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The Devil is in the Retail

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Conference on the study "the economic impact of modern retail on choice and innovation in the EU food sector"

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The devil is in the retail

Ladies and Gentlemen,

Today, we present our retail study, on the economic impact of modern retail on choice and innovation in the EU food sector

This is a long awaited study. It was put to tender in 2012. Work on the study started in May 2013, and it was completed in September 2014.

We started work on this study because we received many complaints about problems in the retail sector, but we lacked the data needed to assess them. Suppliers accused retailers of abusing their increasing power during negotiations. Brand manufacturers expressed worries about private labels: supermarkets selling similar products, often cheaper, and using their own brand name.

To examine the extent of the problem, we had to ask ourselves a number of questions.

1) First of all, we had to gain a good understanding of conditions on the European retail market. How extensive are retailers consolidated on European markets? How has this changed in recent years? We had to be aware of the full context. Has the position of suppliers also changed?

2) Secondly, we had to answer the question how these developments affected competition. We did this by analysing two particular fruits of competition: innovation and choice. To measure choice, the study looked at increased variety of products on supermarket shelves. It also looked at the variety of suppliers for products, which is important for competition.

To measure innovation, the study examined the increase of new products, such as coffee-capsules and allergen-free products. It also looked at other types of innovation, such as new flavours in a product range.

Why these two, and why not price? Competition authorities naturally focus on the impact on prices when investigating consumer welfare. Indeed, six years ago, operators and the European Parliament were much concerned about high price levels. In this case, however, suppliers, small retailers and the Parliament itself asked us to look at innovation and choice. According to their complaints, large retailers unilaterally and retroactively changed contractual prices and put pressure on suppliers to, for example, bear the cost of unsold goods and promotion campaigns.

As a result, suppliers would have less money to invest in new products, which would reduce choice and innovation for consumers. So even if we do not look at the impact on pricing practices, these are captured indirectly.

A third, more general question that had to be kept in mind is: to what extent are we really dealing with problems of competition, and to what extent with unfair trading practices?

Simply put, competition law deals with overall effects on the markets. Consumers suffer because a lack of competition leads to higher prices, stifles innovation and reduces choice. Unfair trading laws deal with fairness in individual business relationships, for instance, when a big supplier bullies a retailer into stocking a product.

What makes this study distinctive is its European scale, its broad approach, and its solid foundation on empirical evidence. The evidence-based approach of this study is important, because policy makers need solid facts to take well-informed decisions about whether to intervene in markets or not.

The study has three main strengths.

First, the broad range of data examined. The study measures choice and innovation available to consumers on the shelves of hundreds of shops all over Europe. It covers an eight year period, from 2004 to 2012. It exhaustively examines the whole range of processed food by looking at twenty-three different product categories, which represent more than one hundred thousand different products available on supermarket shelves at a given point in time. It covers the widest possible sample of Member States for which consistent detailed data on choice and innovation at the shop level is available.

The second strength is the broad spectrum of factors studied. The study measures the evolution of numerous factors that could potentially influence choice and innovation at local and national level. These factors include market concentration, imbalances in bargaining power between suppliers and retailers, private label penetration, the local economic environment and a number of structural factors. All across Europe each of these factors exists in a multitude of different forms. To ensure a representative database, the researchers selected one hundred local areas in nine Member States, representing Europe in all its variety: urban, intermediate and rural, wealthy, intermediate and poor, areas with high, medium and low levels of employment.

This has given us a good picture of what is happening on European shop shelves. To measure what is going on in wholesale, the study covers low, medium and high private label penetration at the national level. It also looks at a full range of concentration levels of suppliers.

A third strength of the study is the econometric analysis. This establishes the relationship between the large range of data on choice and innovation and the factors driving their evolution. As you may know I have been trained as an econometrist. So this aspect I personally found especially interesting.

But remember that in retail, the devil is in the detail. A caveat is in order.

This research does not cover highly concentrated markets with two or three players, such as the markets in Nordic or Baltic countries. Not because we did not want to, but because we do not have the required data at our disposal. This means that the conclusions of this study are not necessarily relevant for highly concentrated markets.

The evolution of modern retail

So, to look at the first research question, the evolution of modern retail, what have we learnt?

First, if one looks at the total food retail market as a whole, the concentration of retailers has increased in virtually all Member States. This increased concentration of retail is a result of a second important change: the expansion of modern retail, so of chains of stores, supermarkets, hypermarkets and discounters, as opposed to traditional independent shops. In most EU Member States, the share of modern retail has increased in the last ten years. Today, it covers between fifty per cent and ninety per cent of total food sales.

Third, in many Member States the top five retailers now cover more than eighty per cent of the whole modern retail segment.

A fourth broader development is the increased importance of buying alliances. Many retailers have been joining buying alliances at the national or international level. By joining forces, retailers increase their bargaining power to obtain better deals in the procurement market. This does not have to be a negative development. In competitive local retail markets, retailers can pass on at least some of the benefits they gain from the alliance to consumers.

And, last but not least, a fifth general development in retail is the great success of private labels in the last decade, that is, the retailers' own brands. This, too, reinforces the bargaining position enjoyed by retailers.

Now, it appears from the study that there is indeed to an extent a greater concentration and apparent dominance of modern retail.

But as I said, when it comes to retail, the devil is in the detail.

First, if we look at the modern retail sector by itself, we see that concentration does not always increase. National markets are constantly in flux. Companies gain market shares at the expense of others. A much smaller number two in a given market can overtake the number one in a few years, as was the case with Mercadona in Spain or Colruyt in Belgium.

We also see new retailers from other member states entering the market and changing the situation. The two large German discounters Aldi and Lidl are a case in point.

Second, retail concentration is balanced out to an extent by other developments. Brand manufacturers have also been consolidating in recent years. In some product categories and Member States supplier concentration is now also reaching high levels. Supplier concentration may in certain situations work in favour of manufacturers to the detriment of retailers and farmers. Especially the latter remain highly fragmented.

Imbalances and Unfair Trading Practices

Let me now look at our second key question: the effects of these developments on competition.

The unprecedented amount of data examined in the study allows us to thoroughly assess two specific concerns expressed to us and to national competition authorities. Namely, concerns about private labels on the one hand, and concerns about the alleged increased power of modern retailers on the other.

I will discuss these one by one.

First. Some people fear that the trend towards bigger and more powerful retail chains will reinforce their bargaining power at the expense of suppliers.

The data examined in the study indeed shows that, in some product categories, the retail sector is much more concentrated than the supply side. Examples are cheese, and frozen and canned vegetables. In these areas, in many countries the retail side of the market is about three times more concentrated than the supply side.

Some people fear that the resulting imbalances in bargaining power distort competition.

They fear that retailers will exploit their position to extract unfair trading terms.

That retailers will extort excessive payments for access to shelves.

That retailers will demand disproportionate access to confidential information.

All this could squeeze smaller suppliers, who will face higher costs, and greater difficulties to get their products on supermarket shelves. This could force them to cut in their R&D investment budgets, which would eventually reduce the stream of new products, leading to reduced choice and innovation for the end consumer. Reducing consumer welfare in that way would be a serious concern for competition authorities.

This scenario is frightful, but reality is more complicated. Once again, the devil is in the detail – or should I say - retail?

Because the inverse situation also exists. The supply side can be much more concentrated than the retail side. This is the case for baby food, in all countries covered by the study. This also occurs in product categories like coffee or cereals. In fact, supply is more concentrated than retail in about half of the more than 140 national wholesale situations analysed in the report.

A second, and more important point: practices such as these are only a matter of competition law, if they have an impact on the overall functioning of the market. For instance, if a retailer twists the arm of a supplier in individual bilateral negotiations, then he may well be in the wrong, but it falls beyond the scope of competition enforcement.

The 2012 ECN report on the food sector made this point. National competition authorities have investigated a number of such practices by retailers. They concluded that, in most cases, there was no evidence that these practices harm the competitive process in the market, and ultimately harm consumers.

The ECN report argued that there are other, better ways of addressing such individual complaints, than by using competition law. Such as using contract law, fair trading laws and national laws that specifically tackle situations of economic dependency and superior bargaining power. These laws are particularly designed to deal with fairness, rather than promoting

competition.

The Commission does address this problem, for instance in the Communication on Unfair Trading Practices adopted by the Commission this summer.

This being said, some national competition authorities, like those in Finland and Spain, have wondered whether the combination of practices by many retailers in a market could have a negative impact on choice and innovation in the long run. In the study we have examined the Spanish situation. The evidence there suggests that the worries seem to be overstated, and that there is currently little cause for concern in that kind of market.

But now I come to my third point concerning concentration, which is very important. Our study suggests that imbalances in favour of retailers do not necessarily have a negative impact on choice and innovation. At least, as far as we can tell. On lightly or moderately concentrated retail markets, they don't seem to have a negative impact. For these types of situations, the study finds that stronger bargaining power of retailers towards suppliers may even improve choice and innovation in food products.

Now, I am sure that this result will spark a lot of debate. One word of caution, however. Here again the rule applies: the devil is in the retail. We do not have evidence on the development of choice and innovation in highly concentrated markets such as those in Nordic countries and the Baltic states. Further research is needed, which may well lead to different results. Experience, after all, suggests that two retailers have much less incentive to compete than four or five. And this could ultimately reduce choice and innovation, to the detriment of the consumer. But further investigation is needed to prove whether this is the case or not.

Concern Two: Private Labels

The second main concern covered by the retail study has to do with the success of private label products.

In many Member States, private labels represent more than twenty-five per cent of modern retail food sales. This clearly shows that the European end consumer sees private labels as a good alternative for manufacturer brands in many product categories.

Private labels have changed the role of retailers. For many years they merely distributed goods. Now they sell products under their own name. Retailers are no longer merely the customers of food producers, but also

their main rivals. This double role of retailers is a big worry for brand manufacturers, who see this as a distortion of competition at the wholesale level.

Brand manufacturers complain that retailers grant more shelf space and the best parts of their shelves to their own private labels. They accuse retailers of forcing manufacturers to hand over detailed information about their products, and then abusing this information to create copy-cat products.

According to the retail study, private labels do not appear to hamper choice and innovation. Put otherwise, in moderately concentrated retail markets, the current degree of penetration of private labels does not appear to influence the extent of choice and innovation. However, the study also shows that when private labels obtain a majority share in a product category, choice and innovation can decrease. Here again the devil is in the retail.

Competition enforcement in the food sector

Neither of these two complaints, the first about the increased bargaining power of retailers and the second about private labels, has resulted in antitrust enforcement at the EU level.

Other areas have attracted or could attract antitrust scrutiny by national competition authorities.

First of all, national competition authorities are looking into buying alliances. In a buying alliance, retailers join forces when buying products in order to gain better conditions such as lower prices. If there is a lot of competition at the local level, then alliance members will normally pass on those benefits to the consumer. However, if competition between them is reduced or non-existent, then alliance members will have fewer incentives to pass on these benefits. They will see less need to, for instance, reduce prices. In this case competition authorities should act. The Italian national competition authority has already started to examine Italian national buying alliances.

Second, some authorities have taken an interest in negotiations on prices. Suppliers and retailers are not allowed to agree what retailers will charge for the supplier's product. This is not new, and we already punish this. What is new, are a kind of "Most Favoured Nation" clauses occurring, for instance in Austria. In this case, a retailer agrees to sell a supplier's product at a certain price, on the condition that the supplier convinces other retailers to do the same.

The report by the Bundeskartellamt released last week suggests that brand manufacturers and retailers in Germany could be colluding to set the prices of brands and private labels, so they can divide up the market between themselves. Certainly if there is little inter-brand competition, such forms of collusion can be very damaging and could well warrant further scrutiny.

Third, the study has not been able to assess what happens on very concentrated wholesale markets. In these markets retailers and suppliers could end up colluding unintentionally, in networks of parallel agreements or parallel behaviour. This could create uniformity which would limit competition between retailers in their sales to the final consumer. It could reduce price competition and limit choice and innovation. In these cases, competition authorities may have to intervene.

The modern retail study

Now, back to the study.

One of its main conclusions is that the key driver for choice and innovation is the economic environment. It is in the first place the economic climate in Europe that has slowed down innovation in this sector.

The importance of the economy reminds us of the main priority for the new Commission. In his agenda "a new start for Europe", president-elect Jean-Claude Juncker emphasises the priority to restore the economy and stimulate growth and employment. This also applies to the food sector. The study also presents interesting additional conclusions worth mentioning.

It demonstrates that new shop openings positively influence the increase in choice in local retail. This supports the Commission's efforts in the context of the European Retail Action Plan to remove legal barriers to the opening of shops. This should help to stimulate the competitiveness of the retail sector and enhance its economic performance.

Conversely, if a main local operator purchases shops in an area where concentrations are already high, then this will probably not stimulate choice and innovation. This conclusion is important, because it vindicates the intervention by competition authorities in a number of merger cases.

Conclusion

A number of national competition authorities have investigated the retail sector in the past few years: this includes the Danish and Spanish

authorities in 2011, the Belgian and Finnish authorities in 2012, the Italian Authority in 2013, and last week the German authority. Our study, like the work of the national competition authorities, is a thorough and detailed piece of work, so it will take a while to evaluate the results.

By providing information on the evolution of consumer welfare in terms of choice and innovation, our study has a different scope, which provides a unique complementary picture.

Differences in methodology between the studies are sometimes large. These differences can be sometimes explained by different legal requirements. In the German case, for instance the Bundeskartellamt is required by law to investigate dependency cases, where small business partners are dependent on a larger business partners. This explains the Bundeskartellamt's interest in studying bargaining power in individual relationships.

So we should take care not to compare apples and oranges. But I am confident that food retail specialists know the difference. For us the publication of the retail study signifies the end of a long process.

In other respects, it is a beginning. Today, you will start with assessing the methodology and discussing the results and identifying new avenues for research. The debate today and the publication of the study will help us to increase our understanding of how competition functions in the food supply chain. We welcome written comments, which can be submitted to us until the end of the year.

I give now the floor to Paul Csíszár, who as director at DG Competition is in charge of the study. I would like to congratulate him and his team with the results and thank them for the hard work they put in. Paul will guide you through the rest of the day.