Trends in Retail Competition: Private Labels, Brands and Competition Policy

Sector inquiry into the German food retail sector

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Bundeskartellamt

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Agenda

1. Challenges and purpose
2. Approach and structure of the empirical investigation
3. Sales market - Some results
4. Procurement markets / Structure
   - Analysis
   - Some Results
5. Procurement markets / Econometric Investigation
   - Survey techniques & data set
   - Estimation models – the important question of efficiencies
   - Robustness through variety
   - Some results
6. Consequences for the future application of competition law

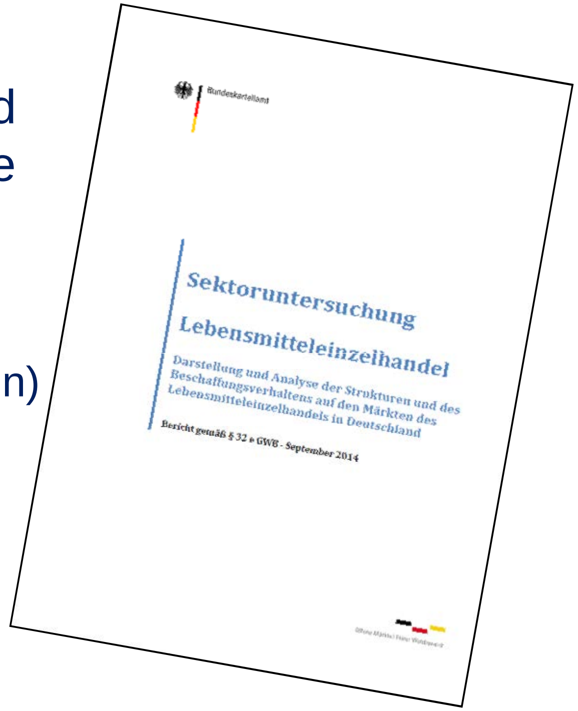
1. Challenges and Purpose

General Objective

Improve **knowledge** of the dynamics in food retailing and **exploring** the market structure of the sales and the procurement markets.

Challenges

- Ongoing concentration process (→ Edeka/Kaiser´s Tengelmann)
- Discussion and complaints about buyer power
- The “new character” of buying alliances



Purpose

- Econometric insights in different – often theoretically discussed – aspects of buyer power.
- Identification of key drivers of buyer power. Better framework for assessment of (merger) cases
- Shedding (a spot)light on market structure

2. Approach and Structure

Sector Inquiry Retail Food

A. Downstream	B. Upstream (Procurement)
Comparison of structural indicators: - turnover - total sales - floor space - outlet density - customer reach - distribution channel concepts	**Ia. Case Studies** (Analysis of seven individual, specially selected procurement markets) **Ib. Comparison of structural indicators** (Analysis of purchasing volume and other figures in every product category and overall & purchasing cooperatives) **II. Econometric Analysis** (Estimation of econometric models based on a unique data set from a stratified sample)

3. Sales markets
Some results

- **high concentration, even increasing.**
- **slight assimiliation of the distribution channels, but graduated competitive relationship is still apparent.**
- **continuing course of expansion of Edeka and Rewe via mergers and buying alliances.**
- **problems of internal growth in particular for smaller retailers and newcomers.**
- **new generation of buying alliances.**
- **developments of private labels in terms of quantity and quality.**

4. Procurement markets: Which product markets were analysed?
…which criteria are important?

- different product categories
- market size
- supplier and buyer structure
- the importance of private labels

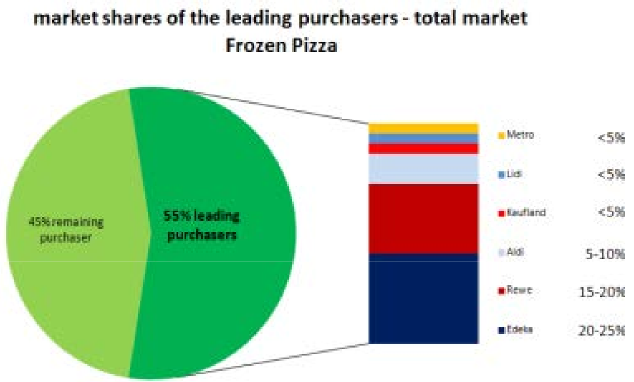
- procurement shares of the individual retailers
- the conditions of competition

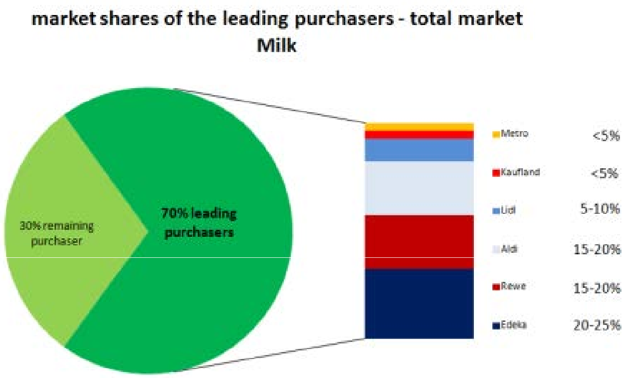
Frozen Pizza compared with Milk

Frozen Pizza

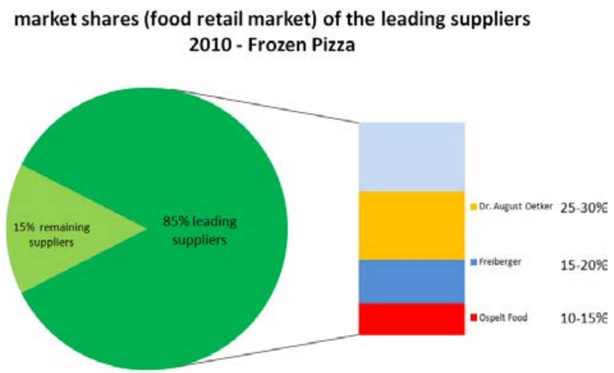
Milk

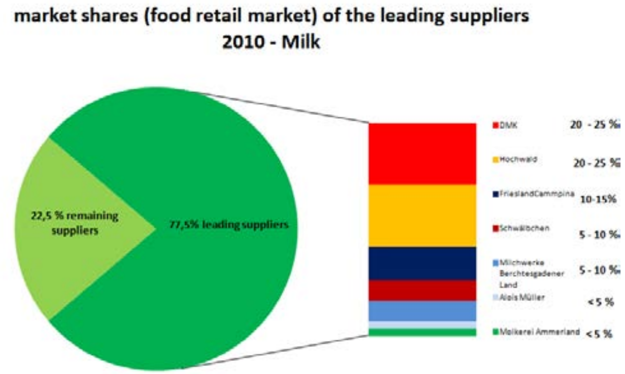
Purchasers





Supplier





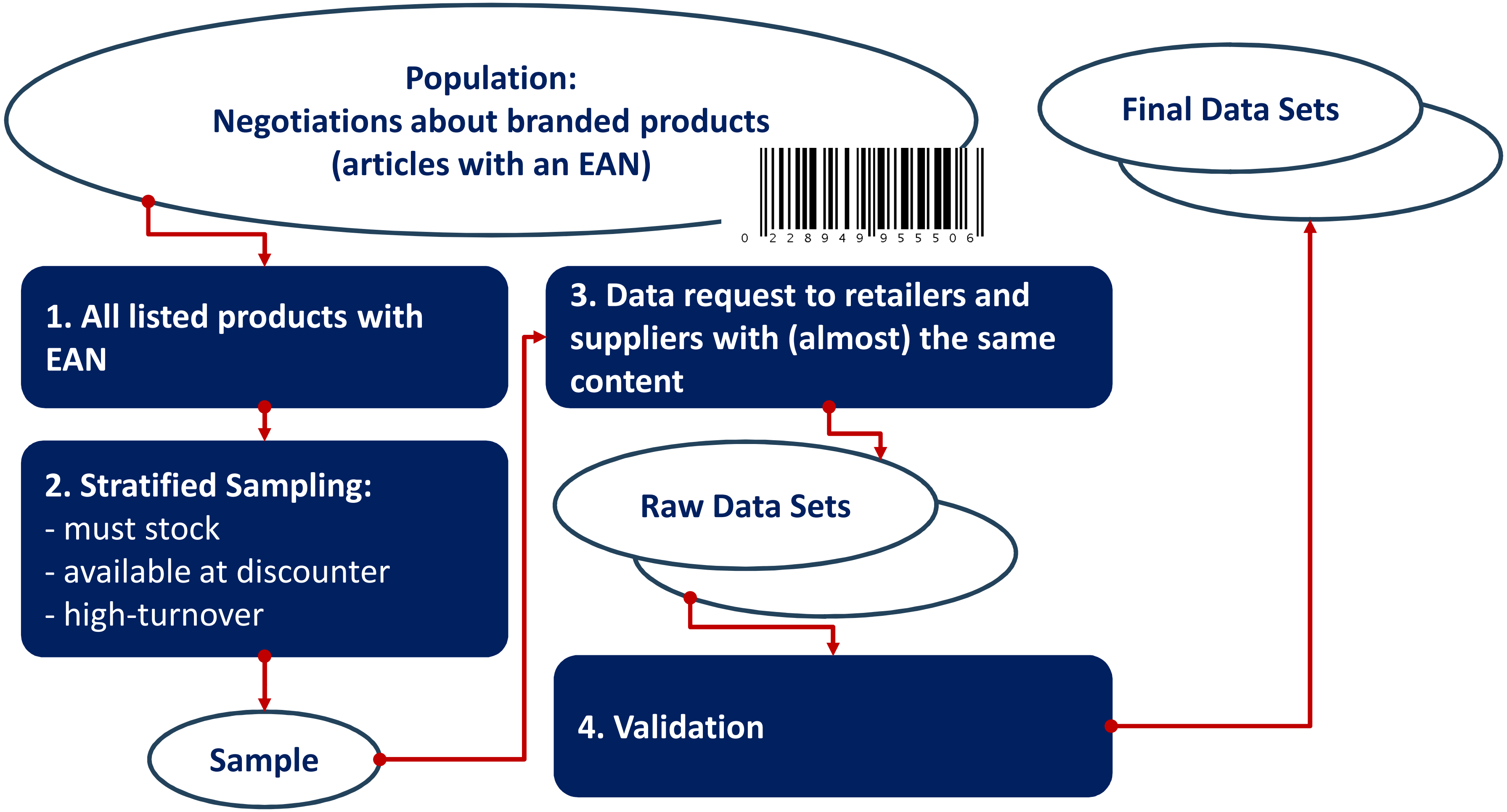
4. Procurement markets / Structure
Some Results I

- Markets for the procurement of **private labels and branded products** are most often **separate markets**, despite the high technical ability to switch production
  - The cost and distribution structures in the manufacture of branded products on the one hand and private labels on the other greatly vary in many cases
  - increasing competition between upgraded private labels and branded products is an economic obstacle for manufacturers to produce private labels
- In all the procurement markets examined the **food retailers in Germany purchase** their goods primarily **from manufacturers in Germany**.
- In all the procurement markets examined the **food retail trade is the most important sales channel** for food manufacturers. Alternative distribution channels are declining.

4. Procurement markets / Structure
Some Results II

- The **group of leading food retailers** (Edeka, Rewe, Aldi, Schwarz Group) account for the largest share of total demand (in all the distribution channels including export) across all procurement markets and irrespective of whether private labels and branded products are in one market or not.
- On the **manufacturers' side** a heterogenous leading group of at the most four to five companies of various sizes account for the substantial part of the goods and services supplied.
- **Shifting sales to another distribution channel** is either regarded as not economically viable or there is a lack of the "absorptive capacity" of alternative distribution channels.

5. Econometric Analysis
Survey techniques and data set I



5. Econometric Analysis
Survey techniques and data set II

Final Data Sets

Variables (examples):

volume / gross price / net-price / purchasing cooperatives / terms of payment / brand / private labels / sales volume / „folding“

	Retailer data set	Supplier data set
# products/items	238	256
# negotiations	2830	2987
# observation	61.632	65.197

5. Econometric Analysis
Basic idea of estimation models

Linear (fixed effect) model…
…to estimate the conditions for the purchase of branded products (dependent variable)
…identify the key factors of successful negotiations (independent variables)

dependent variable	independent variables

$$condition_i = const + \alpha \cdot volume_i + \sum_n \beta_n \cdot neg.factor_{n,i} + \sum_{c=1} \gamma_c \cdot control_{c,i} + \sum_{k=1} FE - Dummy_{k,i} + \varepsilon_i$$

purchasing conditions (adjusted prices)

purchasing volume

determinants of negotiations

control variables

fixed effect dummies (for the articles)

folding

terms of payment

end of negotiation (in every year)

turnover shares (outside options)

well-known branded products

relevance of private labels (in the segment)

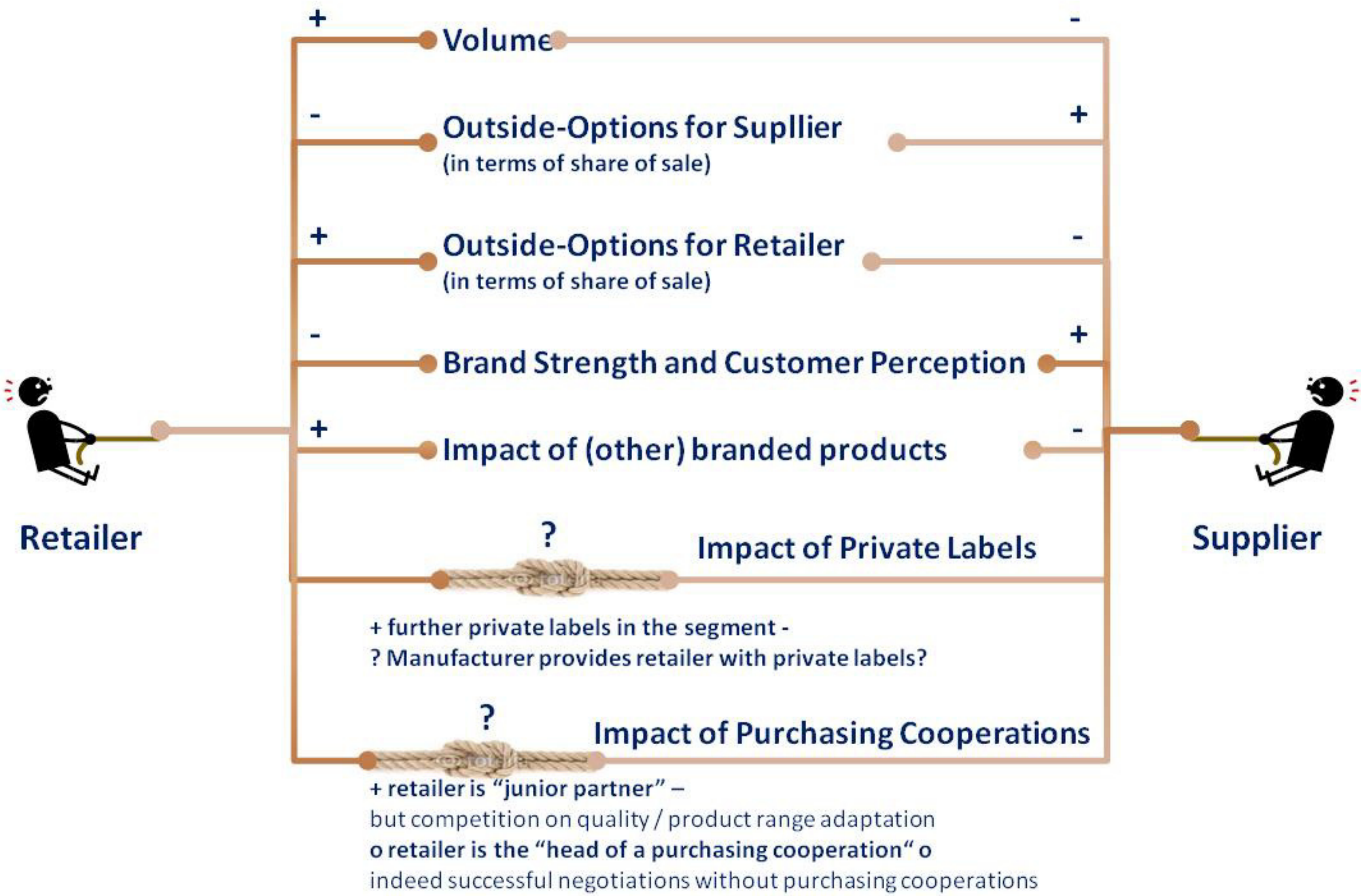
purchasing cooperatives

5. Econometric Analysis
Robustness through variety

Data Sets	**Supplier data set**		**2 alternatives**
	Retailer data set		
Estimation (Models)	**OLS 2010**	**no instrumental variables**	**6 alternatives**
		instrumental variables	
	OLS 2011	**no instrumental variables**	
		instrumental variables	
	Fixed Effects	**no instrumental variables**	
		instrumental variables	
Operationalization	**many ways to measure relevant factors** (you find them in the report)		**4.860 alternatives**

58.320
(alternative) estimation models
were estimated!
(192 finally discussed in the report)

5. Econometric Investigation
Some results I



5. Econometric Investigation
Some results II

- **High purchasing volumes** lead to low purchasing prices (no suprise!), leading retailers enjoy further economies of scale.
- They are **„gate keepers“** with regard to the penetration of the manufacturers products.
- Even **strong manufacturers** with high turnover shares in the food retail sector **can be faced with strong bargaining power** from their customers → check **outside options** on a case-by-case basis.
- In the assessment of bargaining power in bilateral negotiations, the **brand strength** of the products in question is taken into consideration. There is a need to determine to what extent the products of a certain manufacturer are indeed indispensable for the retail trade (about 6% of the sampling).

5. Econometric Investigation
Some results III

- The bargaining position of the retailer is usually strengthened if he also offers **private labels**/depends very much on the circumstances of the individual case.
- At the horizontal level, a retailer offering a **wide range** of **private labels *and* branded products** usually enjoys a structural advantage over its competitors.
- The **"new generation" of buying alliances** can be part of the consolidation of the market and improves the bargaining positions of the leading food retailers.

6. Consequences for the future application of competition law

- Each **acquisition of a food retailer** by one of the large retailers Edeka, Rewe and the Schwarz Group, requires an in-depth examination, also with regard to the procurement markets.
- As to the **control of abusive practices**, the sector inquiry provides important insights regarding the identification the **addressees** of the prohibition of inducing suppliers to grant a retailer specific benefits without any objective justification ("Anzapfverbot").
- The sector inquiry suggests that at least the large food retail companies Edeka, Rewe, the Schwarz Group and Aldi are norm addressees under the control of abusive practices.
- An assessment of whether a **demand is objectively justified** can only be made **on the basis of the concrete facts** in each individual case. The sector inquiry provides indications as to which bargaining scenarios are more or less likely to result in abuse practices.
- In particular the **"new" buying alliances** involving large companies must be carefully examined. They no longer merely represent a time-limited bundling of purchasing volumes, but must be seen as part of the concentration process with significant long-term effects on competition also on the sales markets.

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