers from which they will select or shop around to make their purchases, which can be measured either in terms of a <u>physical distance</u> (e.g. one mile or kilometre, twenty miles or kilometres, etc.) or in terms of <u>travel time</u> (e.g. 10 minutes' drive time or walk time).

### *3.2.2 Physical distance and travel time alternatives*

29. In situations where stores are typically clustered together or in a set type of location, like in a city centre or shopping mall, then the market definition might be based on physical proximity measured by distance – e.g. the competitor set within one mile.[13] Alternatively, where retailers are more scattered and tend to operate in a broader mix of locations, ranging from city centre to sub-urban areas, then what might matter more is the travel time by car for consumers, which might also vary according to whether it is an

12 For instance, the UK authorities' approach to market definition in merger analysis is summarised in CC/OFT (2011). However, for a critical perspective on the UK approach, see RBB Economics (2011).

13 For instance, this is the definition that the UK Competition and Markets Authority (2015) has adopted when considering the geographic extent of the market for high-street discount variety stores.

urban location where stores are densely location and willingness to travel might be low (say, 10 minutes) as opposed to a rural location where stores are spread more apart and so the willingness to travel might be higher (say, 15 minutes).[14] For instance, where car travel is typically used to shop at stores, a local monopoly market area would amount to a situation in which, upon drawing an "isochrone" based on a set number of minutes (e.g. 10 minutes' drive time) around a store, there were no other comparable stores by rival retailers within that area.

### *3.2.3 Catchment areas*

30. In determining the appropriate distance or travel-time, a competition authority might seek to establish the average distance or drive-time for a catchment area based on the proportion of the store's sales that originate within that drive-time or distance, that is, where customers representing those sales travel from to reach the store. In determining the appropriate catchment area measure, the authority should consider the distribution of sales over a range of drive-times or distances, but as a rough guide the catchment area measure might be based on capturing the majority (say using a threshold of 60-80 per cent) of the store's sales.[15]

### *3.2.4 Local nature of shopping*

31. In practice, the geographic assessment may find that local markets overlap and it could be possible that this leads to a "chain of substitution" serving to integrate local markets into broader regional or even national markets. However, fundamentally, consumers shop locally, even though the extent of their search and shopping activity depends on the <u>type of goods</u> (e.g. a short distance for relatively inexpensive or "convenience" goods and a longer distance for more expensive "shopping" goods), <u>shopping occasion</u> (e.g. a short travel-time distance for small and mid-size grocery stores mostly used for top-up purchases and a longer travel-time distance for large grocery superstores used for major primary (e.g. "weekly") shopping needs), the <u>mode of travel</u> (e.g. walking or driving), or <u>area type</u> (e.g. a shorter distance for urban areas and a longer distance for rural areas).[16]

### *3.2.5 Adapting the local offer to consumers*

32. It is usual for the main parties involved in a merger inquiry or market investigation to argue for the widest possible market definition in both product and geographical dimensions. One argument that can be made against the geographic extent of the market being highly localised is that chain-store retailers practice a uniform (e.g. national) pricing policy that applies across their store network, which is invariant to local concentration measures and the number of other retailers present in different localities.[17] However, even if the parties have national uniform pricing, there are a number of other variables which retailers might adapt in response to local competition. These can include (i) the number and type of price

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14 For instance, this was the definition used by the UK Competition Commission (2000; 2003; 2005; 2008) in considering the geographic market extent for large supermarkets.

15 For details and supporting arguments, see OFT/CC (2011). On the US approach, see Hosken and Tenn (2015).

16 For a range of examples from different retail sectors and in different retail contexts, again see OFT/CC (2011).

17 The extent to which chain-store retailers operate with common pricing across their store network varies from country to country and by store format. For example, the uniform pricing evident amongst UK grocery retailers with centralised decision making contrasts sharply with the localised and zone pricing evident amongst US grocery retailers, where pricing decisions are related strongly to local demand and competition conditions. Also, this can vary from one retail chain to another, in part because some chains want to portray a highly standardised and replicated format where there is a consistent offer from one location to another (e.g. hard discounters), while in other chains, such as wholesaler-led associations of independently owned retailers, there might be much more local control over pricing and other decisions.

promotions, vouchers, and special offers; (ii) differences in the extent and degree of local advertising; (iii) the quality of management and staff training; (iv) the product range, availability and quality of goods stocked; (v) the amount of pre- and after- sale service; (vi) aspects about the store including its layout, size, maintenance, decisions to refurbish; (vii) facilities and services at the store (including car parking, ATMs, café, and other complementary services); and (viii) store opening times. Moreover, even if the retail proposition is largely uniform across different localities, prices may be a reflection of the average of local concentration rather than national concentration, so it remains the extent of competition at local markets that still determines the overall price level facing consumers even when retailers practise uniform pricing.[18]

### *3.3 Conclusion on retail market definition*

#### *3.3.1 Shopping needs and product ranges*

33. Defining retail markets is mainly about considering how consumers shop for the goods they require, and the choice set of retailers which they consider offer substitute services. At the product level, retail markets may be narrower than the set of all retailers that sell particular goods because (a) consumers have different shopping needs for different occasions (e.g. large trolley "main" grocery shopping trips as opposed to small basket "top-up" grocery shopping trips), or (b) there might be substantial differences in the goods stocked and the manner in which they are sold by the different retailers (e.g. cheap clothes sold by discounters, mid-price clothes in general clothing shops and department stores, right through to expensive designer clothes sold by upmarket boutiques).

#### *3.3.2 Factors affecting consumer willingness to travel*

34. At the geographical level, retail markets are fundamentally local in nature because consumers are reluctant to spend time and money travelling too far to visit stores. The only major exception is with online or catalogue retailing which provides a home delivery service, so not requiring the consumer to visit a physical store. However, the extent to which consumers will be willing to travel to visit different stores will very much depend on a range of factors. As summarised above, these can include (a) the type of good (e.g. a short distance for low-value convenience goods and a longer distance for high-value shopping goods), (b) the purchase occasion (e.g. a short distance for a small top-up basket of groceries and a longer distance for a large trolley of groceries), (c) the mode of travel (e.g. a short distance like a mile with walking, or a longer distance like five miles by driving, or the equivalent physical distances expressed in travel times), and (d) the type of area (e.g. a short distance in an urban setting and a longer distance in a rural setting due to differences in the difficulty/ease of travelling and the available set of retailers determined by store density).

18 This argument is formalised in Dobson and Waterson (2005). For further discussion and more examples on how the retail offer may be tailored at the store level through micro-marketing, see Dobson (2006a).

### *3.3.3 Market definition in practice*

35. For retail grocery markets, there is a wide range of countries and jurisdictions in which market definition analysis has been undertaken as part of market investigations or court cases. In some instances, the product dimension has been defined very narrowly. For example, in the US 2007 case of FTC. Whole Foods, the US FTC consider that the merging parties, Whole Foods and Wild Oats, were "premium natural and organic supermarkets" as a "distinct line of commerce". In the UK, the Competition Commission has distinguished markets for grocery retailers based on store sizes (large, mid-size, and small). In France, all sizes of supermarkets might be included in the definition of "general food stores", but specialist stores and street traders are excluded. Nevertheless, in France, as in the UK, there is recognition of the asymmetry that hypermarkets compete with supermarkets in the relevant market for "supermarkets" but not vice versa in the relevant market for "hypermarkets", and similar asymmetry in the context of how small retail stores and supermarkets compete with each other. For the geographic definition, the catchment area for a hypermarket is seen as around 15-20 minutes' drive-time in western Europe (or a radius of 20-30 km) and more limited for mid-size stores of around 5-10 minutes. In the US, distances have been expressed in miles, e.g. 3-4 miles radius for supermarkets and 5-6 miles for premium natural and organic supermarkets.[19] For Latin America and the Caribbean, given the preponderance of traditional independent retailer and small supermarkets, it might be considered that retail grocery markets would be even more localised than these distances in different country contexts and particular consideration should be given to possible asymmetry in how small and large format retailers compete with each other in the way that consumers shop.[20]

## 4 Is higher retail concentration inevitable and is that good or bad for consumers?

*Future direction of retail markets*

36. For any retail merger or market investigation it is important to consider not just the current situation but also the direction that the sector is heading to consider future economic welfare. Are retail markets heading over time towards being more or less competitive? Will retail markets become increasingly dominated by a handful of powerful retailers, perhaps even ultimately by just one supremely dominant player? Is the reverse possible, so that consumers face more choice over time from where and from whom to buy?

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19 For further details on the retail grocery market definitions used in an array of countries, see Kobel et al. (2015).

20 In respect of Brazil and consideration of supermarket mergers, Kobel et al. (2014, chapter 5, pp. 102-4) details the market definition approach taken by CADE, as the federal competition authority. In terms of geographic market coverage, "areas of influence" are designated in terms of the radius in metres from each store as to contain 60% of customers, scaled relative to the number of checkouts (as an indication of store size) and population density (with the view that consumer willingness to travel declines with population density). On product market definition, the relevant market for the grocer sector is identified as comprising all supermarkets (defined as 3-40 checkouts, 1,500-5,000 items, more than 300 m2 of sales area), hypermarkets (defined as carrying more than 5,000 items and a sales area larger than 5,000 m2), and self-service wholesale stores, and excluding all bakeries, small grocery stores (with less than three checkouts), butchers, open markets and other small retail establishments which are viewed as not offering significant competitive pressure to the larger stores.

### *4.1 Path dependency and incumbency advantages*

#### *4.1.1 Incumbency advantages acting as barriers to entry and mobility*

37. In part, the answers to these questions lie with the history of the sector and whether there are path-dependent forces at work taking the sector in a seemingly inexorable direction. For example, it could be that a set of incumbent retailers possess an important set of first-mover advantages that then become obstacles to other players to enter or expand in the sector, serving to ossify the market structure. Such barriers to entry and barriers to mobility emanating from incumbency advantages could come from a number of sources but typically might relate to (i) land – with all the best retail store sites having already been taken by incumbents (especially when there is a rigid planning system); (ii) supply chains – with all the best suppliers secured on an exclusive basis by incumbents; and (iii) consumer loyalty – with consumers familiar with and trusting established retail brands (and perhaps even retailers' own goods when store brands and private label, and not just manufacturer brands, are important to consumers).

#### *4.1.2 Efficiency advantages of incumbents*

38. Such incumbency advantages become even more important barriers to entry and mobility when the efficiency of retailers critically depends on economies at different levels of the retail operation. These can take several forms:

- scale economies – where the sheer size of the retail operation provides efficiency benefits through economies of scale operating (i) at the store level (from spreading the fixed costs of stocking and selling products widely across multiple product lines and a high rate of turnover), (ii) at the chain level (from sharing resources across outlets, such as efficient shared warehousing, constructing stores on a common format design, operating chain-wide staffing and training, and negotiating bulk buying discounts from suppliers), and at the corporation level (from sharing resources across all retail formats and retail brands and applying specialist management expertise to all retail operations);

- scope economies – where benefits can be achieved by offering additional products and services through providing *cost synergies* (such as products sharing in-store display space and shelving, shared warehousing, and the same staff selling different goods) and *revenue synergies* (where the stronger portfolio of additional products and services attracts more consumers or increases sales per consumer when consumers value reducing shopping/travel costs and being able to benefit from "one stop shopping");

- span economies – where the integration of the value-chain of retail operations, including integrated bar-code scanning and automated replenishment systems, means that throughput is faster and more efficient, with reduced inventory costs and less waste (which is especially important with perishable products like fresh produce and other short shelf-life groceries); and

- network economies – where the store network density provides logistics and stock replenishment advantages to reduce transportation costs and the speed of stock replenishment, especially when served from warehouses as regional distribution centres, and when it also helps to "crowd out" other players to prevent them having similar benefits.

- experience economies – successful retailing is both an art and a science and business knowledge and know-how builds over time, so the length of time and amount of experience from learning by doing can be important at all levels in the organisation, spanning from senior management to shop-floor retail assistants as well as the lessons gained from collaborating with suppliers, producers and service providers that make up the entire supply chain, all combining to drive retail efficiency.

39. In short, it is a fallacy to believe that there are not important barriers to entry and mobility in retailing – just as with other key sectors of the economy. Anyone can open a small independent shop, but only the few can build and sustain massive retail empires.[21]

## *4.2 Drivers towards increasing retail concentration*

### *4.2.1 Extent of competitive advantage or disadvantage*

40. Given the possibility of strong incumbency advantages in retailing, it might be considered that these alone might take a retail sector along a path towards relentlessly increasing concentration. However, what matters is the degree of advantage these afford and how effectively they are employed strategically to provide competitive advantage, while placing others at a competitive disadvantage. This latter aspects is important in understanding not just the path dependency for the sector as a whole, but also for the individual players – with some retailers on a growth path and others on a decline path, which then inevitably leads to greater retail concentration. The key principle at stake is whether some retailers are on a "virtuous circle" (or "upward spiral") of growth, while others are in a "vicious circle" (or "downward spiral") of decline. In particular, because of the above noted economies at stake in retail operations, mostly attributable to retailer size, there can be a tendency for the big retailers to become bigger and the small retailers to become smaller or at least fewer in number, i.e. the sector consolidates towards one dominant or a few large multiple retailers and a shrinking number of small or independent retailers.

### *4.2.2 Market share momentum*

41. The key driver for such a move towards a tendency for retail concentration and how virtuous and vicious circles might work in practice can be down to the importance of market shares and whether retailers can benefit or suffer from the momentum behind market share movements. Such movements might be small or even imperceptible to start with but then could accelerate and differences become magnified over time. In doing so, the performance gap between retailers can widen, driving increasing concentration over time as investment inequalities increase.

### *4.2.3 Large retailers enjoying virtuous circles of growth*

42. The trigger for benefiting from a *virtuous* circle would seem to be that once some kind of competitive advantage (either differentiation or cost based) on the retail side is achieved then this can be translated into higher market share. At this point, the retailer can benefit from further efficiency gains through reaping economies of scale and other economies (as noted above) along with greater control over its supply chain and notably increased buyer power of suppliers. The combination of these benefits lead to high gross profits, through superior profit margins and higher volumes. Crucially, these high gross profits can then be ploughed back into the business in the form of further expansion of the store network (i.e. opening new stores), improvements to existing stores (through improved store amenity and facilities) and/or investments in product and process innovation (e.g. developing store brands and label goods and improving logistical support) to provide a (further) differentiation advantage. This, in turns, can allow the firm to increase its market share, and so on as the process repeats itself, all the time allowing the retailer to build market share. Figure 1 illustrates this argument diagrammatically.[22]

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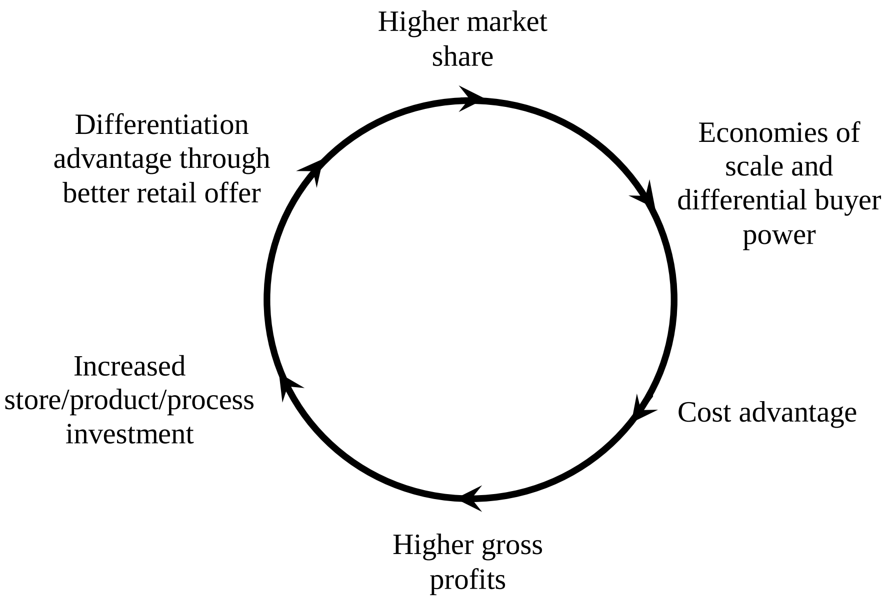
21 For further details and discussion on the different forms and magnitude of barriers to entry and mobility in retailing, see UK Competition Commission (2000; 2008) and Australian Competition and Consumer Commission ("ACCC") (2008).

22 See Dobson (2009), where the operation of such circles are discussed in the context of UK supermarkets.

**Figure 1. The Virtuous Circle of Growth for Large Retailers**




*4.2.4 Small retailers suffering vicious circles of decline*

43. While large retailers might be enjoying the benefits of a virtuous circle promoting their growth in both absolute and relative terms, smaller retailers might face the exact opposite and be caught in a *vicious* circle of decline. This is where a competitive disadvantage results in a firm losing some market share with the consequence of a loss of economies of scale and decreased buyer power feeding through to higher unit costs and reduced profits, in turn leading to reduced investments and a weakened retail offer, resulting in reduced market share, and so on. This can not only affect individual retailers but whole sub-sectors of retailing where loss of market share can build momentum with the end result that many retailers may exit the sector. This is particularly a concern with traditional independent retailers which do not have the scale and efficiency advantages of large closely integrated retail chains unless they can benefit from affiliation with other similarly positioned independents through associations or cooperatives that provide efficient buying and logistical supply (e.g. joint purchasing and supply coordinated by a major wholesaler) and shared marketing benefits (e.g. with a shared image through a common banner name and access to private label goods or other elements that allow effective competition with fully integrated retail chains).[23]

[23] For a discussion on the motives for horizontal alliances amongst small retailers with application to Brazil, see Ghisi et al. (2008). Despite the efficiency benefits that such alliances and associations may offer (such as through buying economies), competition law may restrict the extent of vertical and horizontal agreements permitted by authorities. For example, common pricing across members might be prevented if this is viewed as tantamount to resale price maintenance when vertically led by a wholesaler setting price lists or a retail cartel if horizontally led. Similarly, there might be restrictions on joint purchasing requirements if viewed as restricting competition.

### *4.2.5 Anti-competitive behaviour undermining rivals*

44. From a competition standpoint, what is crucially important to recognise is how retailer seller and buyer power can interact and work together to drive market share changes and propel such circles, which then leads to higher retail concentration and the potential for ineffective competitive to result. To give an illustration, consider how large retailers might use seller power through anticompetitive practices which undermine small retailers' market positions like large retailers. For example, a large multiple chain-store retailer might seek to use below-cost pricing on some of its lines to intentionally target smaller or specialist retailers (whose product range is necessarily more limited). Such targeted below-cost selling can have predatory effects both *directly* through causing small and specialist retailers to lose market share and *indirectly* through the loss of market share leading to worse trading terms with suppliers. The latter indirect effect is an instance where the exercise of seller power affects differential buyer power amongst retailers, which in turn will widen retailers' differential costs and so magnify differences in their respective competitive conditions, making predatory behaviour increasingly effective as differences widen.

### *4.2.6 Regulation unwittingly supporting incumbency advantages*

45. However, the widening gap does not have to be driven entirely by deliberate strategic or predatory action. Importantly, government-created market restrictions can unwittingly impose a greater burden on smaller retailers than on larger retailers seeking to grow and this is most evident through government planning policy and the operation of planning systems. For instance, planning policy might favour store extensions while new stores require a long planning process. This might allow large incumbent retailers to grow more easily when they can simply extend their existing stores or build on existing land holdings. Smaller, newer retailers may face greater barriers to expansion when tight planning restrictions limit new store openings. Similarly, incumbency advantages can be exacerbated by licensing restrictions, zoning restrictions, FDI restrictions, and restrictions on competitive behaviour such as price controls that restrict price discounting (as these can make it harder for new entrants to provide a distinctive and novel retail proposition involving undercutting the prices of established rivals).

### *4.2.7 Competition policy disadvantaging independent retailers*

46. Furthermore, it is not just government policy and business regulation in respect of planning and other restrictions on where and how retail activity takes place that could distort market positions by enhancing incumbency advantages. The way competition policy is designed and implemented could also limit the ability of different retail forms to compete effectively. In this regard, it is common for competition policy to prohibit or restrict horizontal and vertical agreements, respectively amongst competitors at the same level of the supply chain and firms trading between different levels of the supply chain. For instance, it is not unusual to ban separate firms at the same supply level collaborating together in what they might provide for customers, through the concern that this might lead to cartel-like collusive outcomes that will restrict competition and work against the interests of those customers, which is most evident in the logic advanced in banning *horizontal price agreements*. Similarly, while it is accepted that trading firms at successive stages of a supply chain must cooperate to ensure that trade takes place and works effectively, it is not unusual to prevent these trading firms using vertical agreements that can restrict competition at their respective stages. For example, this could include banning *vertical price agreements* in the form of resale price maintenance when the retailer has to re-sell the goods supplied by the supplier at a contractually fixed retail price, or banning *exclusive supply arrangements* which imposes exclusive purchasing obligations on retailers to only buy through a specific supplier. In many contexts, there might be good economic reasons for prohibiting or restricting such horizontal and vertical agreements. However, this policy could severely disadvantage independent retailers if they operated through associations, either horizontally managed in the form of *retailer cooperatives* or vertically managed through a *wholesaler-led association* of independent retailers, simply because they had a different ownership structure from a

vertically-and-horizontally-integrated multiple chain-store retailer. Specifically, the integrated ownership of a chain-store retailer would permit such agreements as an internal business matter, but competition policy might, perhaps unwittingly, prevent independent retailer associations benefiting in the same way. The result could be that competition policy on vertical and horizontal agreements might create an uneven playing field, favouring large integrated multiple retailers but disadvantaging independent retailers who are simply grouping together to try and remain efficient and competitive, with the upshot that the unequal treatment reinforces retail consolidation tendencies.

#### *4.2.8 Retail buyer power driving growth/decline circles*

47. This point leads in turn to consideration about supply chain relations which might feed through to propel virtuous and vicious circles and so drive retail consolidation. Firstly, there might be a barrier to entry or mobility issue, where to obtain additional grocery supplies the large established retailers can rely and draw on their extensive network of existing suppliers while smaller, newer retailers may be prevented access to key supplies due to suppliers already being at full capacity in supplying the large retailers or the suppliers preferring not to trade with the rivals of their major retail customers for fear of losing future contracts with them. Secondly, and building on the last point, suppliers will be keen to focus on trading with the very largest retailers when this guarantees them a large level of sales and may be prepared to offer more favourable trading terms to these large retailers to gain that security of large sales. This might then afford these large retailers differential buyer power, allowing them to obtain lower supply prices than smaller rivals, which they can then partly pass on to consumers with lower retail prices, where these discounts then allow to grow their market share, which in turn reinforces their buying power and the eagerness that suppliers will have to trade with them.

#### *4.2.9 Favourable supply terms for large retailers*

48. However, the last point begs an important question: why should suppliers give more generous supply terms to large retailers? Empirical studies have supported this finding.[24] Nevertheless, it is important to understand and appreciate the mechanism by which this can arise, and equally understand its limits, not least since suppliers will be conscious that they will not want to ultimately face just a single buyer who can squeeze them to the point of capturing all available profits in the supply chain. Suppliers will ideally want to ensure that they have alternative routes to final consumers and so wish to maintain a broad base of retailers they can supply. However, if faced with the prospect of its products being delisted by a large powerful retailer and replaced by a rival supplier, then a supplier might have little scope but to give in to demands for providing more favourable terms of supply.

#### *4.2.10 Gatekeeper power*

49. We should appreciate that retailers which have large, loyal and/or distinct customer bases will be relatively well positioned in bargaining with suppliers who are keen to gain shelf space and thereby access this pool of consumers. Holding a strong “gatekeeper” position, such retailers should be well placed to play off suppliers against each other to obtain the best possible terms; the more so if they can extend supplier competition by sponsoring new entry through operating their own private label product ranges. In contrast, other, particularly smaller retailers may not be so fortunate. Having fewer (and probably less loyal) shoppers and fewer supplier substitution options (especially when they rely on selling just key brands and cannot afford investments in developing private label ranges), suppliers will not be so desperate to offer favourable terms and conditions of trade to such retailers.

24 On empirical estimates of the price advantage enjoyed by the largest UK supermarkets, see the analysis of differential buyer reported by the UK Competition Commission (2000; 2008).

### *4.2.11 Inter-linkage of retailer buyer and seller power*

50. The point is that an individual retailer's buyer power may depend on its seller power. To the extent that the latter is linked to retailer size, then with different retailer sizes we should expect to observe *differential* buyer power resulting in larger retailers obtaining better terms than smaller retailers. However, this in turn is likely to affect retail competition on the selling side. With smaller retailers already at a competitive disadvantage from not having the scale economies and resources of larger retailers, differential buyer power could further tilt the already imbalanced playing field. As a consequence, large retailers could be better positioned to gain additional shoppers and increase market share at the expense of smaller retailers. With increased market share, large retailers would then likely be in an even stronger position to exert buyer power while smaller retailers would be in a weaker position in future negotiations with suppliers. This would widen the gap in differential buyer power, and further extend the relative competitive disadvantage of smaller retailers vis-à-vis large retailers.

### *4.2.12 Waterbed effect*

51. As a consequence of such *differential* buyer power, small retailers can suffer a "waterbed effect" where the improved terms for larger retailers ultimately lead to worse terms (in both a relative and absolute sense) for them.[25] Moreover, once initiated, this process could become self-perpetuating, with the widening gap in terms received from suppliers strengthening the market position of large retailers but weakening that of small retailers. This, in turn, may allow large retailers to gain market share at the expense of small retailers, thereby further widening their relative ability to exert buyer power, and so on. Consequently, ever widening differential buyer power may assist large retailers to benefit from a virtuous circle of growth while small retailers suffer a vicious circle of decline.

### *4.2.13 Counterbalancing bargaining effects*

52. Even if we accept this logic, we should appreciate that there might be limits on how far this argument can be carried. Firstly, just as powerful retailers might wish to play off suppliers against each to negotiate the best terms and lowest supply prices, then powerful suppliers might wish to play off retailers against each to improve terms and negotiate higher supply prices, and thus benefit by keeping smaller retailers in play by providing them with favourable terms. Secondly, in the limit where one retailer becomes a dominant buyer, it might reach a point where it uniquely provides a "pivotal role" in sponsoring entry or maintaining viability for its suppliers because of its sheer size, to the extent that without generous contracts these suppliers would not exist, allowing smaller retailers to free ride on these suppliers being kept in play by agreeing lower supply prices with them (i.e. once the suppliers' fixed costs are covered).[26]

25 Note that this a more involved argument than the naive perspective often attributed to a waterbed effect argument that runs along the lines that as a major retailer uses its buyer power to extract greater discounts from suppliers then these suppliers compensate for their lost income by raising prices to smaller retailers (say, to cover their fixed costs or achieve a certain targeted profitability level). The fallacy of this argument is that if suppliers were able to raise prices to small retailers then they would have done so already and not have waited until forced to give discounts to the major retailer. For details on the underlying economic theory about the market circumstances that can more credibly allow for a waterbed effect to arise and the consequences for consumer welfare, see Dobson and Inderst (2007; 2008) and Inderst and Valletti (2011).

26 This "pivotal role" argument is developed by Raskovich (2003) and Adilov and Alexander (2006).

### *4.2.14 Effects on consumer welfare*

53. A further aspect is that even if it is found and accepted that virtuous and vicious circles are operating, giving rise to contrasting fortunes for large and small retailers, and the retail sector is becoming more concentrated over time, it does not necessarily mean that consumer welfare will suffer. To the extent that increased retail concentration results in increased retailer efficiency, while still allowing for intense competition between a group of evenly placed leading retailers, then consumers may continue to benefit from low prices and without significant loss of choice or amenity; especially where small retailers can successfully occupy differentiated niche positions. However, if the market becomes very asymmetric, allowing one or two very large retailers to dominate the market and all other retailers struggling to survive, then price competition may be dampened and choice and amenity may be reduced; all to the consumer's detriment.

## ***4.3 Factors limiting the extent of retail concentration***

### *4.3.1 Positive dynamic forces*

54. While the logic of virtuous and vicious cycles working to consolidate retail markets sounds intuitive and appealing, we should not rule out counteracting forces which might provide a more positive dynamic for the retail sector to ensure that retail markets remain fluid and highly contestable. If the full logic of the waterbed effect and the operation of virtuous/vicious cycles was carried right through then ultimately we would be left with the retail sector controlled by a "winner takes all" monopoly position. There can be a number of reasons why in fact this is not likely to happen beyond competition authority intervention to prevent mergers and break up monopoly positions.

### *4.3.2 Limits to retail growth*

55. First, there may be practical reasons why the virtuous circle runs out of steam for many if not most retailers. For example, even successful retailers might reach the limits of growth when there is market saturation or victims of their own success when there are limits to retail brand appeal, and indeed work negatively from over-exposure of the retailer's presence that could lead to brand fatigue in consumers' eyes and negative sentiment, as well the possibility of complacency setting in and poor management decisions happening when competition is ignored and treated as irrelevant. This may then open up opportunities for other retailers to fill with a differentiated offer, perhaps through competing with a different image, different store locations, and an innovative retail service or novel product range.

### *4.3.3 Limits to squeezing suppliers*

56. Secondly, and following the above point about a dominant retailer holding a "pivotal role" in retailing actually being a bargaining liability rather than an advantage, it seems reasonable to consider that suppliers can only be squeezed so far before their viability is undermined and to the extent that a major retailer then holds a pivotal buying position, determining whether suppliers stay in business or exit the market, it may be forced to support their continued existence by limiting its demands.

### *4.3.4 Supplier consolidation and countervailing power*

57. Thirdly, supplier competition itself may be impacted whereby the increased retailer buyer power of the growing major retailers pushes the producer sector to consolidate (either as a result of some suppliers being forced out of business or induced to merge in order to compete more effectively). This consolidation might restore suppliers' profitability by allowing them to set higher prices (if at different levels to different customers and thus may be a further source of a waterbed effect). However, it might also create "must-use" supplier positions where retailers have no ready alternative (to suppliers' "must-stock" products) and so cannot exploit buyer power regardless of how advantageous is their retail position.

In this respect, in the face of strong retail buyer power, supplier consolidation offers a means of generating countervailing bargaining power to help suppliers better withstand the bargaining pressure being exerted by powerful retailers. Nevertheless, whether this countervailing power is socially benign and leads to consumer benefits or simply a coalescence of market power conspiring to harm consumers is a moot point and likely to depend very much on the dynamic of the supply chain and whether consolidation at both levels will lead to mutual recognition of the need to avoid antagonistic competition to protect profits at the expense of consumers' interests.[27]

#### *4.3.5 Retail new entry and cross entry*

58. Fourthly, despite the presence of barriers to entry and expansion, it is possible that retail markets may be kept dynamic by the innovation and spread of new retail formats and new retail business models, as well as cross-entry from adjacent retail sectors lured by the attraction to make a profitable pitch for disaffected consumers. Thus large retailers seeking to exploit their strong market position might in itself attract new competition, so profitable exploitation could be short lived rather than sustained when new entry or expansion by rivals is feasible. Indeed, this has been observed when large incumbent retailers tend to concentrate on the so-called "big middle" market position,[28] where the bulk of consumers lie, but are then exposed to attack at the bottom end of the market, with the emergence of lean, super-efficient, low-cost "hard discounters", and at the top end of the market, from "upmarket" retailers and specialist niche retailers, focusing on providing a differentiated high quality service and high quality product range.[29] Similarly, there are cross-entry opportunities. Just as some large supermarkets have moved into selling a wide range of non-food goods like electrical products, clothes, books, music/video, and homeware, equally general merchandise retailers, department stores and variety stores have an opportunity to increase their food lines. However, perhaps it is through the internet and potential penetration for online retailing that offers the greater possibility for profitable cross-entry and expansion into selling a variety of products, to the point where selling vast product ranges becomes feasible if there is warehousing capacity.[30]

#### *4.3.6 Phases of retail life cycles*

59. Fifth and lastly, and this relates to the first point made above about complacency setting in and virtuous circles running out of steam, there is an old and established principle in the evolution of retailing with the notion of the "wheel of retailing" where retailers go through different phases in their life cycle.[31] The principle is that established "mature retailers" hit a vulnerable phase, especially when they are characterised by top-heaviness in management, conservatism and risk averse to trying new approaches and

27 For a more detailed discussion on how competing, countervailing and coalescing forces can operate in the retail sector, see Dobson (2006b).

28 On the relevance and importance of the "big middle" market position to retail markets, especially in the retail grocery sector, see Levy et al. (2005).

29 For instance, this has been a noticeable pattern in the UK in the last couple of years, where Aldi and Lidl as limited assortment discounters and Waitrose and Marks & Spencer as upmarket retailers have all grown their market share at the expense of the big mainstream supermarket chains, and particularly the market leader, Tesco, has suffered hugely as a result in experiencing declining market share and a huge decline in its profitability (e.g. see http://www.standardlifeinvestments.com/GRE_Insight_UK_Supermarkets/getLatest.pdf).

30 For example, even online specialist retailers like Amazon.com which started off by selling books has now established itself as a full retail platform selling vast ranges of products, even to the extent of online grocery retailing in some countries (e.g. see http://www.forbes.com/sites/wendyliebmann/2013/06/25/amazon-changes-the-game-again/ and http://www.retailthinktank.co.uk/white-papers/the-future-of-the-grocery-sector-in-the-uk).

31 This idea was first formalised by McNair (1958) and Hollander (1960), but see also Brown (1987; 1990).

new formats, and declining return on investment arising from complacency and bloated costs. Such mature retailers are then vulnerable to losing share to new "innovative retailers" who can prosper on the basis of a distinctive offering or particularly a low-cost minimalist basis with limited product offerings, a basic service and often poor store facilities but selling at ultra-keen prices. This innovative positioning allows them to grow their customer base and then make investments to gradually trade-up to morph into "traditional retailers" by bolting on additional services, taking up higher rent locations, with more elaborate facilities and an extended product offer. However, their continued growth leads to become "mature retailers", so themselves vulnerable to new entry and decline. Indeed, history is quite telling that many once seemingly almighty retailers with apparently unassailable and impregnable market positions did eventually decline and fall out of favour as new, innovative retailers gained ground. Only time will tell if current dominant retailers will retain their strong position. However, shifting shopping patterns can have dramatic effects, and so for instance where big-box retailers, whether hypermarkets or category killers, only a few years ago seemed thoroughly dominant, the combination of consumers choosing to shop online for non-food goods and buying more frequently and in smaller amounts for foods from smaller convenience stores, have made such large-format retailers vulnerable and exposed to sharply declining values in their property portfolios and so undermining their overall profitability.[32]

### *4.4 Overall assessment*

#### *4.4.1 Need for careful empirical analysis*

60. Given these opposing arguments about whether retail consolidation is inevitable or has its natural limits, competition authorities need to undertake a careful empirical assessment to determine the nature, overriding direction and speed at which dynamic processes are operating and the extent to which barriers to entry and expansion are inhibiting the competitive process. This is especially important if the sector is on track for relentless consolidation given that such a situation may lead on to future market ossification if a limited set of retailers were completely to dominate the sector and learn to avoid intense profit-damaging competition. As well as providing a better understanding of the dynamic competitive processes in local retail markets, such empirical analysis could be directed at considering how effective and consistent retail buyer power is exercised and whether this is solely the preserve of the very largest chains or whether it is possible for skilful smaller chains to negotiate competitive (if not sometimes better) deals. Put simply, is the gap in net supply prices across retailers increasing or stable/declining over time and how is this impacting retail competition? Or, to put it another way, to what extent do large retailers benefit from better terms of trade with suppliers, and are the terms of trade becoming worse in both relative and absolute terms for small retailers? Also, is there any evidence that large retailers are leveraging their market power to deliberately undermine smaller retailers, through predatory tactics in abusing their seller power (e.g. with selective below-cost selling) in retail markets or restricting supplies by abusing their buyer power (e.g. requiring exclusive trading from their suppliers) in procurement markets? Finally, is there evidence that, through a coalescence of market power and perhaps involving the exchange of information with suppliers, the different major retailers have devised ways, either unilaterally or in a coordinated manner, to avoid intense rivalry and competing head-to-head to prevent consumers gaining the benefits from otherwise lower prices and an improved retail offer?

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32 On the decline of big-box retailers, see http://business.time.com/2012/05/24/are-we-witnessing-the-death-of-the-big-box-store/ and http://www.huffingtonpost.com/2014/07/30/big-box-store-dying_n_5630572.html; and on the decline of hypermarkets and consumers shopping around more, see http://www.telegraph.co.uk/finance/newsbysector/retailandconsumer/11141300/Shoppers-lose-appetite-for-bigsupermarkets.html and http://www.bbc.co.uk/news/business-29442383.

*4.4.2 Implications for mergers analysis*

61. Of course, mergers between large retailers will likely substantially increase market concentration but this need not necessarily be anti-competitive if competition remains vigorous.[33] First, appropriate market definition analysis should identify those markets where there is a risk of a substantial lessening of competition and a likelihood of upward pricing pressure and/or consumers facing less choice, quality or innovation. Second, the merger might well offer efficiency benefits to the merging parties, so if competition is not significantly weakened then the merger should proceed unhindered. Third, in situations where there are competition concerns about specific (but not all) markets then authorities should look to see if a suitable remedy can be applied; preferably a structural remedy as a permanent fix rather than a behavioural remedy that requires ongoing monitoring. For instance, with retail markets, it might be concerns about specific geographic local markets where local concentration is already high so competition concerns are already pronounced, but these concerns could be addressed by suitable store divestments. Fourth, authorities should take heed of the track record and business model of the acquiring retailer, and if it has a history of being an innovative and positive force by disrupting and shaking up competition then credence should be given to its commitments to deliver benefits to consumers when it can really benefit from the greater efficiencies and improved reach to consumers facilitated by the merger, but only if strong competition can be assured to continue in the longer term such as through the merger making competition less asymmetric.[34]

## 5. Is retailer dominance over suppliers good or bad for economic welfare?

62. Retailing has witnessed many changes over the last few decades, not least the spread and prevalence of large chain-store retailers that have come to dominate the retail scene in most areas of retailing and in most countries. This is not to say that small, independent retailers have disappeared and have no key role to play in competition, because they still remain an important feature of many retail markets, as plainly evident in Latin America and the Caribbean, and they continue to provide choice and a distinctive offer for consumers. However, it is the emergence and increasing domination by chain-store retailers, either fully integrated in terms of owning the entire store network or by contractual agreements through associations of independent store owners sharing common branding and operations, which are profoundly changing the face of retailing and for which most consumers increasingly rely on for their main purchases.

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33 Hosken et al. (2012) review the impact of retail mergers from a US perspective highlighting the importance of market concentration as a key factor in determining whether prices increases post-merger. Davis (2010) shows how post-merger pricing behaviour may also change, finding evidence of less price discounting and fewer price promotions. Allain et al. (2014) show the significance of raised local concentration supporting higher prices.

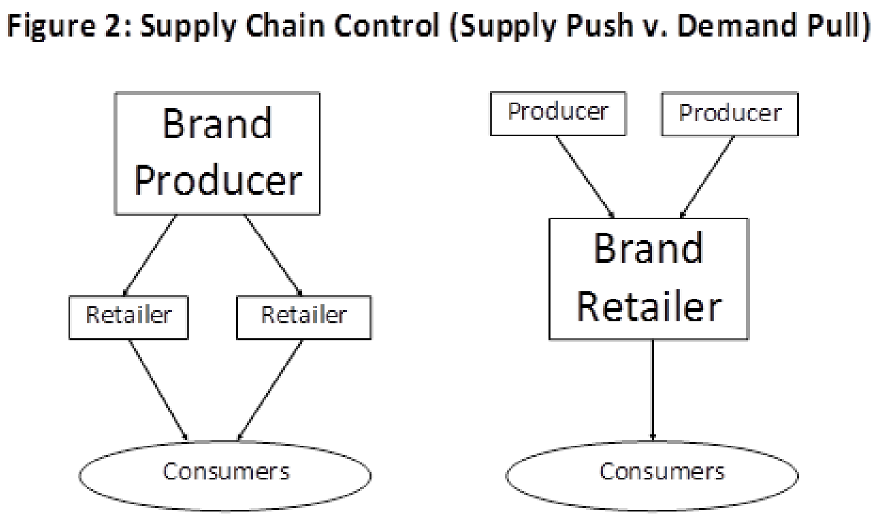
34 An interesting example was in the UK, when back in 2003 the then fourth ranked grocery retailer, Safeway, was the target for contemplated acquisitions by the other top five retailers. However, the Competition Commission (2003) ruled out the top three retailers (Tesco, Asda and Sainsbury's) from proceeding with the acquisition but did allow the fifth ranked retailer, Morrisons, to proceed with the acquisition subject to making a number of store divestments in specific locations where local concentration would be significantly raised by the merger. The Morrisons-Safeway merger was concluded in early 2004. Morrisons had promised the Competition Commission during the inquiry that it would cut Safeway stores prices immediately upon acquisition. As Chakraborty et al. (2014) show in a very detailed post-merger review of the subsequent pattern on grocery prices in the UK, Morrisons delivered on its promise and price competition in the whole sector seems to have been intensified even several years on after the merger. Of course, we will never know what would have happened if one of the top three retailers had been allowed to conclude the merger, but this post-merger evidence does point to the Competition Commission making the right decision not to block Morrisons. For further post-merger evaluation analysis on this case, see Skrainka (2012) which builds on Smith (2004).

### *5.1 Retailer-led supply chains*

#### *5.1.1 Supply-push vs. demand-led supply systems*

63. This ascent of chain-store retailers to dominate many retail sectors around the world has led to a fundamental change in the organisation and control of supply chains. It used to be the case that supply chains were very much dominated by major consumer-goods producers, who would coordinate the production of their goods from their own raw material suppliers and then choose and use retailers merely as a means of distributing those goods to consumers. However, now the tables have been turned. Increasingly, it is the large retailers who control supply chains, coordinating the supply of goods to their stores and making sure producers cater for their precise needs. The difference is quite stark. The former model is very much about a producer-led "supply-push" approach, while the latter is about a retailer-led "demand-pull" approach. The two contrasting approaches are illustrated in Figure 2, where the difference might be encapsulated by whether it is the producer or retailer that is the more important brand to consumers in determining where they shop and what they buy.

**Figure 2. Supply Chain Control (Supply Push v. Demand Pull)**




64. It is important to appreciate how this change has come about, why it makes a fundamental difference to the power relationship in supply chains, and its implications for consumers and economic welfare more generally in changing the nature of competition throughout supply chains.

#### *5.1.2 Suppliers' economic dependence on major retail customers*

65. First for foremost, the rise in retailer power, associated with increasing retail concentration and significant barriers to entry (e.g. arising from required sunk investments in developing retail brands, store portfolios, IT/logistical/supply-chain infrastructure, and specialised personnel, as well as institutional restrictions such as planning regulations), has allowed major multiple retailers to exploit the increasingly important gatekeeper role they occupy for producers seeking to sell goods to final consumers. Producers now face fewer choices as to which retailers they can use to distribute their goods and if scale economies are important to them then they will be desperate to have contracts with multiple retailers that control large market shares and have the greatest reach to consumers. This opens up the prospect that suppliers may

become "economically dependent" on major retailers to the extent that they would be willing to concede to their control of the supply chain relationship.

### *5.1.3 Control over integrated supply systems and sales data*

66. A second supporting feature has been the growing significance of data management and the way that information technology ("IT") is integrated with modern logistics and replenishment systems, so that bar code scanning on store sales triggers automatic ordering for re-stocking, thus integrating the entire operation of the supply chain into a seamless operation that facilities quick response and just-in-time systems that reduce storage and waste costs. Here, it is the retailer's control of consumer sales data that is the driver for such integrated supply systems and so makes the retailer the natural coordinator for the entire supply chain.

### *5.1.4 Coordinating large networks of suppliers*

67. A third factor is the sheer size of modern retail outlets and the vast numbers of product lines they stock, where it is not untypical for grocery hypermarkets to stock over 20,000 different products and similarly big-box category killer retailers and large department store also stocking vast ranges of goods, and in the process using a huge network of different suppliers. This is very much in contrast to traditional retailers, which might have sold a limited number of lines from a smaller set of suppliers, and perhaps using a single wholesaler to meet those needs, or a single brand store which serves as a dealer or franchisee for a single producer (e.g. as might be found with clothing, jewellery/watches, cars, furniture, and coffee shops, etc.). For large multi-brand retailers and the need to coordinate across a huge network of different suppliers, it makes obvious business sense for the retailer to act as the coordinator in determining which products to stock, how to allocate display space, which goods to feature or promote, and how it wants products to be designed and tailored to meet the needs of its customer base and clientele.

### *5.1.5 Changes in the direction of vertical control*

68. A fourth factor, and more historical in nature, is that previously it might have been possible for manufacturers to be allowed to dictate to retailers the way their goods were sold and particularly how they were priced when resale price maintenance ("RPM") agreements were enforceable. However, competition law in many jurisdictions now often prohibits RPM or only allows it in the form of a price ceiling (i.e. maximum RPM) or a manufacturer price recommendation.[35] In the past, when RPM could have been enforced, a manufacturer could oblige all its dealers to sell its goods at the same price, so avoid intra-brand competition. However, with RPM not enforceable, retailers are free to set whatever retail prices they consider appropriate, and so taking away the control of the manufacturer to dictate how they must price and sell its goods. Unshackled from vertical price control, retailers have used discounting to increase their size and market share which in turn has allowed them to build greater power in bargaining with manufacturing, whereby improved supply terms can offer them further competitive advantage in the retail marketplace, and so on as explained with the virtuous circle notion explained above. Indeed, it is now the case that the tables have been turned to such an extent it is the retailers that are leading and dictating vertical restraints to their suppliers, rather than *vice versa* as might have been the case in the past.

[35] Even so, the competition law stance against RPM may now be softening and a rule of reason approach rather than per se prohibition might be taken even for fixed or minimum RPM which prevents retailers discounting goods. For instance, see the discussion and views on RPM of different authorities in OECD (2008).

### ***5.2 Retail control of supply chains and forms retailer buyer power***

#### *5.2.1 Retailers as customers, competitors and suppliers to producers*

69. Before discussing the significance of these retailer-led vertical restraints, it is important to understand how far the changes in the control of the supply chain might have affected the position of suppliers. It remains the case that there are still powerful brand producers, often with a multinational or even global presence with a loyal consumer base that provides them with a strong competitive advantage over their rivals, such as household name brands which consumers trust and repeatedly buy in preference to other available brands or private label alternatives even if available at a substantial discount. Yet, even major brand producers may be engulfed by the different relationships that a key retailer represents to them. For example, a key retailer may act as their "customer" (for the route to consumers), as their "competitor" (in making private label goods) and as their "supplier" (in providing shelf and in-store advertising space). These three roles may then be jointly exploited to ensure that the retailer controls the relationship with the brand producer. In this way, the retailer can the enjoy the advantage of acting as the "gatekeeper" for access to consumers and a "double agent" in selling branded goods while at the same time developing and selling its own private label goods. This broadens its scope to play off suppliers against each other to obtain the most preferential terms while in the process being able to increase its competitive advantage over smaller retail rivals. As such, it may facilitate the retailer entering into and then capitalising on a virtuous circle where buyer power begets seller power and vice versa, all the time increasing domination over suppliers and competitors.

#### *5.2.2 Assessing retailer-led vertical restraints*

70. With major retailers in the ascendency and leading the coordination of supply chains, they might seek to enhance that control further by the types of agreements they strike with their suppliers, and in particular how they might impose retailer-led vertical restraints that restrict the behaviour, actions or outcomes for their suppliers through the contracts, agreements and understandings they enforce. Agreement or acquiescence to retailer-led vertical restraints might come about as bargaining concessions to powerful buyers or just be part of custom-and-practice in trading relationships, but they may directly or indirectly affect the nature of competition in supplier markets. Equally, they may also affect competition in retail markets when retailers possess seller power in addition to buyer power. Consequently, it will be important to assess their economic effects and whether such restraints serve to prevent, restrict or distort competition that is ultimately to the detriment of consumers through an adverse effect of the prices, choice, quality, or innovation they face. In particular, an assessment is required as to whether retailer-led vertical restraints generate or extend market power to the detriment of consumers. Nevertheless, as with any form of vertical agreement, it needs to be recognised that there can be efficiency benefits associated with such practices, because vertical restraints which aid control might also help make the supply system more efficient and effective. Accordingly, a balanced assessment by the competition authority is required.

### ***5.3 Types of Retailer-led Vertical Restraints***

#### *5.3.1 Retailer buyer power and contractual obligations on suppliers*

71. It is usual to think about retailer buyer power as being expressed simply through the ability to obtain from suppliers more favourable terms than those available to other retailers, or which would otherwise be expected under normal competitive conditions. For instance, this might arise as a consequence of size differences among retailers (essentially advantages based on scale) or if there are a limited number of buyers of a certain scale (i.e., an oligopsony). Yet, retail buyer power represents more than just the ability to extract discounts and obtain low prices from suppliers. Buyer power can also manifest itself in the contractual obligations that retailers may be able to place on their suppliers to obtain

more favourable non-price terms through negotiating or imposing restrictions and particular conditions of trade (i.e., beyond price) on suppliers of goods and services.

### *5.3.2 Direct and indirect financial benefits*

72. These additional terms and conditions of trade beyond the unit price of the supplied good or service may be aimed at providing the retailer with a direct financial benefit, such as requirements on suppliers to pay lump-sum payments to initiate or continue trading with the retailer. Alternatively, they could be used as a means of securing more indirect financial benefits. For example, retailer enforced application of most-favoured-customer clauses, which oblige the supplier not to sell to another retailer at a lower price, guarantee that the retailer will not be placed at a purchase cost disadvantage relative to a rival retailer. Similarly, exclusive supply arrangements deny other retailers access to the supplier's product, which may allow the retailer to gain a product differentiation advantage over its rivals in retail markets. Furthermore, the terms and conditions of trade applied by a powerful retailer may also be about shifting the burden of any financial risk squarely on to suppliers. For instance, the retailer may require the supplier accept the return of unused or unsold supplies or impose long delays in payment (to protect its own cash flows but at the supplier's expense). In a similar vein, if there is the prospect of a supply disruption or delay, then a powerful retailer may insist that it receives supplies ahead of other rival retailers, thereby shifting the risk of non-availability on to its rivals.

### *5.3.3 Non-price requirements through bargaining leverage*

73. As with demands to grant price discounts, suppliers may be under considerable pressure to agree to such non-price requirements when they are "economically dependent" on major retailers as their key customers. In this situation, failure to concede to the retailer's demands may result in a significant loss of trade for the supplier that cannot easily be made up through other contracts and which would then undermine the economic viability of the supplier. Moreover, the share of purchases taken by the retailer may not necessarily have to be very high for the buyer to exercise substantial bargaining leverage – since even a small loss of sales for the supplier can affect its viability, especially when economies of scale are vital to the profitable functioning of the business.

### *5.3.4 Other reasons for non-price requirements*

74. However, while a position of control by a powerful retailer over its suppliers may greatly assist in the imposition of vertical restraints, this is not a prerequisite for retailer-led restraints to arise. Firstly, they may arise through mutual consent between broadly matched trading parties, e.g., as part of the bargaining process where in agreeing to a restraint a supplier gains something in return, such as financial recompense (for any foregone income) or perhaps a reciprocal restraint placed on the retailer (e.g. to buy other goods it produces). Secondly, these restraints may be in the context of standard "custom and practice" arrangements that might have emerged in the industry over time, e.g. being used by most or all retailers, perhaps to ensure an even playing field and ensure no discrimination between competing retailers. Thirdly, the restraints may arise in the context of a retailer facilitating a suppliers' cartel, for example supporting a conspiracy of producers to prevent a price collapse through, say, agreements on resale price maintenance or on exclusive supply. Fourthly, such restraints may be associated with a group of retailers acting in unison, for example seeking to thwart a more efficient retail operation from capturing their customers (e.g. store-based "bricks-and-mortar" retailers seeking to deny suppliers to an online retailer). For the most part, though, the kind of retailer-led vertical restraints that might be expected to occur most commonly are those in which the retailer holds some bargaining advantage over suppliers that ensures their compliance or consent.

### 5.3.5 *Classification of different types of retailer-led restraints*

75. These practices can be wide-ranging and quite diverse in nature. One way of viewing them is to consider how they affect the behaviour of trading parties and impact on competitors. With this perspective in mind, Table 6 provides a simple classification (in no particular order) of different types of retailer-led restraints, providing examples for each of the six suggested categories.[36]

**Table 7. Types of Retailer-led Vertical Restraints**

| Category | Nature | Examples |
|---|---|---|
| 1. Conditional Purchase Requirements | Supplier required to provide significant concessions in respect of whom else it may trade or what it (uniquely) provides the retailer as a condition of purchase | Insistence on exclusive supply<br>Minimum supply obligations<br>Exclusive distribution<br>Reciprocal dealing<br>Tying purchases |
| 2. Additional Payment Requirements | Supplier required to provide lump-sum payments or special discounts for gaining/retaining access to a key distribution system or to ensure that the retailer is rewarded for its efforts and compensated for any failings on the part of the supplier | Listing fees<br>Slotting allowances<br>Retroactive (overriding) discounts<br>Joint marketing contributions<br>One-off requested payments |
| 3. Non-Discrimination Clauses | Requirements placed on a supplier either to ensure that it does not offer (significantly) better terms or products to other purchasers or to assist in helping the purchaser compete on effective terms against other purchasers | Most favoured customer clause<br>Requirement to match service quality<br>Margin support guarantee<br>Open book accounting requirement |
| 4. Refusal to Buy | Purchaser boycotts a supplier or limits its purchases in such a way as to weaken its competitive position or put it out of business (potentially distorting supplier competition and perhaps raising other retailers' buying costs) | Refusal to initiate trading<br>Terminating long-standing trading relationship at short notice<br>Delisting certain products |
| 5. Deliberate Risk Shifting | Retailer pushes on to its supplier the financial risk that it faces from uncertainty over its own performance and realised demand in its downstream markets | Delayed payments<br>Enforced sale-or-return<br>Product wastage payments<br>No written contracts |
| 6. Service or Input Requirements | As part of the terms and conditions of supply, the retailer requires a supplier to provide particular services or to use particular inputs (beyond those normally offered) to suit its own specific needs | Tailored delivery terms<br>Customised product presentation<br>Obligations to use third-party contractors<br>Category management services |

## 5.4 *Economic Welfare Effects of Retail-led Vertical Restrains*

### 5.4.1 *Different possible economic effects*

76. The kinds of retailer-led restraints illustrated in Table 6 may be employed simply as a means to allow the retailer to extract additional surplus (through non-price terms over and above straightforward price discounts) from suppliers and have a broadly neutral effect through a simple transfer of wealth (essentially a different division of the same profit pie). However, as the arrangements by their nature act to restrict or influence supplier behaviour then there is the possibility that their economic effect may extend beyond a simple wealth transfer and they could directly or indirectly affect the nature of competition in supplier markets. These terms may also affect competition in the retail markets, notably when retailer

36 The table and examples are adapted from Dobson (2008), where there is a detailed discussion.

buyer power can be used as a means to reinforce retailer seller power (and perhaps vice versa). Moreover, while the effects may directly fall on the firms competing at either of these vertical levels, the knock-on consequences for consumers from restraints that serve to prevent, restrict and/or distort competition may take the form of an adverse impact on prices, choice, quality, or innovation. In other words, retailer-led vertical restraints can have the capacity to generate or extend market power to the detriment of consumers. Nevertheless, it has to be borne in mind that they might also offer significant economic benefits through enhancing efficiency, improving quality, and allowing for innovation.

### *5.4.2 Beneficial Effects*

77. The European Commission's 2010 Guidelines on Vertical Restraints provides a useful classification of the efficiency benefits that can arise from vertical restraints, dividing them into nine classes: [37]

1. *solving a free-rider problem* – e.g. a distributor free-riding on the promotion efforts of another distributor or a supplier free-riding on the investments of a rival supplier in a retailer which might be avoided by using non-compete obligations (e.g. exclusive supply/distribution);

2. *facilitating new entry into markets* – e.g. a retailer requiring innovative private label ranges might offer exclusive supply to encourage a supplier to make necessary product investments;

3. *certification of free-rider problems* – e.g. a high-quality retailer using its reputation and expertise to sell and promote a brand might need exclusive/selective distribution to stop other retailers (such as "discounters") free-riding on its reputation resulting in under-investment;

4. *avoiding a hold-up problem* – e.g. where a retailer is required to incur relationship-specific investments to sell a specific brand that has no other use and so might require the assurance of exclusive distribution or supply guarantees to ensure its investments are not undermined;

5. *avoiding a hold-up problem on the transfer of know-how* – e.g. where a retailer undertakes substantial market research on the best means to sell a brand but requires a non-compete obligation to the brand supplier sharing that know-how with its other retailers;

6. *tackling vertical externality issues* – e.g. where a retailer's own effort to increase sales by cutting prices or increasing promotional effort increases profits for the supplier (i.e. provides a positive externality for a given contract and set wholesale price) but which in turn dampens the retailer's incentive to provide this effort, resulting in sub-optimal sales when retail prices are set too high or promotional effort too low from their joint perspective, which can be respectively avoided with resale price maintenance and co-funded promotions;

7. *achieving economies of scale in distribution or production* – e.g. where a retailer restricts the number of its suppliers to allow them to reap economies of scale but with the requirement for them to pass on cost savings to the retailer with discounts or lump sum payments;

37 See European Commission (2010). The EC Guidelines largely focuses attention on consideration of producer-led restraints, but there is consideration of some types of retailer-led restraints, notably on upfront access payments (like shelf-space fees, slotting allowances, and listing fees) and also category management agreements (and particularly the role of category captains as information facilitators).

8. *alleviating capital market imperfections* – e.g. where banks and equity markets providing capital might do so sub-optimally when they lack the industry insight which trading parties possess, so that a retailer might be prepared instead to invest or provide loans to a private label supplier but conditional on exclusive supply or quantity forcing placed on the supplier;

9. *allowing for uniformity and quality standardization* – e.g. a retailer requires a private label producer to follow quality and service standards as well as meet product/packaging design requirements that fit and support the retailer's brand image and provide reassurance for consumers over product/service standards and so encourages them to make purchases.

### *5.4.3 Efficiency benefits in combination*

78. Often vertical restraints employed retailers can serve joint or multiple purposes. For instance, exclusive supply might be enforced to prevent rival retailers free riding on investments made by a retailer in developing new sources of supply or new product lines, while at the same time encouraging relation-specific investment by the supplier and perhaps financial support by the retailer (e.g. a loan when otherwise raising capital for the supplier might be difficult). Reciprocal dealing or tying purchases might be a means to access a new market as well as providing closer ties to avoid vertical externality issues. Customised product presentation (e.g., in the form of packaging) might be required by a retailer to facilitate a promotional strategy in its retail markets but also a means to support its high quality and distinctive reputation. Requiring suppliers to use third-party contractors such as for product presentation (e.g., labelling a product supplied to a retailer) might be required to aid uniformity of the retailer's brand image, while a similar requirement for trucking might allow for economies of scale in distribution.

### *5.4.4 Aligning incentives and reducing costs*

79. More generally, these and other efficiency benefits typically arise from aligning trading parties' incentives and/or reducing transaction/exchange costs which may afford lower final prices and improved product/service quality to the benefit of the ultimate consumers. Some of these effects can be derived directly (e.g. improved service quality as a result of imposed service requirements; and reduced transaction costs by deliberately limiting the supply base to reduce negotiating, handling, and invoicing costs whilst also allowing for more effective monitoring of supplier performance). Others may arise by altering incentives (e.g. in retailing, over-riding discounts may provide a financial reward for increased selling effort on the part of retailer, sale-or-return contracts may encourage the retailer to experiment with new goods, and contributions towards marketing costs may encourage retailer promotion effort).

80. However, for efficiency arguments to have a material bearing on the assessment of an individual restraint (especially where there is a noticeable restriction on competition) it should be the case that the purported benefits flow directly from the restraint and that the restraint serves an important role in achieving such benefits (i.e. they would not otherwise likely be attainable to the same degree or with the same efficiency).

### *5.4.5 Harmful Effects*

81. In regard to the potential negative welfare effects, the three key anticompetitive effects that may arise are commonly expressed as:

1. foreclosure of other suppliers or other buyers by raising barriers to entry;

2. softening of competition amongst suppliers or facilitation of collusion amongst these suppliers, e.g. resulting in a reduction of inter-brand competition between brand suppliers operating on a market;

3. softening of competition amongst buyers or facilitation of collusion amongst these buyers, e.g. resulting in a reduction of intra-brand competition between distributors of the same brand.

*5.4.6 Impact on inter-type and intra-type competition*

82. While this representation of the negative effects is common, the specific wording relates most directly to producer-led restraints in promoting and selling a brand. Clearly, in the context of retailer-led restraints, it makes better sense to express and relate anticompetitive effects directly to the precise level of the supply chain affected, e.g. where competition is prevented, restricted, or distorted at the producer level or the retailer level, so perhaps better phrased as *inter-type* and *intra-type* competition, rather than merely considering effects purely in terms of *inter-brand* and *intra-brand* competition.

*5.4.7 Subtle competition distortion*

83. More pointedly, there is a need to consider separately the effects on competition at the different levels in the supply chain at which the supplier and retailer operate (taking account of the relevant economic market in each instance). Sometimes, competition can be affected in a very direct manner – such as where restraints are used to foreclose markets through naked exclusion by a dominant retailer or used as a means to facilitate collusion. Often, though, the effects can be subtler, through distorting competition rather than blatant foreclosure. Moreover, when the retailer uses a combination of restraints or the restraints occur in a network of retailers, then there may be a cumulative effect (with one distorting effect reinforcing or building on another).

*5.4.8 Impact on choice, quality and innovation*

84. Consumers may feel the impact of these restraints when they serve to reduce or inhibit product choice, quality and innovation either as a direct consequence of the restraints (through foreclosure effects) or more indirectly when supplier competition is distorted resulting in less intense product competition and/or under-investment. Consumers may also face higher prices when the restraints operate in a manner that serves to consolidate supplier and buyer positions, thereby reducing the number of effective competitors at each level of the supply chain, giving rise to the possibility of successive or coalescing power emerging. For instance, in the context of retailing, suppliers may improve the terms and conditions afforded to major retailers while reducing them to smaller retailers – giving rise to the possibility of a "waterbed effect" as discussed in the previous section where distorted retail competition leads to dampened rivalry and ultimately higher prices for consumers.

*5.4.9 Distorting supplier competition*

85. Yet, often the most pronounced effect of retailer-led restraints is on upstream competition without any immediate impact on consumers. For instance, a restraint may reduce producer welfare but may not have a direct or immediate effect on consumers, perhaps only becoming apparent over a long time period when supplier under-investment or distortions to supplier competition result in reduced product quality and/or variety. This can make building an effective case against such practices difficult if legislation or case law relies on a consumer welfare standard rather than a total welfare standard. Also, at least in the short-term, the exercise of retail buyer power may benefit consumers by reduced retail prices (when cost savings are at least partly passed on), making it difficult to rely on arguments relating to future (and thus inherently less certain) detrimental effects, such as anticipated loss of retail variety and/or product variety/quality.

*5.4.10 Combination of retailer buyer and seller power*

86. Even so, a further reason for emphasising consideration of the impact of retailer-led restraints in is that retailer buyer power often goes together with retailer seller power, with the exercise of one offering the prospect of reinforcing the other, and vice versa. The concern then is whether a waterbed effect is in operation, which drives consolidation and reduces choice for consumers if it drives small retailers to exit the market and generally dampens retail competition. In terms of economic welfare, the operation of a virtuous circle of reinforcing growth may not necessarily be bad from society's perspective if it allows major retailers to derive increased efficiency from scale, scope, span and other economies while allowing for healthy competition between them to continue. From a consumer welfare perspective this should not mean that consumers just gain in terms of lower prices, but that they should continue to benefit from easy access to and a wide choice of both products and retail formats/styles. Nevertheless, if the effects of such restraints are to exacerbate differences in competitive positions in retail markets, making them more asymmetric over time, then it is not just access and choice that may suffer, but prices may rise as well as competitive intensity declines.

*5.4.11 Overall assessment of net effects on competition*

87. As with other classes of vertical restraints, economics has identified that retailer-led vertical restraints can offer both efficiency benefits and anticompetitive effects. This points to the need for to apply a general rule-of-reason approach for consideration of these restraints. Economic analysis points to the main competition concerns with retailer-led restraints arising when one or both sides of the procurement market are concentrated and/or dominated by one or a few major players. In such circumstances, retailer-led vertical restraints may be a particular concern when they serve to foreclose markets (by directly reducing consumers' choice of products and/or distribution services) or lessen price competition (either by facilitating collusion or strategically dampening competition). Even so, existing work in this field remains quite fragmented, despite market enquiries, and certainly further theoretical and empirical contributions would be welcome to build up a more complete picture of the circumstances where anticompetitive effects are likely to dominate efficiency benefits, and vice versa.

*5.4.12 Competitive assessments in practice*

88. However, there have been a number of important investigations of retailer-led restraints, most notably in the retailer grocery sector. In particular, the UK Competition Commission has undertaken two full markets enquiries and identified a multitude of different retailer-led restraints in operation, and as a consequence a government-backed industry code of practice has been set up and is overseen by an adjudicator to ensure there are no anti-competitive abuses of retailer buyer power and unfair trade practices (like delaying payments to suppliers without good cause). Similarly, Australia has adopted a code of practice designed to ensure fair and equitable trading practices among industry participants. More tailored actions have also been undertaken in other countries where specific abuses of retailer buyer power were found, such as in Japan, Germany, Hungary and Bulgaria. There have also been a number of other market investigations in other countries, including Finland, the Netherlands, Austria, Hungary and Romania, amongst others. Thus, there is a growing body of studies and cases on which to draw for insights for investigating retail buyer power.[38]

[38] For further details and a summary of all these investigations and cases in a range of countries, see Kobel et al. (2015). Also, see UNCTAD (2014).

## 6. How can regulation work to promote rather than impede effective competition in retailing?

### *6.1 Motives for business regulation*

89. Regulation of business activity is an important element of government policy to ensure the efficient functioning of economic markets, promote economic growth and prosperity, ensure that consumers benefit from and share in the rewards of economic advancements, ensure that workers and employees are treated fairly, and support wider social and economic goals. However, the manner in which business regulation operates can provide benefits in one or more dimensions but carries with it the risk of acting detrimentally in other dimensions. This is a particular concern when regulation serves to protect the vested interests of one economic group at the expense of another group to the extent that overall economic and social welfare is not well served. For instance, incumbent firms can benefit from protectionist policies and regulation which restrict or limit competition, but this can serve against consumers and economic welfare when it impedes new entry, curtails innovation and obliges consumers to buy goods and services at inflated prices and/or of lesser quality than they would do otherwise. Ideally, well-designed policy will avoid protectionist regulation that serves restrict, distort or prevent effective competition.

### *6.2 Consumer protection and rights*

90. Retailing, as a key economic sector and one that directly faces and serves consumers, is typically subject to a wide range of different forms and types of regulation with different objectives. Much of the regulation of retailing activity relates to consumer protection and consumer rights. For example, there might be legal measures overseen by regulators to ensure that the quality of goods sold are of satisfactory quality (including food safety measures), fit for all intended purposes, and as described when sold, as well as providing consumers with rights on seeking refunds or other compensation where the retailer supplies faulty goods. Equally, there can be regulations in the way that goods are promoted and sold to consumers, to prevent consumers being misled on prices or product quality through how these aspects are advertised and promoted. To the extent that these measures provide assurance and encouragement to consumers to purchase goods, then consumer protection regulation can promote competition and economic welfare by supporting and enabling consumers to make well-informed purchasing decisions.[39] Indeed, well-designed consumer policy can act as an important complement to well-designed competition policy to assist in the effective functioning of retail markets and promotion of economic welfare.

### *6.3 Regulations which can potentially impede effective competition*

91. There are, though, other types of regulation of retail activity that have the potential to impede effective competition and so need to be considered very carefully in their design to ensure that economic benefits outweigh economic costs. These include:

- Foreign direct investment (FDI) and foreign ownership restrictions – these can protect incumbent national retailers and ensure that retail ownership remains in the country but this can be at the expense of retail markets not having access to innovative and efficient international retailers that could spur domestic competition and bring greater choice and other benefits for consumers.

- Planning, zoning and licensing restrictions – these can protect incumbent retailers that already have established retail outlets and prevent retail sprawl if seen as an environmental concern but this can be at the expense of preventing the entry new retailers and diffusion of new retail

[39] As an illustration, the UK's Competition and Markets Authority (2015b) undertook a detailed empirical investigation of the extent to which UK supermarkets might be employing misleading and deceptive price promotions in the wake of a complaint from a consumers association.

formats, such as when planning restrictions restrict the location and size of "big box" superstores and hypermarkets or other modern forms of retailing.[40]

- Opening hours restrictions – these can protect workers' rights on the number of hours worked but if applied differently for different retailers (e.g. tighter restrictions for large format retailers than smaller traditional retailers) can distort competition and restrict consumer choice and shopping convenience.[41]

- Price controls and restrictions on price discounting – fixed retail prices can ensure that consumers face common prices wherever they shop and restrictions on discounting (e.g. preventing below-cost selling) can encourage competition on non-price aspects (like service and quality) but can protect inefficient retailers, discourage efficiency improvements, and lead to higher prices for consumers.[42]

- Economic dependency laws and supplier protection regulations – while preventing abuses of retail buyer power and can encourage suppliers to make appropriate investments for improving efficiency and also help maintain product choice for consumers, measures which restrict how hard retailers can negotiate with their suppliers and the demands made upon them to give good terms of supply can potentially soften supplier competition and lead to higher supply prices obtained by retailers which feed through to higher retail prices to the detriment of consumers.[43]

### *6.4 Making markets work well for consumers*

92. Ultimately the test for regulations should be to see how well they allow markets to work for the benefit of consumers and the general public. This is rarely an easy empirical task for authorities in the absence of good natural experiments providing contrasting economic and regulatory conditions to make comparisons and allow for consideration of credible counterfactual situations. Also, there is the political dimension given that regulations can often bestow considerable benefits for some parties but be to the detriment of others, such that once regulations become established then they can be difficult to remove or amend. Accordingly, designing regulations well in advance of their implementation can be vitally important to ensure the markets work well and continue to do so in the future as well. There is much that can be learned from studying the experience of how regulation has worked in other jurisdictions, yet

40 There have been a number of studies examining the impact of planning and zoning regulations for a range of countries including Uruguay (Borraz et al. 2014), Australia (ACCC 2008; Australian Government 2011); the UK (CC 2000; CC 2008; Haskel and Sadun 2012), France (Bertrand and Kramerz 2002), and Italy (Schivardi and Viviano 2011). Tight planning restrictions and licensing regimes run the risk of impeding new retail entry which can act as an important stimulus to competition and prevent markets ossifying. On the scale of benefits that new retail entry can bring to consumers, see Hausman and Leibtag (2007), Jia (2008) and Basker and Noel (2009).

41 For example, see Boylaud and Nicoletti (2001). For a review and multi-country study, looking at the impact of relaxing Sunday trading across 30 European countries, see Genakos and Danchev (2015).

42 For example, Biscourp et al. (2013) examine the impact of the Loi Galland in France which prevented below-cost selling and show how its inflationary effect on raising prices and stifling competition. Similarly, evidence indicates that the rescinding of the Irish Groceries Order preventing below-cost selling also led to a general fall in retail prices and greater retail competition amongst supermarkets in Ireland – see Collins and Burt (2011).

43 For details on countries which use regulations to protect suppliers, see the summary international report in Kobel et al. (2014). This is an area where different countries adopted different policies and it is not yet evident as to which policy represents best practice given the difficult balancing act required between preventing anti-competitive abuses of retailer buyer power but still allowing for and encouraging effective competition and bargaining within retail supply chains. For a discussion on policy and regulatory options for tackling anti-competitive and abusive retail buyer power, see Dobson (2002) and UNCTAD (2014).

unintended consequences are almost inevitable with the operation of even seemingly well-designed business regulation when the behaviour and responses of different economic agents cannot be guaranteed or taken for granted.[44]

## 7. Summary and Conclusion

### *7.1 Economic importance of effective competition in retailing*

93. The retail sector is a key component of any modern economy. As the interface and medium by which consumers buy most goods, retailing is a sector which serves and affects the whole population. However, retailing is much more than a distribution function and conduit by which producers reach final consumers. Retailing in its own right adds economic value through the service it provides to consumers, in stimulating demand and coordinating the supply of vast ranges of products sold in retail outlets with products typically sourced from across the world. Yet, retailing is also a sector that is developing rapidly, with the emergence of very substantial national and international chain-store operators, often with new, innovative store formats which spur competition and enhance choice for consumers. At the same time, the emergence of these large retail businesses challenge the existing traditional base of retailing, historically made up of small independent retailers. In some countries, the result has been that traditional retailing has declined sharply, but in other countries it remains important and thriving. Yet, for all countries, how the retail sector develops in the coming years can have a major impact on consumers and spur to economic prosperity, and it is important for the sector to be highly competitive for the sake of ensuring that consumers benefit from low prices, availability of high quality products, a wide choice and assortment of products, and accessibility to a good range and variety of stores.

### *7.2 Concerns about increasing retail concentration*

94. While the battle between different retail forms and retail formats striving for supremacy is encouraging for consumers as a stimulus to competition, there is nonetheless concern that increasing concentration in retail markets can result in less vigorous competition and increase the scope for anti-competitive practices to operate to the detriment of consumers. This is particularly the concern with mergers amongst already large retailers which can considerably increase market concentration and reduce direct the amount head-to-head competition. While there might be efficiency benefits from such mergers, so allowing merged parties to lower their costs, there will nonetheless be concern about anti-competitive *unilateral* effects from the increased market power of the merged parties and/or *coordinated* effects arising amongst the remaining rivals after the conclusion of mergers. In such circumstances, competition assessment requires analysing the balance of efficiency and market power effects to determine the net outcome of such mergers. In this regard, it is important not just to focus on “price” as the most easily measurable element of retailers’ proposition, because in addition consideration needs to be given to the other aspects of the P-Q-R-S retail proposition, i.e. “quality”, “range” and “service”, while taking account of consumer behaviour and preferences. This requires competition authorities to have a good understanding of consumers and their behaviour – something which might require surveys on consumers’ preferences or careful analysis of sales data to identify shopping behaviour and consumers’ willingness to shop around and substitute between different retailers and different store formats.

44 For a wide ranging discussion with numerous examples and vignettes, see OFT (2009) which provides a guide setting out the rationale for government intervention in markets and demonstrates that for these interventions to be effective in the long term, their impact on competition needs to be a central consideration.

### *7.3 Market definition assessment*

95. Understanding consumers' shopping behaviour and preferences is also a vital element for defining relevant retail markets. Which retailers do consumers view as substitutes? Do large supermarkets and small/specialist food retailers cater for the same shopping needs and so can be viewed as being in the same market? Do consumers differentiate by store format (big box vs. small stores), the nature of the shopping trip (superstore one-stop shopping vs. convenience-store top-up shopping), the quality/range on offer (full service supermarkets vs. limited assortment discounters), and type of foods (general supermarkets vs. specialist wholefoods/organic food retailers). If so, to what extent? How tightly are different types of retailers constrained by the behaviour of other types of retailers in terms of adjusting their retail proposition (e.g. in their ability to raise prices and/or reduce quality, range or service)? Do they compete asymmetrically, so one type constrains another type but not the other way around? Similarly, in respect of the geographic scope of retail markets, how far or for how long are consumers willing to travel to visit different stores to serve their specific shopping needs and shop around for the best deals? To what extent does that physical distance or travel time vary according to the nature of shopping expedition? Do retailers operating across different locations have the capability or flexibility (even if not exercised) to alter their retail proposition at the local level?

### *7.4 Merger analysis*

96. Defining markets is important in assessing the economic effects of retail mergers. While sophisticated quantitative techniques, like Upward Pricing Pressure (UPP) and demand-estimated merger simulation techniques promise to provide a sophisticated and nuanced assessment of the complex interaction of product and geographic markets without the need of market definition, they nonetheless have their limitations.[45] They require data, expert staff and time to be properly applied but more importantly are limited by their emphasis on price to the exclusion of other elements of the retail proposition that could matter considerably to consumers. More tellingly, these techniques tend to emphasise incremental, linear changes in behaviour and outcomes when in fact a merger might fundamentally alter the industry dynamic in distinctly non-linear ways (such as a move from price setting shifting from an antagonistic, highly competitive form to a soft, coordinated form). Accordingly, it makes sense in retail merger assessment to undertake general qualitative as well as an array of different quantitative analyses to serve as a rounded guide in determining the likely effects to result from the concentration and understand how retail markets are likely to evolve post-merger. Moreover, taking a broad perspective is important in considering the full breadth of possible merger remedies, especially involving structural aspects. Here, store divestment requirements have become increasingly used by competition authorities, and these might effectively tackle local competition concerns. Nevertheless, limited store divestments might not be sufficient to allay concerns about broader unilateral or coordinated effects or indeed how the merger impacts on procurement markets, which might only be resolvable through blocking the entire merger in the absence of sufficient

[45] Farrell and Shapiro (2010) argue the case for using "upward pricing pressure" techniques for screening mergers instead of using market definition and market share analysis. On some of the practical challenges, see Schmalensee (2009), Sørgard (2012), and Wiethaus and Nitsche (2015). In respect of merger simulation analysis, an important aspect affecting the scale of predicted increases in post-merger prices is the choice of demand functional form (and specifically its curvature), so it has to be selected and used with care; see Shapiro (1996) and Crooke et al. (1999). The last few years has witnessed authorities employing a variety of different measures including IPP (illustrative price rise), UPP (upward pricing pressure), GUPPI (gross upward pricing pressure index), PPI (pricing pressure index), and CMCR compensating marginal cost reduction, all attempting to reflect that a merger can raise prices unless there are compensating efficiency benefits. For retail merger applications, see the views of OFT/CC (2011) and observations by RBB Economics (2011) and OXERA (2013). The approach adopted in Canada is summarised at http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/eng/03796.html.

alternative structural or behavioural remedies. Completely blocking a retail merger might appear drastic but it might be the only way to ensure that the relevant retail markets remain competitive in some cases.

### *7.5 Regulation and intervention*

97. The risk of a retail merger having adverse effects on competition are, though, enhanced if regulation and institutional measures create or enhance entry barriers or otherwise stifle competition. Even highly concentrated retail markets can demonstrate vigorous effective competition so long as the market conditions are conducive to intense, transparent competitive interaction. Active consumers, willing to shop around and search for the best deals, are a key component to ensuring that retail competition remains keen. However, any obstacles put in their way, or equally put in the way of retailers developing new ways of satisfying their needs, are likely to impede competition. Accordingly, competition authorities need to be vigilant and aware not just of anti-competitive practices and competition avoidance that retail firms might take on their own accord, but also ensure that regulation and policy intervention measures do not inhibit competition and insulate competitors rather than protect and promote competition and so make retail markets work well for consumers.

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