The Economic Impact of Buying Power on Retail Competitiveness and Consumer Welfare

Competition Economics and Marketing Science based Remarks by Dieter Ahlert

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In recent years, it is not rare to meet quite peculiar concepts of buying power, unfair trading practices and barriers to market entry in studies on the retail sector. One example is the Sector Inquiry of the German Federal Cartel Office (Sektoruntersuchung Lebensmitteleinzelhandel des Bundeskartellamtes - BKartA, B2-15/11, SU LEH, September 2014). Alongside Carl Christian von Weizsäcker[1] it can be stated that market dominance and barriers to market entry are terms that depend on the general orientation of competition. "Those competition authorities who have a narrow concept of competition see barriers to market entry everywhere, and as guardians of competition see themselves very extensively prompted to intervene in market action in order to safeguard competition and improve consumer welfare". Quite in contrast to this concept, it must be held that if the structures, practices and results are to be observed within a market that functions without any problems, one needs to accept these facts as being a ´per-se optimum outcome of the selection behaviour of consumers´. In other words, given the premise of functional competition, it may be said that ´modern retail is entitled to an existence because it exists´ (freely adapted from Nobel Prize Laureate John Richard Hicks).

1 Increased power of retailers vis-à-vis their suppliers, increased private label success and insurmountable barriers to market entry: Evaluation from the perspective of a general functional competition orientation

1.1 The general orientation concept of functional competition

The orientation concept predominant within competition economics assumes that nobody is capable of knowing or determining the **optimal structures** of markets, neither on an *ex post* nor on an *ex ante* basis. Given the high degree of complexity (intricacy and dynamics) of competitive activity, such a claim would have to be described as an "arrogation of knowledge" alongside Friedrich August von Hayek[2]. It is therefore <u>not</u>

[1] Cf. Von Weizsäcker, C.C.: Marktzutrittsschranken; in: Oberender, P. (ed.): Effizienz und Wettbewerb, Berlin, p. 59 ff; also cf. by the same author: *Barriers to Entry. A Theoretical Treatment,* in: *Lecture Notes in Economics and Mathematical Systems*, No. 185, Heidelberg 1980.

[2] Cf. v. Hayek, F. A. (1975): Die Anmaßung von Wissen. Address at the Nobel Memorial Prize Award for Economics, held on 11 Dec. 1974 at the Faculty for Economics in Stockholm, in: ORDO, Vol. 26, 1975, pp. 12-21.

possible to research what degrees of concentration are, for example, optimal within the ´grocery supply chain´ on the part of the trade (or also industry), even with the aid of empirical studies. However, if these optimal structures are unknown, no deviations from optimums can be determined either or consulted as the basis for state interventions. The possibility of defining **optimal modes of behaviour** or even **optimal market outcomes** as a yardstick for the evaluation of the functionality of a market is just as low. The welfare economics based, sustained 'best' prices, quantities, market shares and forms of quality cannot be specified by anyone, neither by the participating stakeholders within the value chain nor by scientific experts.

Consequently, wishing to specify the following target values for a specific sector or value chain and to sanction their achievement must likewise be described as an "arrogation of knowledge":

- the **optimum product diversity** on supermarket shelves (measured on the basis of the number of product types on offer),
- the **optimum market share of private labels** within the various categories of goods,
- the **best possible rates of innovation** within the relevant markets (measured on the basis of the number of completely new or new types of products),
- the **"fairest" conditions** as the negotiation outcomes between suppliers and marketing intermediaries,
- the **optimum division of labour, specialisation and risk distribution** within the context of the relationship between trade and industry, etc.

Market structures, modes of conduct and market outcomes are optimal from a competition and welfare economics perspective when and only when these result from **"functional competition as discovery process"**. As a rule, optimality establishes itself automatically, provided that market processes function in a (sufficiently) disruption-free manner. What is therefore essential and should therefore be the objective of regular tests (including by means of empirical studies) is the problem-free functioning of **market processes**. For the purposes of identifying non-functional markets (market failures) and thus the need for competition policy based intervention, it should be checked by means of regular analyses of market processes whether the market is satisfactorily fulfilling control and co-ordination tasks incumbent upon it and whether specific minimum requirements are being met.

There is general agreement within the area of competition policy based general orientations that five processes determine the functionality of a market:[3] The **market**

[3] In this regard, by way of example, cf. Grossekettler, H.: Eine neue Methode zur Messung der Funktionsfähigkeit von Märkten: Die KMK-Funktionsfähigkeits-Analyse, in: Die Betriebswirtschaft 1991, p. 467ff.

clearing process has the task of reconciling quantities being offered with those being demanded through an appropriate variation of prices. The task of the **yield normalisation process** consists of correcting over- or under-performing yields caused by exogenetic disruptions through the varying of capacities. The **erosion of superior market power process** has the task of eliminating power imbalances between suppliers and consumers. Market power erosion can be facilitated through entries on the stronger side of the market or through concentration on the weaker side of the market. **Product advancement processes and system advancement processes** have the task of preventing advancement deficiencies at the product level and, where applicable, at the system level (e.g. in distribution and trade), i.e. to implement innovations. Potential disruptions of this process can, for example, be due to the introduction of an innovation not appearing worthwhile to an individual supplier because of an inability to achieve a 'return on investment' without impediments, as well as exclusively (absence of incentives to innovate).

One generally considers markets to be functional when **no fundamental barriers to market entries** (and market exits) exist, and stakeholders are afforded a **sufficient measure of organisational freedom**[4]. If no fundamental process disruptions are discernible within a market, the structures, modes of conduct and outcomes observable here can be described as **optimal *per se* –** not only from a competition theory based but also from a welfare economics based perspective. If, for example, high rates of concentration and retailers working on an efficiency orientation basis ('modern retail') are encountered here, this is not to be characterised as a reason for complaints, but as **evidence of general orientation conformance**. Given the premise of functional competition, as Nobel Prize laureate John Hicks[5] did, it may be said that: *Trade is entitled to an existence because it exists!*[6]

1.2 Consumer welfare through diversity in competition

The **most substantial gain in welfare** is experienced by consumers when they can continuously select afresh on the basis of a substantial, attractive diversity of innovative, as well as tried and trusted price-performance combinations at the same time (Cf. Fig. 1).

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4 Cf. Ahlert, D./Kenning, P./Olbrich, R./Schröder, H.: Vielfalt durch Gestaltungsfreiheit im Wettbewerb. Ein ökonomisches Manifest zur Deregulierung der Konsumgüterdistribution, Munich, 2001.
5 Cf. Hicks, J. R.: Einführung in die Volkswirtschaftslehre, 8th ed., Reinbek (near Hamburg), 1971.
6 By way of this statement, the practice exercised over centuries to deny the trade its right to exist is carried out *ad absurdum*. The French early socialist Charles Fourier (Theorie der vier Bewegungen und der allgemeinen Bestimmungen, Frankfurt a.M., 1966, p. 296 f.) summarised the discomfort of the population and portions of the professional world in a particularly drastic way. At the beginning of the 19th century he described the trade *"as a party of lies with the munitions of bankruptcy, speculation, usury and fraud of all types that consists of pirates and flocks of vultures that devours agricultural work and factories and in every respect subjugates the entire nation."*

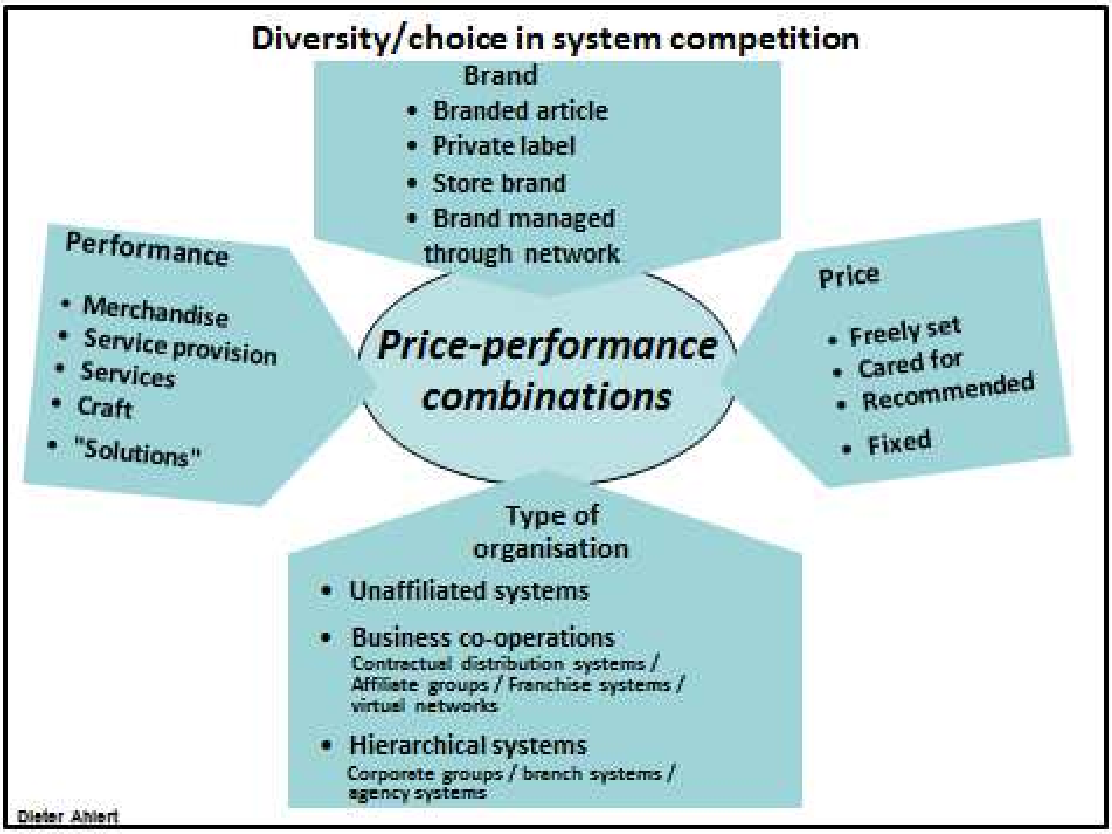

Fig. 1: The components of price-performance combinations

In order to reveal market disruptions and the need to act from a competition policy perspective within the grocery supply chains of the European member states the analysis of the symptomatic outcomes of innovation activity to be encountered there, i.e. the degrees of innovation and product diversity, is however entirely inadequate. Attention should rather be focussed on the issues of

- whether the processes pertaining to the development and diffusion of new service/supply concepts, the so-called product and system advancement processes, function disruption-free, and
- whether functional system competition can also be determined in terms of the tried and trusted, established service/supply concepts.

Diversity in competition is not an end in itself and can only be evaluated as positive (or also negative) as part of a theoretically based evaluation context. Within this context it is appropriate to distinguish between purely quantitative multiplicity and (qualitative) diversity. In the event that **numerous very similar products** (so-called me-too products) are offered on the basis of comparable terms and conditions, their multiplicity may be described as extensive without, however, already being able to refer to qualitatively noteworthy diversity. Nonetheless, this scenario can certainly be evaluated positively as an indicator of intensive competition from a welfare economics perspective, and more specifically in terms of the aspect of alternative options for the consumer. Within the food sector we experience this type of (quantitative) multiplicity when specific types of products are offered not only as industrial branded articles by a variety of manufacturers, but additionally also within all larger trading systems as components of the relevant private label programs. When consumers do not encounter their preferred problem solutions despite the quantitatively numerous product/service alternatives, the ambivalence of multiplicity becomes obvious: consumers would have wished that the (always scarce) shelf space within the trade would have been better filled with different product alternatives instead of duplicates. Only competition that operates in an undisrupted manner as discovery process can cope with this ambivalence in a welfare optimized way. It has repeatedly been attempted on the part of the branded article industry to decry an **imitation of successful branded products by way of private labels** as a mistake. In the course of this, a popular option is to draw on the argument of power asymmetry within the distribution channel. This notion is, however, devoid of a general orientation appropriate basis if no drawbacks can be demonstrated that would impair the functionality of competition as discovery process.

1.3 Barriers to market entry: An ambivalent phenomenon

In the course of the regularly to be conducted check of the functioning of market processes, the most important testing criterion is the extent of **barriers to market entry within the relevant market**. These determine the potential and latent avoidance alternatives of customers in the event that their suppliers were to seek to *worsen* (!) terms and conditions significantly. If market process disruptions are to be observed within a particular supply chain of a country, implemented degrees of concentration or the own brands of the trade <u>cannot</u> be made responsible for this. The hypothesis that advancing trade concentration and rising market shares of 'private labels' would ultimately end in market failure while reciprocally strengthening each other is devoid of any valid theoretical basis:

- Increasing concentration and rising market shares of private labels can at best occur as <u>symptoms</u> of market process disruptions. <u>The causes</u> of disruptions are, in contrast and as a rule, barriers to market entry within the applicable relevant market that are too high – these causes should be counteracted by way of state interventions!

- Increased concentration and higher own brand shares are, however, frequently not only the opposite of disadvantageous in terms of competition and welfare, but can be the by-products of increased professionalization and the efficiency enhancement of retailors to the benefit of consumers – these should therefore be evaluated as positive from the perspective of competition policy and be protected against counter-productive interventions (e.g. by the competition authorities).

When one contemplates the significance of **barriers to market entry**, given the background of functional competition as the predominant general orientation concept, one reaches the surprising conclusion that this is **an ambivalent phenomenon**. This may also be the reason why its existence is often highly contentious. Within this context, ambivalence means that a distinction is to be drawn between barriers to market entry that are desirable (or at least tolerable) from an economic policy perspective and those that are undesirable:

- Barriers to market entry that are to be **evaluated as positive** from a competition and welfare economics perspective are based on specific services of suppliers that are viewed to be extremely useful by consumers. On the part of the trade, these for example include excellent price-performance combinations of customer orientated and efficiently operating systems of ´modern retail´ that ensure a **high quality** supply to consumers at **reasonable prices**. Here, a prerequisite for entry of the market by other businesses would be that they would have to be in a position to attain or, where possible, even to exceed these standards and benchmarks. **Strong brands** also form part of the barriers to market entry that are desirable from an economic policy perspective. Within the trade, these can both be trade brands (private labels) that form part of the ranges of shopping locations and outlet brands (store brands). Strong brands have also established themselves on the basis of remarkable achievements in relation to consumers. The barriers to market entry to be evaluated as positive have in common that they only remain in place for as long as the price-performance ratios do not substantially deteriorate to the detriment of consumers. Or, in other words:

  Only consumers can erect these barriers and cause them to tumble
  by means of their selection decisions.

- Barriers to market entry to be **evaluated as negative** from a competition and welfare economics perspective, in contrast, are those that can cause functional disruptions of market processes or even totally market failure. In contrast to the positive barriers, these are characterised by the fact that they cannot be eliminated through appropriate selection decisions on the part of consumers. These can, for example, prevent a horizontal price cartel active within the market from being 'disempowered' by current or potential entries into the market.

Here, indeed, it could possibly be the task of appropriate state interventions to act towards the elimination of these causes of market process disruptions.

The fact that the extent of a barrier to market entry to be evaluated as negative is measured variably in an actual individual case has many causes. In part this has to do with different approaches to the **demarcation of a relevant market**. In part, the time-based observation horizon, however, also differs. I.e. some experts only accept actual market entries and others also entry options of potential or even latent competitors. An example of diametrically opposed assessments of actual barriers to market entry is provided by virtue of the controversy between the German Monopolies Commission and the German Federal Cartel Office concerning the food trade in 2008: Whereas the German Federal Cartel Office recognises that there are practically no opportunities for market entry within the food trade (which would point towards considerable deficiencies in terms of functional competition)[7], the German Monopolies Commission deems "the prerequisites for effective potential competition [to be] fulfilled, because barriers to market entry at the trade level do not prevent market entries." [8]

During the analysis of market entry opportunities within the consumer-goods trade, a distinction is to be drawn between two different levels:

Market entry at the retail level is currently being made more difficult by two factors, despite the existence of effective wholesale acquisition sources. The barrier of capital is effective – even though it is not insurmountable, even by absolute newcomers. In particular as a result of the tendency towards large-scale types of businesses that correspond to consumer wishes and the merchandise management systems required for optimal operational control, the demand for capital has increased significantly in the recent past. On the other side, this however faces forms of business start-up support on the part of the commercial affiliate groups. Currently, the decisive and, in the case of large-scale trading firms, virtually insurmountable barrier to market entry may be seen to be the scarcity of locations that hold the promise of success and sufficiently large business premises. This permits the conclusion that a market entry is largely only still possible by taking over existing business premises.

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[7] "In the case in question, the market is in particular characterised by market structure based barriers to market entry for the food retail trade that counteract the entry of potential competitors." (German Federal Cartel Office 2008, Fusionsverfahren Edeka/Tengelmann, ref. no. B2-333/07, p. 94). "Accordingly, market entries by foreign suppliers (ITM Enterprises S.A. and Walmart) have never succeeded in the past. The high cost pressure within the food retail trade (LEH) is in fact having the result that smaller domestic competitors have already departed from the market or that they at least commit themselves to one of the market leaders within the food retail trade for the procurement of their goods, thus losing a substantial portion of their entrepreneurial independence." (ibid., p. 95).

[8] German Monopolies Commission: Preiskontrollen in Energiewirtschaft und Handel? Zur Novellierung des GWB. Sondergutachten der Monopolkommission, 2007, p. 34.

A **market entry that involves a complete trading system** can only succeed if it is competitive not only on the sales side, but also on the procurement side (within the context of conditions of purchase). Lastly, the market entry of a complete trading system only makes sense if gaps were to arise within this market or existing stakeholders were to seek significantly to worsen their transaction conditions in relation to consumers. Since, as can be observed in Germany, generally no shortage of sales floor area exists, competition within the trade sector is extremely intensive, and achievable profits are below average at an international comparison level, the absence of market entries comes as no surprise. This can be advanced as one of many reasons why no international grocery business has hitherto succeeded in asserting itself on the market within Germany.

Conclusion:
When contemplating the current situation, for instance within the German grocery sector, one must agree with the German Monopolies Commission that there should be no reference to a globally superior position of the grocery trade that is of concern from a competition policy perspective in relation to the food industry (*et vice versa*). The author of this statement is currently not aware of any sub-segment of the grocery supply chain in Germany in which an original superior market power position of the trade already exists or acutely threatens to establish itself.
The departure hypothesis for a comprehensive analysis of the ´purchasing muscle phenomenon´ should therefore, at least in terms of the German grocery supply chain, state that the market processes within this sector can largely be confirmed to be functional. Only impairments of advancement processes caused by the cartel law based (excessive) regulation of consumer-goods distribution can currently be mentioned as noteworthy disruptions of functional competition". [9]

[9] We have repeatedly pointed out the necessity of deregulation. By way of example, cf. Ahlert, D.: The Liberation of the Value Chain from Cartel-Law Restraints – The Risks and Opportunities of Deregulation, in: ZVertriebsR 4/2012, pp. 207-218 and Ahlert, D./Schefer, B.: Vertical Price Coordination and Brand Care – Interdisciplinary Perspectives on the Prohibition of Resale Price Maintenance, Springer Briefs in Business, Wiesbaden, 2013.

2 Bargaining power versus monopsony power as the cause of market failure: Market dominance through buying power or vice versa?

A diversity of conjectures concerning cause/effect relationships within the area of European grocery supply chains forms the basis of the current discussion (Cf. the examples presented in Fig. 2). What is at issue are (alleged) effects to which specific developments within the retail trade could potentially lead concerning the situation within the food industry, as well as consumer welfare. The ultimate upshot of these effect conjectures is that in particular the high degree of concentration and the growing private label share within the area of ´modern retail´ would or could lead to a negative economic influence on "choice and innovation" within a sector.

The central construct that is predominantly modelled as the intervening variable within these conjectured cause/effect chains is the so-called "purchasing muscle of the trade". On the one hand, this refers to the alleged power predominance of retail enterprises in relation to their individual suppliers ("bilateral relations"). On the other hand, the term of purchasing muscle is used to refer to the supposed global superiority of the trade that exists in relation to the industry ("power over the majority of suppliers"). Evidently, complaints have been submitted (in particular on the part of suppliers and their associations) that culminate in the demand to the EU Commission and national competition authorities for regulatory intervention into the grocery supply chains.

Behavioural relationships within the value chains of the consumer-goods economy to be evaluated as negative from a competition and welfare economics perspective (in particular unfair or dishonest commercial practices) have already been decried vehemently time and again over a number of decades.[10] This, however, largely concerns interest contingent viewpoints aimed at providing the motivation for official competition policy to intervene against power concentration on the part of the trade. These statements are devoid of a valid theoretical basis to the greatest possible extent. The assertions and conjectures concerning bilateral and multilateral relationship constellations within value chains can thus also not be substantiated theoretically with respect to the previously outlined competition policy based general orientation concept of 'functional competition as discovery process'.

[10] In this regard already critically cf. Ahlert, D.: Das Sondergutachten der Monopolkommission zur Konzentration im Lebensmittelhandel - Grundzüge einer kritischen Stellungnahme aus betriebswirtschaftlicher Sicht, in: Markenartikel, Issue 11/1985, pp. 536-555; Ahlert, D./Wellmann, Th.: Die Machtkonzentration im Lebensmittelhandel - Ein ungelöstes Problem der Wettbewerbspolitik?, in: asw, Issue 6/1989, pp. 106-115.

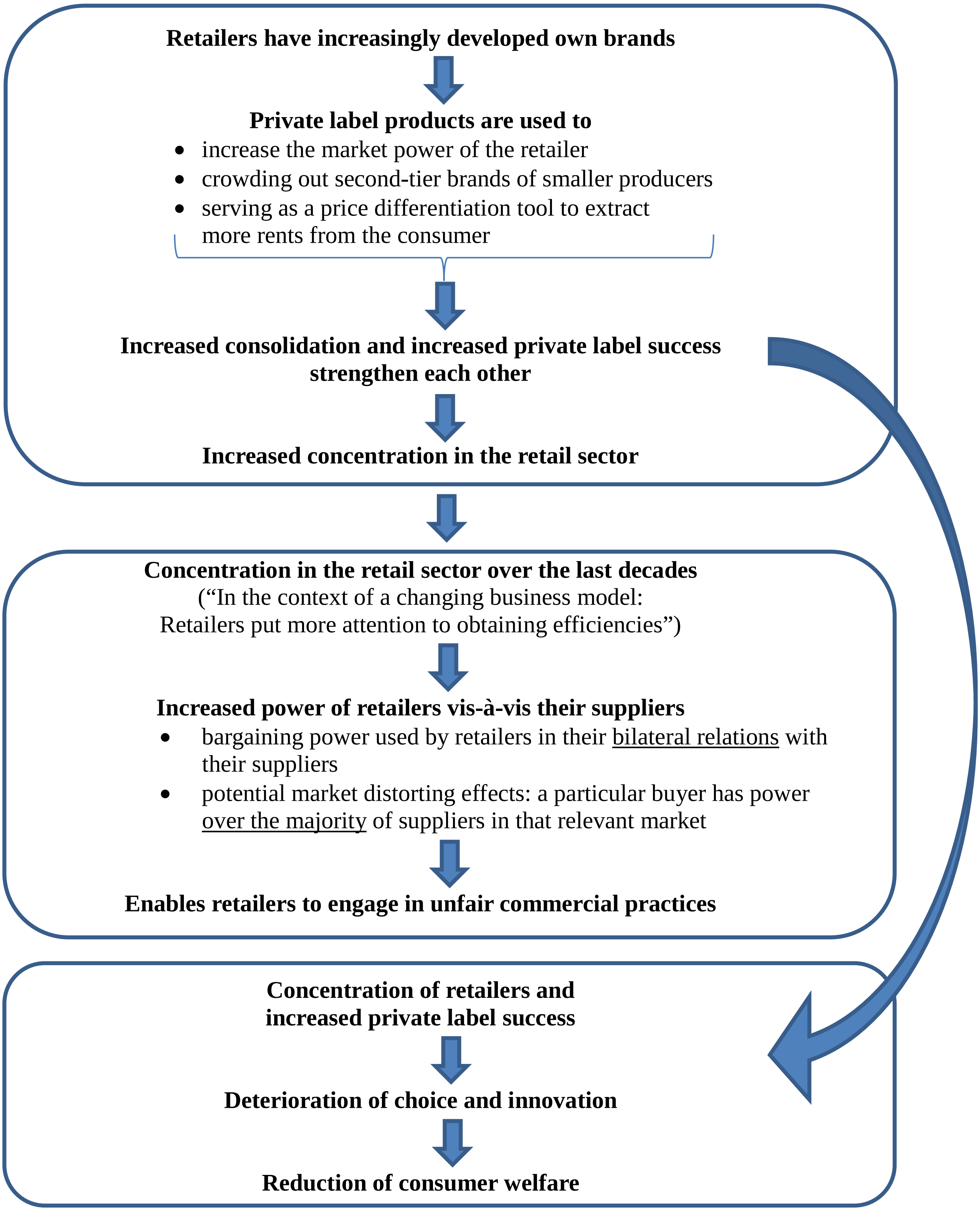

Fig. 2: The economic impact of modern retail on choice and innovation in the EU food sector (derived from the EU study COMP/2012/015)

2.1 Superior market power positions of traders and unbearable dependency positions of manufacturers within the grocery supply chains: Reality or systematic measurement error?

A particularly high disruption potential for the functionality of markets is – and it appears feasible for consensus to be reached on this – accorded to a serious asymmetry of power between the supply and demand sides. As already outlined by way of introduction, a disruption of the ´erosion of superior market power process´ applies in this case. The purpose of this process is to ensure that permanently are prevented at in each instance one of the distribution levels (industry or trade level) through the erosion of these positions by way of structural variations. Market power erosion can be facilitated through entries on the stronger side of the market or through concentration on the weaker side of the market. Reference is also made to "countervailing power"[11] within this context.

One can of course also view markets to be functional in instances when power imbalances are observable and in the long term do not display any tendency towards erosion, but no substantial barriers to market entry exist. In this case, the **potential threat of the option of market structure alteration** is already sufficient to prevent a misuse of superior market power. This has been and is still often overlooked when the complete trade level is denounced as overly powerful because individual suppliers are said to have to suffer as a result of a form of 'unbearable and unreasonable' dependency.[12]

The terms of **power and dependency** are often accorded a <u>subjective</u> interpretation as a basis within the context of economic practice. In this regard, economic dependency and superior market power are seen as 'two sides of the same coin': Entrepreneur A has power in relation to entrepreneur B to the extent that B subjectively deems to be dependent on A, and in other words believes not be able to avoid A. Power (and accordingly also its counterpart: dependency) is here a relational, personal factor, the extent of which is determined by the subjective assessment of people, or more precisely "people holding power" and "people subjected to power". On the basis of these subjective assessments, it is only possible to reach a conclusion regarding any objectively existing, inter-subjectively verifiable power potential to a very limited extent. However, when the ´dependency of businesses´ is referred to in cartel legislation (for instance in § 20 GWB (German Act Against Restraints of Competition)), only the <u>objectively</u> existing but not the subjectively perceived power potential can be intended.

[11] Cf. Zhiqi Chen: Dominant Retailers and the Countervailing-Power Hypothesis, in: The RAND Journal of Economics Vol. 34, 2003, No. 4, pp. 612-625

[12] At the time of the price control ban (1973) in Germany, this issue was already discussed extensively, but exactly the other way around. At the time, it tended to be manufacturers of branded articles (shoulder to shoulder with the 'saturated' specialised trade) who were suspected of being capable of holding an 'unbearable', superior market power.

The central question is how this power potential can be determined and measured as the basis of dependency.[13] If one were to follow the deliberations of the German Federal Cartel Office and also those of the European Commission, one could make things relatively easy for oneself in terms of **measuring the relative market strength** of a commercial enterprise and the supplier dependency accompanying this, in that a conclusion concerning their dependency is reached on the basis of the actual evasive behaviour of manufacturers. The effective evasive behaviour of the supplier manifests itself in the **"share of sales"** of the applicable commercial enterprise in relation to the overall sales of the supplier factor.[14] If the above statement is converted into a hypothesis, it would be this: ´The higher the share of sales of a commercial enterprise on the demand side is in relation to the total sales of the supplier, the higher is the dependency of the supplier on precisely this commercial enterprise.´

This hypothesis is, however, already not tenable at a terminological level, because an above average share of sales can certainly also reflect "not wanting to avoid", in other words the so-called bond a supplier has with their merchant. The reasons for this could be the particularly attractive goods presentation of the merchant or comparatively advantageous terms and conditions.

[13] The interviewing of entrepreneurs affected by the exercising of power, as often practiced by the competition authorities, is not entirely unproblematic within this context. It is true that these interviews can provide some details in the form of expert opinions. The prerequisite for this is, however, that the interviewees have a clear idea of what is actually referred to with "adequate and reasonable opportunities to switch over to other enterprises". As the following remarks will show, this is highly contentious. The prerequisite for the validity of such interviews is additionally that the entrepreneurs provide answers in their professional capacity and not as emotionally predisposed representatives of interests.

[14] In connection with the proposed EDEKA/Plus amalgamation, the German Federal Cartel Office is selecting a quantitative approach of this type in order to determine dependency: "Incidentally, the extent of the sales achieved by a supplier in conjunction with the amalgamation participant is characteristic for their dependency on the amalgamation participant. These **individual dependencies** are to be taken into account within the context of the verification of whether dominant access to procurement markets exists." (German Federal Cartel Office 2008, Fusionsverfahren Edeka/Tengelmann, ref. no. B2-333/07, p. 109 f.). In addition, this declaration of the German Federal Cartel Office states: "The European Commission even takes the individual dependencies of suppliers into account directly in order to determine market dominance. In line with European decision-making practice, market dominance represents a position of economic power in terms of which the relevant business is in a position to prevent effective competition in a lasting fashion in a market in which it can not only adopt independent conduct in relation to its competitors, but also in relation to the opposite side of the market of which its suppliers form part. Accordingly, the European Commission determined the following with respect to the REWE/MEINL proceedings, which concerned the amalgamation of two grocery retail (LEH) chains, in particular with effect in Austria: in the event that a supplier achieves in excess of 22% of their sales on the basis of a particular purchaser, such purchaser - should demand on their part then cease - is only replaceable subject to heavy economic losses or not at all" (ibid., p. 110).

The avoidance options of a supplier according to the relevant market concept[15] *may, however, only be verified in the event that their merchant sought to worsen terms and conditions significantly. This would, for example, be the case if a commercial enterprise sought to exploit its net power (e.g. following on from a monopolisation process) in order to induce the supplier's acceptance of terms and conditions that are clearly less favourable to the supplier.*

In terms of the dependency question, only "not being able to avoid" is relevant, in other words the so-called bound state. In this context, avoidance options that result from potential entries into the market by merchants are also to be taken into account. The "share of sales" key figure therefore does not indicate anything viewed in isolation. (More details concerning this are provided in Ch. 2.3.)

2.2 The power predominance of consumers within the distribution channel: Derivative purchasing power versus original trading power

The issue of whether and given which prerequisites bargaining power is to be evaluated as negative from a competition and welfare economics perspective at all is of fundamental importance. If the power constellation in terms of the relationship between an individual food manufacturer and an efficiently operating trading system is observed in isolation, it is indeed possible to state a considerable predominance on the trade side in numerous cases. It may be feasible for the dependency position of manufacturers connected to this to be traced back to the fact that, due to their specific brand policy objectives, e.g. an available everywhere promise in relation to their brand name products, they are urgently reliant on being listed at all leading trading firms. A high dependency on the trade generally in particular exists amongst manufacturers who find themselves within a **buyer market situation** characterised by a supply surplus. The potential forms of demand of consumers that can be referred on or withheld by of the individual trading systems to manufacturers within this situation constitute sanction bases of the trade that are to be evaluated as very substantial (Cf. Fig. 3).

These sanction bases are, however, not generally to be classified as dangerous. The competition policy based assessment of the purchasing power of the trade (and the supplier dependency connected to this) is primarily to be made dependent on whether this refers to original or derivative power. In this regard, it is initially to be pointed out that

[15] In this regard, fundamentally cf. Ahlert, D.: Relevante Absatzmärkte, Marktbeherrschung und Fusionskontrolle im Lebensmittelhandel – Der Fall Metro/Kaufhof, in: Der Betrieb, Supplement no. 9/1987 to Issue no. 16.

the demand of the trade is always derived from the demand of end consumers, who bring this to bear at the lower level of the relevant distribution systems.

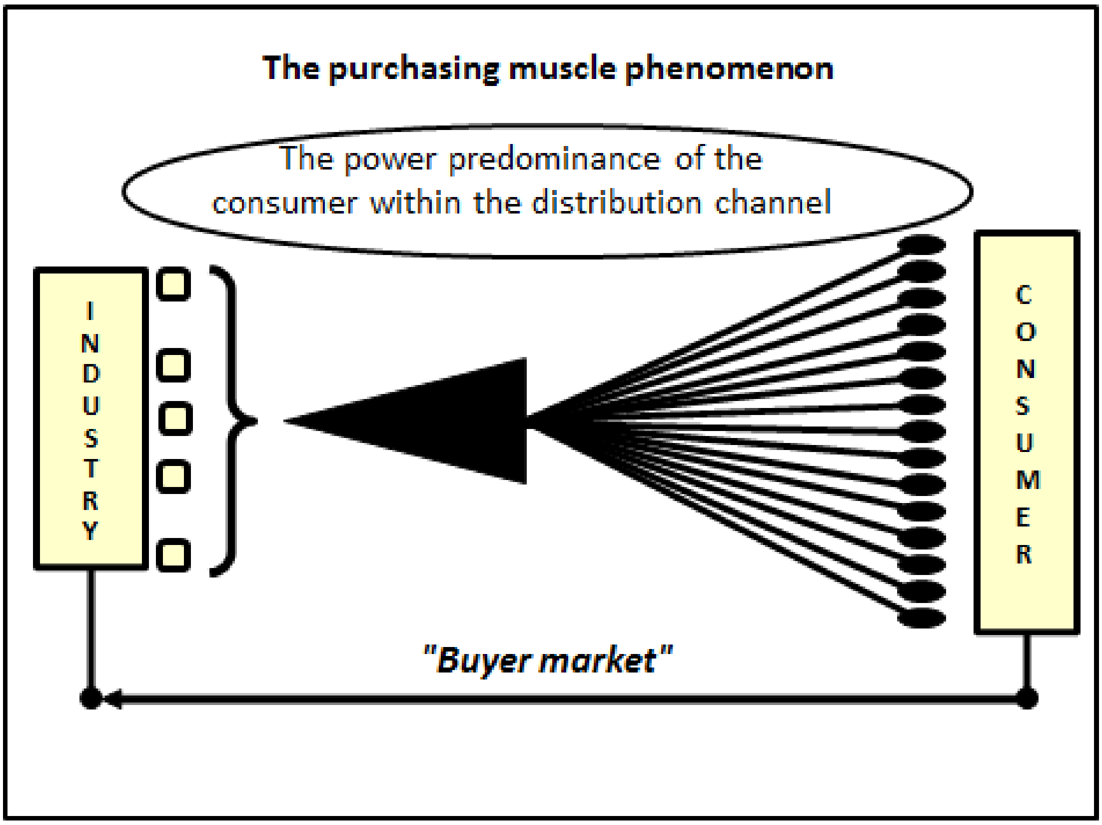

Fig. 3: The power predominance of consumers within the distribution channel

(1) Derivative purchasing power ("bargaining power")

If there is a supply surplus of food brands at the retail level, and there is additionally a more than sufficient choice of end consumers at alternative shopping locations, the trade faces a **double buyer market situation**, more specifically in relation to the trading goods it offers and in relation to the trade services made available by it. What results from this circumstance is a **permanent selection process**, which emanating from the consumer level on the one hand leads to the slimming down of shopping locations and thus to concentration within the trade. On the other hand, this selection process propagates right through to the manufacturer level via the trading levels. This pressure on the existing level of manufacturer selling prices is understandably experienced as extremely uncomfortable by manufacturers with a comparatively weak marketing position. It, however, relies on surplus power on the part of the trade, which is ultimately entirely derived from the purchasing muscle of consumers.

The splintered forms of power potential of end customers are brought to bear at the manufacturer level by the trade in a bundled form. The supplier dependency that becomes evident at this point is based on the **derivative purchasing muscle** of the trade. It constitutes the reflex of functional supplier competition between retailers on the basis of limited end consumer demand and must be evaluated as **positive from a competition policy perspective** (Cf. Fig. 4).

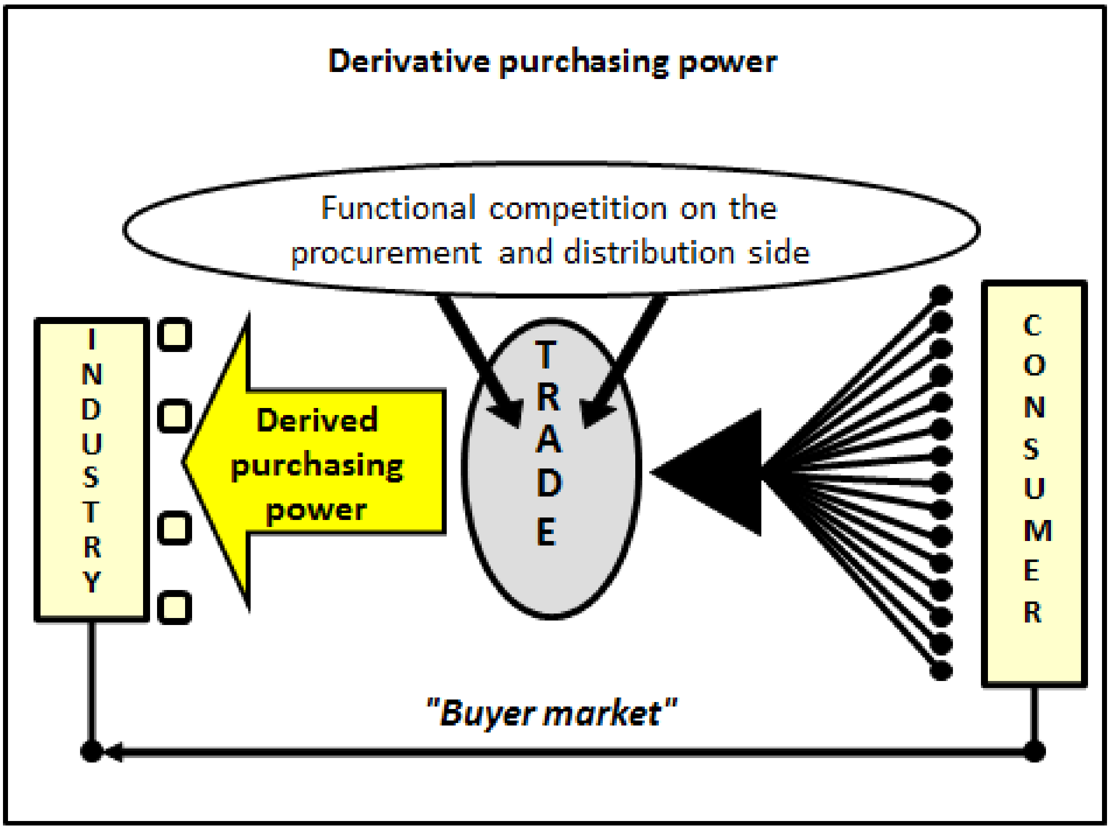

Fig. 4: Derivative purchasing power

(2) Original trading power ("monopsony power")

An alternative view would be appropriate if there were (no longer) any supplier competition worth mentioning amongst trading organisations. In the event of the continuing existence of a supply surplus of consumer goods in relation to end consumers, this would only be conceivable if trade performance were itself to become marginal and therefore a dominant bottleneck factor. Only in such an instance does the trade accrue purchasing power in the sense of power predominance in relation to the manufacturer level that is not merely derived from the buyer market situation at the end consumer level (derivative purchasing muscle), but results from the **sellers' market situation in relation to the factor of trade performance** (original purchasing muscle). Original monopsony power can therefore not only be *purchasing* power, but is simultaneously always also *supply* power in relation to the consumer (Cf. Fig. 5). An isolated contemplation exclusively of the market relationships between trade and industry cannot do justice to this circumstance.[16]

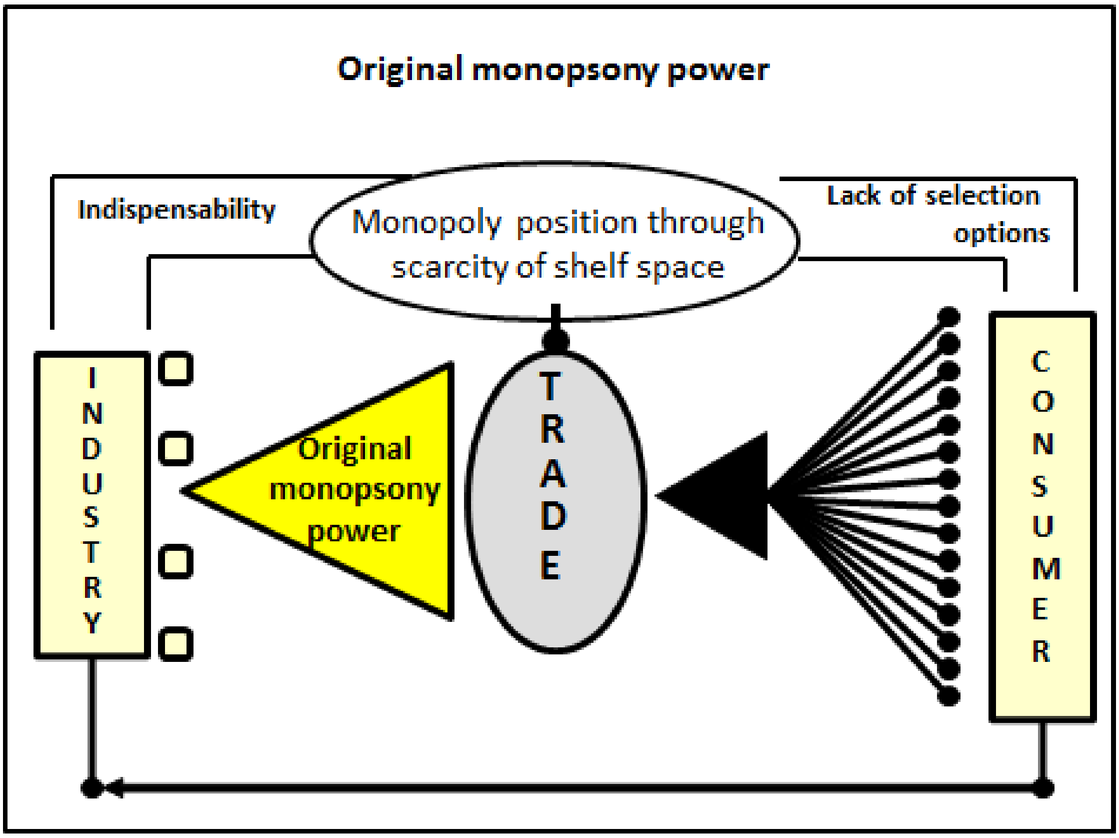

Fig. 5: Original monopsony power

Conclusion: Not the derivative purchasing power, but exclusively the **original purchasing power and simultaneously supply power** of the trade is to be evaluated as **negative from a competition policy perspective**. The trade artificially running short in the relationship between industry and consumers could generate a scarcity-induced yield by on the one hand absorbing a producer's surplus at manufacturers and on the other hand a consumer surplus at consumers: The prices to be paid by consumers for consumer

[16] This may also be interpreted as severe criticism of the green paper of the EU Commission.

goods are higher, and the sales prices achievable in relation to the trade are lower than under functional competition.[17] The causes of original power (in trade or industry) are primarily barriers to market entry that cannot be overcome that have led to monopoly-like structures and that stabilise these.

This type of contemplation of purchasing power[18] recommended over many years by Muenster based distribution and trade research has now finally also become established in competition economics literature[19]:

"Buyer power is concerned with how downstream firms can affect the terms of trade with upstream suppliers. There are two types of buyer power: monopsony power and bargaining power. The welfare implications, and therefore the appropriate enforcement policies, of the two types of buyer power are very different. Both result in lower input prices, but the exercise of monopsony power usually results in higher prices downstream. Reductions in input prices in the case of bargaining power are typically beneficial."[20]

2.3 Criteria and key figures for the identification and measurement of relative market strength in the relationship between industry and trade

The objectives of branded article profiling on the part of manufacturers and shopping location brand profiling on the part of merchants can be conflict-prone. However, they can also be pursued in a mutually complementary manner and culminate in a 'bond between partners'. Value chains as a rule exhibit different **constellations of reciprocal dependencies** between suppliers and merchants.

[17] These disadvantageous effects of original monopsony power for industry can, under certain circumstances, also continue to exist when, for example as a result of a reduction in capacity, the buyer market situation were to be transformed into a seller market situation in terms of the relationship between industry and consumers (in other words, in relation to trading goods). The scarcity-induced yield resulting from this would deprive manufacturers of trade. This would be of concern from a competition policy perspective to the extent that the indicator function of price in relation to goods would be invalidated, something that would lead to the expansion of scarce manufacturer capacities under functional competition. The scarcity-induced yield would not accrue to economic agents serving as the location of the production bottleneck (manufacturers) but exclusively to the holders of (equally) scarce "shelf space". A negative side-effect could occur in the form of the demoralisation of manufacturers in relation to the development of new products, i.e. innovation processes could be impaired. Only under these circumstances would the central conjecture contained in the "Specifications" therefore be confirmed.

[18] Cf. Ahlert, D./Wellmann, Th.: Deregulierung oder Verschärfung des GWB? - Wettbewerbspolitische und wettbewerbsrechtliche Konsequenzen der Konzentration im Handel, in: BFuP, Issue 3/1988, pp. 250-275.

[19] By way of an overview, cf. Inderst, R./Wey, C.: Buyer Power and Supplier Incentives in: European Economic Review 51/2007: pp. 647-667, as well as OECD Policy Roundtables: Monopsony and Buyer Power, 2008.

[20] OECD Policy Roundtables: Monopsony and Buyer Power 2008, overview.

For the empirical study it is important to develop criteria and, where applicable, key figures on the basis of which power constellations can be measured in a practical way. These measurements form the basis for a segmenting form of recording suppliers according to their <u>objectively existing</u> – but not according to their <u>subjectively perceived</u> – dependency. I would like to propose the following conceptual design in this regard:[21]

(1) The ´acquisitory potential´ of the manufacturer of branded articles

The ´acquisitory potential´ of a manufacturer of branded articles, as already referred to in this way by Erich Gutenberg[22], is initially based on the functional utility of products, as well as the psychological added value to the <u>consumer</u>. Instead of exchangeable mass consumer goods, it is important to offer innovative products as problem solutions for demanding consumers. For manufacturers, the necessity to substantiate their specific performance potential from the perspective of the <u>trade</u> is, however, also deduced on the basis of the interpretation of the manufacturer-trade relationship as a principal-agent constellation.[23] This in a concrete way demonstrates the issue of the acquisitory potential of the branded article that merchants can utilise for their own purposes. The direct utility of the acquisitory potential of an article for traders results from its **demand pull capability**. The accompanying lower information related effort and expense on the part of the consumer is tantamount to a resource saving on the part of the merchant in terms of information, business development and repurchase stimulation.[24] The indirect utility is essentially based on **reputation transfer** amongst the product, shopping location and consumer.

The trade therefore exploits both the reputation of its suppliers and the price premium connected to the acquisitory potential to its benefit. It either skims off forms of willingness to pay, as a result of which the article advances to a **loss compensator within the range**. Or it consciously foregoes the enforcement of the price premium in order to demonstrate a price worth paying to the consumer in order thus to gain an advantage in the context of horizontal competition. This in particular appears to hold the promise of success in the case of familiar, high-volume manufacturer brands. As a result, the article becomes a **loss leader within the range**.

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[21] Concerning this conceptual design, cf. Ahlert, D./Köster, L.: Strategic Brand Coordination, in: Ahlert, D. *et al.* (ed.), Exzellenz in Markenmanagement und Vertrieb, 2nd ed. Wiesbaden, 2005, p. 194 ff.
[22] Cf. Gutenberg, E.: Grundlagen der Betriebswirtschaftslehre – Der Absatz, 15th ed., Berlin, Heidelberg, New York, 1976, p. 243 ff.
[23] Cf. Mattmüller, R./Tunder, R.: Ein neues Selbstverständnis der Hersteller gegenüber dem Handel – Theoretische Hintergründe und Umsetzungsalternativen, in: Trommsdorff, V. (ed.): Jahrbuch der Handelsforschung 2000/2001, pp. 3-26.
[24] Cf. Twardawa, W.: Share of Customer – Der langfristige Erfolgsfaktor, in: Markenartikel, Vol. 60/1998, No. 3, pp. 30-36.

(2) The criterion of competition intensity within the trade

Strong horizontal concentration within the trade, continuous verticalisation and globalisation tendencies as well as centralisation and internal streamlining processes, have turned the German grocery trade into a highly competitive environment. The intensity of competition is, however, not equally high within all groups of goods. According to the five (competitive) forces model of Porter[25], five factors determine the actual situation of competition intensity within the trade: the threat resulting from new entries into the market (threat of entry), the rivalry amongst existing businesses (threat of rivalry), the threat as a result of substitute products (threat of substitutes), the bargaining power of suppliers (threat of suppliers) and that of buyers (threat of buyers). The intensity of competition in particular depends on the extent to which the competing merchants seek to exploit the product for profiling within the context of horizontal competition.

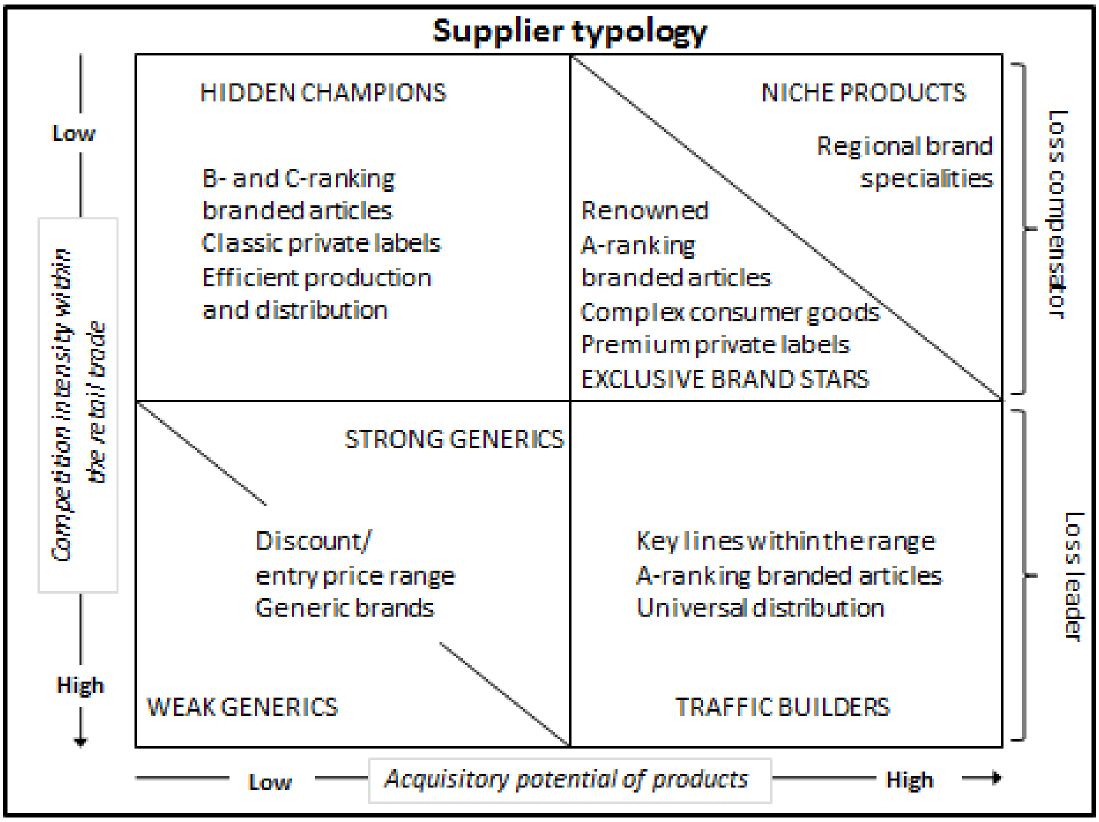

Fig. 6: Supplier typology according to acquisitory potential and competition intensity within the trade

[25] Cf. Porter, M. E.: Competitive Strategy. Techniques For Analyzing Industries And Competitors, New York, 1980.

The above contemplations permit the construction of a matrix as a **frame of reference for individual dependency verification** by means of the axes of competition intensity on the part of the trade and acquisitory potential of the branded article (Cf. Fig. 6). In order to measure the power and dependency positions within the various supplier clusters, the following key indicators may be consulted.

(3) Measures for the analysis of the power constellations within the context of the bilateral relationship between suppliers and merchants

The relative **Reciprocal Share of Sales (RSS)** key figure designates a relationship consisting of the reciprocal shares of sales of branded article manufacturers and retailers. The numerator is the share of sales of the trading company in the product line of the relevant supplier. Inversely, the denominator is the share of sales of the relevant supplier based on sales within the relevant group of goods of the trading company. It is certainly possible for the share of sales of the trading company within a specific product line bracket of the supplier significantly to exceed the 20% mark, but for the supplier then also to hold 20% of the market share within the narrower group of goods, e.g. only coffee, at this trading company. In this case, the indicator would assume a value of 1, which would correspond to a symmetrical, quantitative power constellation. When calculating the RSS indicator, it is particularly important to carry out an adequate demarcation of the product line of the manufacturer, as well as the group of goods of the retailer. Here, neither the widest conceivable demarcation (for example, all product lines of a large FMCG manufacturer like Unilever) nor a very narrow demarcation right through to the individual product level should be carried out.

The absolute **Comparative Category Position (CCP)** key figure relates to the significance of a supplier in terms of all products of this supplier present within the specific group of goods of the trading company for the qualitative performance of the category. This refers to the sales policy related potential of this group of goods and thus also to the contribution that this category renders towards the range competence of the merchant. With the aid of a point assessment scheme, it is possible to depict the significance of the relevant branded article manufacturer to the trading company on the basis of the CCP. The higher this key figure is, the higher is the qualitative significance of the manufacturer to the retailer, and accordingly the more dependent the trading company in turn is on this supplier.[26]

[26] Inversely, the significance of a shopping location for the qualitative performance of the distribution of a manufacturer can be recorded by way of a key figure. This lends expression to how important the positive irradiation of the merchant image on the product image is for the manufacturer of branded articles within the scope of their distribution channel selection. This key figure can be described as a **Comparative Distribution Position (CDP)**. The higher this key figure is, the higher is the qualitative significance of the retailer to the manufacturer, and accordingly the more dependent the supplier in turn is on this trading

2.4 On the question of a realistic evaluation of the relative market positions within different merchant/supplier constellations

On the basis of the matrix in Fig. 6, it is possible to differentiate amongst seven supplier clusters with different power constellation characteristics. Within the scope of the EU Study COMP/2012/015 as well as the Sector Inquiry of the German Federal Cartel Office (BKartA, B2-15/11, SU LEH, September 2014), the issue of in which of these constellations a negative influence of modern retail on diversity and/or innovation could exit needs to be clarified.

Cluster I: "Exclusive brand stars"

Cluster I encompasses the manufacturers of **renowned (A-ranking) branded articles with selective distribution**. This refers to suppliers who distinguish themselves on the basis of comprehensive innovation activity, high quality standards for themselves and their intermediaries and high acquisitory potential in the eyes of consumers. The intensity of competition within retail is to be classified as tending towards the lower end of the scale. This is not least to be traced back to the fact that the manufacturers of these products predominantly practice selective distribution and do not need to expose themselves to the significant price competition within the discount sector. The products of the exclusive brand stars can be treated as so-called "cash cows" within the trade. These are *loss compensators*, on the basis of which merchants can generate high profit contributions, which they need in order to be able to finance the cross-subsidised areas of product lines within the scope of combined costing.
It is to be assumed that in the case of exclusive brand stars, no one-sided supplier dependency is in place. The Reciprocal Share of Sales (RSS) indicator should be at a magnitude of 1. The Comparative Category Position (CCP) of the supplier is above average, since decisive significance is accorded to these articles within the applicable category of goods. The manufacturer often holds marketing leadership within this area, as well as net power in relation to the trade. In relation to commercial enterprises with strong store brands, a symmetrical distribution of power, i.e. a **well-balanced attractiveness equilibrium**, is however also conceivable.
No threats against "choice and innovation" exist within this segment.

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company.
If the two indicators of CCP and CDP are considered in relation to one another, this once again results in a relative key figure that may be referred to as a **Reciprocal Benefit from Participation (RBP)**. It indicates to what extent manufacturers and merchants are reliant on one another in order to achieve their qualitative marketing objectives.

Cluster II: "Traffic builders"

The manufacturers of **renowned (A-ranking) branded articles with universal distribution and intensive price competition** distinguish themselves from those in Cluster I through a high level of competition intensity being present at the trade level. Since acquisitory potential is also above average, these manufacturers find themselves at the bottom right of the potential-intensity matrix. The traffic builders (also referred to as "frequency generators") often serve retailers as a platform to expand a favourable price appearance. Within this context, they consciously forego the enforcement of the price premium of A-brands in order to evoke the impression of reasonable prices on a *pars pro toto* basis.

Such branded articles have an evidently high CCP for most merchants, since they represent the **key lines of the entire range in terms of price measurement**. To discontinue carrying these would significantly lower the range competence of the merchant in the eyes of consumers. In contrast to the exclusive brand stars of Cluster I, they are also not suitable for replacement by premium private labels. The trade seeks to earn money with premium private labels, and due to availability exclusively within one trading system, these are also not suitable as key lines within the range. As a rule, the RSS here once again has a magnitude of 1. To the extent that power predominance exists within this cluster at all, this would tend to be at suppliers. The retail trade, here as a rule, does not hold any substantial threatening potential.

No threats against "choice and innovation" therefore exist within this segment either.

Cluster III: "Hidden champions"

The hidden champion cluster encompasses the **cost-effectively producing manufacturers of products of low to medium brand strength with low competition intensity.** These are products that are referred to in specialised jargon as B and C branded articles. They do not exactly occupy pole position within the relevant set of consumers, and the price knowledge of consumers in terms of these products is very low.[27] Since these branded products consequently do not function as key lines, the intensity of intra-brand competition amongst trading systems is comparatively low. These products are, however, increasingly subjected to intensive competition within shopping locations, and more specifically they there **compete with the own brands** of the commercial enterprises.[28]

[27] Cf. Ahlert, D./Vogel, V.: Umsonst günstig? Die schlechte Preiskenntnis der Konsumenten macht Preiskriege in bestimmten Artikelgruppen des Lebensmitteleinzelhandels überflüssig, in: Markenartikel, Vol. 66/2004, No.5, pp. 14-17.

[28] In this regard, merchants occasionally have a particular interest in keeping the prices of the B and C brands high in order to lend their own private labels a visible profile as a result. This strategy of "umbrella pricing" can as of late be counteracted by manufacturers through the negotiation of fixed maximum prices

To a substantial degree, it is also the **renowned branded article manufacturers** of Clusters I and II who include such brands as "second or third brands" within their portfolio. It is true that they are currently testing a radical slimming down of this brand segment in light of the increasing competition from private labels. They are, however, also aware that they are still in a position to achieve sufficient profit contributions by way of these products insofar as they are able to use up their free capacities in this way. The **small and medium-sized manufacturers of such brands** therefore often find themselves in a quandary between private labels that are growing stronger and the still virulent second and third brands of renowned branded article manufacturers. It is therefore no wonder that it is especially these manufacturers who are raising complaints concerning purchasing muscle. It may, however, not be overlooked here that this ultimately concerns consumers (also see customer sovereignty) whose power to select is transferred on to the industry level by the trade. Insofar as manufacturers find no successful way out of their quandary, e.g. through cost-lowering process innovations or excellent demand pull marketing, they will have to live with the high terms and conditions based pressure of the trade. Entering into the commissioned production of private labels might deserve consideration as an additional or even alternative business model.

One thing, however, certainly needs to be noted: Given functional supply competition amongst competing merchants, it is not the task of competition policy to erect high protective fences against the pressure of selection, and it will also not be able to succeed in this.

The two indicators not seldom indicate a **considerable power advantage on the part of major trading systems** in terms of these products. CCP is predominantly positioned within the lower middle field, and RSS is significantly higher than 1. It may, however, not be overlooked that **noteworthy dependencies of the trade** not seldom exist here. That is because such articles are indispensable to those who offer the full range spectrum in order to attain range competence or, where applicable, in terms of one-stop shopping. They form part of the compulsory agenda of the grocer, even if they do not meet with a great degree of involvement amongst consumers. The B and C brands cannot be entirely substituted with classic private labels; because they are needed to demonstrate supply diversity. Apart from this, these products offer merchants margins that are by all means adequate as a *loss compensator*, even though not too much money can be earned with these, at least not on a per unit basis. What tends to apply here is the motto: "It's all in the quantity".

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without having to risk cartel law based penalties. Cf. European Commission: Guidelines on Vertical Restraints (Text with EEA relevance) (2010/C 130/01), Paragraph 225.

By way of summary, the functionality of competition processes can be attested for this segment without reservation, and with this being the case, competition policy based interventions are a mistake. "Choice and innovation" do <u>not</u> appear to be under threat in this segment. It is to be expected that in particular here the number of articles is constantly increasing, namely on the basis of the growth in sales floor areas of modern trading firms. By way of their own brand programmes, large trading systems in particular are participating in this growth sector. This in no way only refers to "me too" products, but instead increasingly also to innovations in the form of attractive price-performance combinations.

Cluster IV: "Strong generics"

The "strong generics" refer to **volume manufacturers of weak brand products with excellent cost positions** that can thus be deemed to be cost leaders. Manufacturers of this type utilise the most modern of basic technologies during production, but suffer from a high degree of comparability and the feasibility of the substitution of their products due to low brand strength. These manufacturers are particularly susceptible to employment rate fluctuations due to an extremely high fixed cost intensity. This can result in a **considerable merchant threat potential**. Commercial enterprises are, however, in fierce competition relationships with discount systems with articles of this type at the consumer level, with the result that they are, as a rule, dependent on manufacturers of these very reasonably priced products. In particular to those who offer a full-range spectrum, these excellent volume manufacturers are indispensable for an entry level range. To this extent, a **considerable industry threat potential** is also to be stated.
Given the substantial volumes that are traded within this range sector, the trade is dependent on even the smallest of advantages based on terms and conditions in order to shift this article sector out of the loss leader position into at least a neutral position or perhaps even to earn something from it. **The trade is therefore dependent on attaining particularly favourable terms due to the mobilisation of its derivative purchasing muscle.** This is even more the case since the CCP of suppliers is not particularly high, but the RSS is significantly lower than 1.

The danger of negative influences of modern trade on "choice and innovation" presumably does <u>not</u> exist within this segment. These excellent volume manufacturers have abundant switching opportunities at their disposal, be it to other merchants or, for example, to the manufacturing of private labels, namely on the basis of the extremely good cost-efficiency of their production. Market entries within the area of this cluster, for example on the part of small or medium-sized manufacturers, are hardly conceivable given the current capacity situation. Manufacturers are, however, dependent on *consolidating and expanding their cost leadership by means of permanent process innovations.*

Cluster V: "Niche suppliers"

This cluster predominantly encompasses **small to medium-sized manufacturers with special competencies that are highly attractive for small consumer segments.** Regional top products in particular can exhibit an above average market strength. In contrast to the renowned nationally or even internationally familiar "power brands", which are aimed at the majority of consumers, these branded products as so-called "personal brands" only have a high degree of acquisitory potential in specific regional markets and, where applicable, within special consumer segments.

Regional branded products can represent an identity anchor within a region, even if they do not have any particular taste or usage specific product benefits. Affiliation with a region is expressed via the brand origin, which has a positive effect on the inward connection of consumers with the regional brand. Besides this direct effect on brand loyalty, an indirect effect exists: the perception and emotional relevance of the brand origin promote a positive perception of the brand image of merchants who offer these products and therefore indirectly also influence the business operation type brand loyalty of consumers.

During the calculation of the two indicators it is important to demarcate the relevant markets correctly from a spatial/regional and factual perspective. The RSS indicator can be at a magnitude of 1 if the category only extends to articles of this specific type (e.g. regional brands). The CCP is extraordinarily high under these circumstances. To this extent, in the same way as with respect to Cluster I, it may be assumed that these articles justify a **reciprocal dependency between trade and industry**. This fact is sometimes misjudged by central purchasers of major trading systems. The danger then exists here that "blood will be left on the carpet", since precisely the small and medium-sized manufacturers of such special products are not afforded any permanently adequate terms and conditions. For those amongst merchants who offer a full-range spectrum, this type of conduct would, however, be dangerous, since it can significantly contribute towards the erosion of their store brands. Within the co-operative trade groups, the trend of withdrawing supplier management from central buying within this sector and to organise this on a decentralised basis is therefore increasingly establishing itself. In this regard, **innovative forms of co-operative category management** between industry and trade are playing a major role. Market leadership is neither one-sidedly held by industry nor trade. Brand management across levels/stages and vertical price co-ordination are indispensable in this regard and should not be strangled as a result of cartel law based interventions. They should be deemed to be ex lege exempt pursuant to Art. 101, Sect. 3 of the TFEU.

It is this cluster of niche suppliers to which the particular attention of the empirical studies should be devoted in order to reveal acute dangers pertaining to "choice and innovation".

Cluster VI: "Weak generics"

The large group of producers who manufacture **extremely weak brand products at relatively high costs** may described as "weak generics". Due to their limited if at all present acquisitory potential, as well as the in turn higher competition intensity on the part of the trade, these suppliers are to be allocated to the bottom left of the potential-intensity matrix. The RSS key figure is significantly above 1, and the CCP has the worst value imaginable.
These manufacturers are **dependent on every single merchant**, no matter how small. In the event that a major trading system drops out as a consumer, it may happen that the manufacturer will instantly experience existence-threatening degrees of capacity utilisation. In the case of a number of small merchants, it may be necessary for a number of these to drop out of the list simultaneously for this effect to arise. If these manufacturers do not succeed in modernising their production, e.g. through process innovations towards cost leadership or the achievement of an alternative strategy towards quality leadership, given functional competition, **a departure of manufacturers of this cluster cannot generally be avoided**.

Under these circumstances, it appears digressive from a business management perspective to research deviation alternatives at other merchants who, as has been shown, are in intensive competition with one another and subject to fierce bargaining. It is superfluous to pose the question concerning the danger of negative influences of modern trade on "choice and innovation" here. It cannot be the task of competition policy to guarantee the survival of manufacturers of this segment, and it would also be impossible for it to do so.

Cluster VII: "Marginal suppliers"

In economics, marginal suppliers refer to those businesses that are **barely still viable** due to their capacity, cost and revenue situation and are **constantly under threat in terms of selection**. Marginal suppliers possess no field of their own within the potential-intensity matrix, since they may be positioned within all fields. As explained above, Cluster VI suppliers are to be counted amongst these almost without exception. However, suppliers under threat in terms of selection can also crop up in the other clusters. Even manufacturers of renowned branded articles, but also regional specialists may belong to these. In the event that these producers are not capable of or prepared for a radical change in strategy, they will get into difficulties in the same way as is currently the case with large business groups who have missed out on consumer trends. In the event that such selection processes were not generally observable within a market, the suspicion of severe functional deficiencies (e.g. exit barriers in the form of high safety fences) would force itself to the fore.

In terms of these marginal suppliers, it fundamentally does not make any sense to ask whether they are dependent on a specific commercial enterprise as a manufacturer (or, where applicable, as a merchant on a specific branded article manufacturer). The stipulation that they are dependent by definition in the event that they were to have no adequate and reasonable alternative options, appears to be grotesque from an economic perspective. These businesses are indeed dependent, but not on one of their major customers alone, and they are instead dependent on all their transaction partners, on environmental conditions and in particular on the capabilities of their employees and managers and then later also on the qualification of their insolvency administrators.

3 Conclusion: The economic impact of buying power on retail competitiveness and consumer welfare depending on different scenarios of functional competition

3.1 The economic impact within buyer market versus seller market situations

The statements contained in Section 2 as presented may be summarised as follows:

- Within pure **buyer market situations at the consumer level** (both in terms of trading goods and trading performance), no original purchasing power results for commercial enterprises. They in fact function more like an *"extended arm of consumers"*, who as the protector of their interests perform a 'powerful' role in relation to the manufacturer level. This form of derived bargaining power already observable in most consumer good sectors for a long time is **highly desirable from a competition policy perspective**.
  In Clusters VI and VII, it brings about selection pressure at the industry level that is sensible from an allocation theory perspective. In Cluster IV, fierce competition for the most cost-effective acquisition sources unfolds at the trade level, during which similarly desirable adjustment effects arise from an allocation theory perspective. The backward integration of the trade by way of own brand programmes here in the same way brings about a vitalisation of competition than the setting up of one's own production facilities. For Cluster III, the outcome of the here particularly efficiently functioning competition as discovery process cannot even be divined, and the envisaged investigation design of the commissioned study unfortunately does not lead

one to expect any types of information in this respect: who – given the fierce competition battle amongst the classic second and third brands of the major groups of food companies, the B and C brands of the small and medium-sized producers, as well as the own brands of virtually all major trading systems that are increasingly becoming more significant – will gain what market shares within this rapidly growing segment cannot currently be forecast.

Particularly within this area, it is immensely important for competition policy to refrain from exercising any type of systematic influence.

- In **seller market situations, at the manufacturer level**, in contrast, commercial enterprises as a rule function as an *"extended arm of manufacturers"*.
  Cluster I and II manufacturers of branded articles, as well as a few particularly renowned Cluster V niche suppliers have succeeded in occupying this pole position within the 'relevant set' of consumers. From various welfare aspects, it would be fatal to act against this **preferential position of the strong brands** by means of economic policy based interventions. They constitute the outcome of innovative achievements of manufacturers and virtually also always of co-operating merchants and consequently the entire value-added systems that are to a high degree rewarded on the part of consumers. They are not least also responsible for the high regard in which the products are held abroad. Strong brands deserve protection against brand piracy, brand vandalism and image damaging pricing.

  To the extent that the legal system cannot grant this protection, it should at least permit the self-help measures of the economy by granting the relevant forms of organisational freedom.

- Commercial enterprises only attain their own **original position of power** on the demand side (in relation to manufacturers) and simultaneously on the supply side (in relation to end consumers) when resource based trade performance ("shelf space") itself becomes a dominant bottleneck factor. It is then possible to refer to a **seller market situation in relation to the factor of trade performance**. Only original monopsony power is relevant from a competition policy perspective. Cartel law based interventions should here be aimed against the causes of market failure. This essentially refers to barriers to market entry, but only those types that bring about functional disruptions of market processes.

  To proceed against these in a systematic way may be seen as the most important option to combat original monopsony power. It is to be hoped that the EU study will shed light on this.

3.2 The impact of unfair commercial practices and dynamic market dominance within the best-case and worst-case scenarios of functional competition

During the evaluation of the asymmetrical power constellation within value chains, focus is often one-sidedly directed onto the allegedly power-contingent **modes of behaviour** of the trade that in the view of the top organisations of the industrial economy could threaten so-called efficiency-orientated competition (e.g. admission fees, listing fees, unjustified advertising surcharges, space rental fees, subsequent enforcement of more favourable terms and conditions, unjustified discount spreading, etc.). The EU Green Paper "On Unfair Trading Practices in the Business-to-Business Food and Non-food Supply Chain in Europe" (COM 2013/37) in detail addresses dishonest and unfair modes of behaviour within value chains and describes these as "unfair business practices" (Cf. the examples presented in Fig. 7).

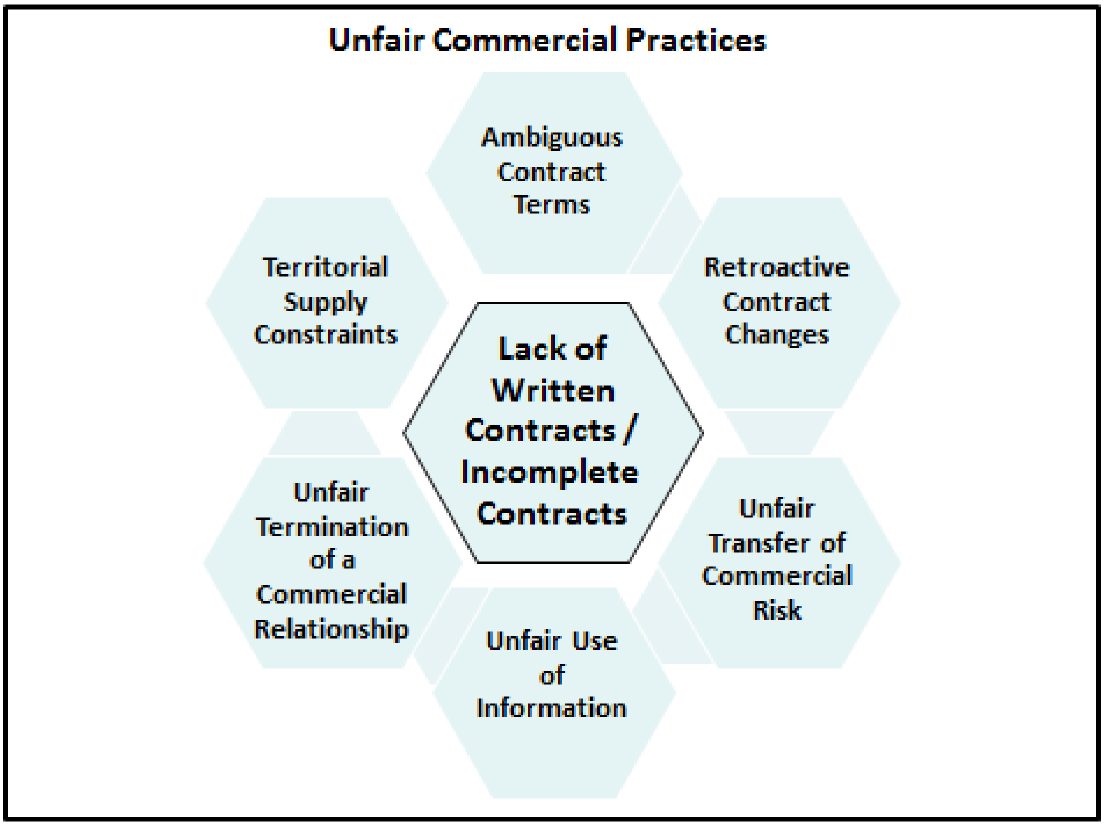

Fig. 7: Types of Unfair Commercial Practices in accordance with the Green Paper

This assessment is one-sided and flawed, as is already shown by the following statements:

(1) In terms of the competition policy based evaluation of power within the distribution channel what is of primary importance is not the actually practiced conduct of businesses, but power potential. A situation in which a business would have the **opportunity to trigger serious functional disruptions of competitive processes** would be relevant from a competition policy perspective. It is also appropriate to refer to a **´dynamic market dominance´**.[29] Under certain circumstances, a form of power predominance can also be assessed as dangerous from a competition policy perspective when it draws attention to itself not as "improper" conduct but conduct deemed to be "fair".

(2) By the way, it appears suggestive to refer to unfair trading practices time and again. Trade and industry can be responsible for functional disruptions of competitive processes to the same degree, be it through dishonest or unfair conduct or through the sheer threatening effect of a market power superiority position.

(3) Most important is the clear distinction between the two extreme scenarios of competition (Cf. Fig. 8):
Within the **best-case scenario**, i.e. under functional and fair competition as a process of discovery, commercial practices don't matter at all, because the level of bargaining power and the process of bargaining itself are part of the per se optimal market outcomes.
Within the **worst-case scenario** of totally market failure commercial practices are not the cause, but are a symptom of existing superior market power positions. Of primary importance is therefore not the actually practiced conduct of businesses, but the question what causes insurmountable barriers to market entry and how these barriers are to be pulled over.

[29] Power that is relevant from a competition policy perspective may be defined as the capability of a systematic disruption of market processes. What is at issue here is the potential - not even the process of so-called 'improper' exploitation of such potential - on the part of an economic agent or a number of economic agents (e.g. an oligopoly that exhibits collusive behaviour) to influence market processes - potentially as part of a dynamic, cumulative process - in such a way that, as a result, the conditions for functionality within the market system are invalidated. We already coined the expression "dynamic market dominance" for this power position in 1988. Market dominance accordingly does not already refer to an entity that holds a particular market share, but one that 'dominates' (controls) a development process, as a consequence of which (severe) functional disruptions within the market system can occur. Cf. Ahlert, D./Wellmann, Th.: Von der Machtkonzentration zur dynamischen Marktbeherrschung im Handel – Wirtschafts-wissenschaftliche Grundlagen einer Diskussion zur Kartellrechtsnovelle, in: BFuP, Issue 3/1988, p. 214 ff.

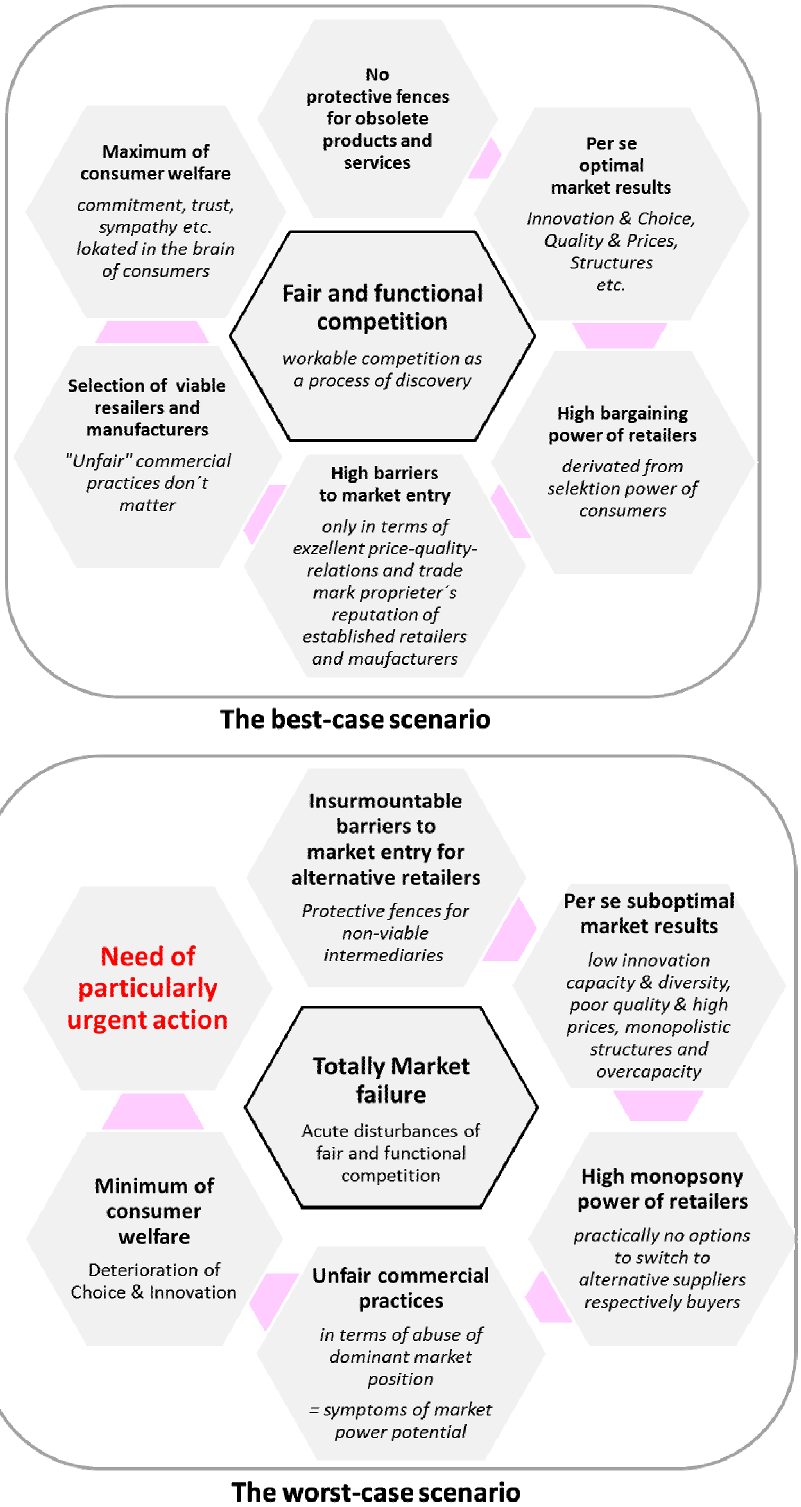

Fig. 8: Fair and functional competition versus totally market failure