

Courtesy Translation

Summary of the Final Report of the Sector Inquiry into the food retail sector

This condensed summary outlines the key messages from the sector inquiry into the food retail sector. The full text of the comprehensive report (more than 400 pages) is available at

http://www.bundeskartellamt.de/Sektoruntersuchung_LEH (in German).

The contents page of the final report (in German) can be found at the end of this summary.

Summary

Aims of the sector inquiry into the food retail sector

For decades buyer power has been widely discussed by competition law experts. Above all in highly concentrated market structures identified by the Bundeskartellamt in numerous regional food trade markets and in the demand market for food, several complex issues have emerged at the interface between the food industry and the retail trade which have a bearing on competition law practice. In the wider public the topic is vividly discussed. When the living conditions of plantation workers in Andalusia are criticised, German farmers are said to receive prices for their milk which are too low or the consumer is worried about the quality of meat production, the buyer power of the retail trade is often given as the cause.

The term buyer power is used to describe in very general terms the ability of a company to unilaterally influence conditions for the procurement of primary products required to its advantage and to increase its profit. On a theoretical level the opinions, articles or speeches which have been published on the theme are often highly abstract. However, the empirical basis for the arguments used in the discussion is often very weak. One major reason for this could be that the necessary data sets are not publicly accessible. The strong and often opposing economic interests of the stakeholders affected also often seem to hinder any objective and neutral discussion of the causes and effects of buyer power.

In its competition law practice the Bundeskartellamt has been reproached on several occasions in recent years for exercising strict control over further concentration processes or purchasing cooperations involving the major food retail companies without giving actual evidence of the structural advantages which the companies have as market leaders in the sale of food as well as in their negotiations on conditions with the food industry. Furthermore, the behaviour of leading food retailers in negotiations with their suppliers has increasingly come into focus due to a large number of complaints from manufacturers as well as smaller food retailers. The retailers affected by these allegations complain of being

accused of using abusive practices in negotiations on conditions although they argue that these are not anti-competitive negotiations but "hard bargaining" which benefits the consumer. The consequence, they argue, was excessive state interference in the contractual freedom of the market players.

Sector inquiries conducted in accordance with § 32 e of the Act against Restraints of Competition (*Gesetz gegen Wettbewerbsbeschränkungen, GWB*) offer the Bundeskartellamt the possibility to closely examine a specific branch of industry without being bound to a time limit and independently of individual proceedings. The prerequisite for this is that rigid price structures or other circumstances could restrict or distort competition in the domestic markets. The discussion illustrated above clearly shows that applying this competition law tool to analyse the German food retail trade and buyer power is both useful and effective. The Bundeskartellamt has therefore made use of the sector inquiry to compare its current case practice with a multi-stage and extensive analysis of the markets and results of negotiations between the market players. At the same time the empirical basis for the authority's future case practice was greatly improved. Finally, the Bundeskartellamt will, where necessary, base its method of assessing individual cases on the knowledge gained from the findings of the inquiry.

However, from the onset the sector inquiry was not designed to answer the broader question of whether there is a general and widespread problem of buyer power in the German food retail trade. Such an objective would neither be possible nor useful in this general and less differentiating form because any existence of buyer power which could be harmful to competition under competition law provisions can and must ultimately only be examined in each individual case. The results of this sector inquiry greatly contribute to the future decision practice of the Bundeskartellamt as they further develop and empirically confirm the relevant methods of assessment and thus the conceptual basis for the necessary investigations in each individual case.

Approach and procedure

The sector inquiry into the food retail trade was conducted in a two-stage procedure following an extensive phase of preliminary investigations.

In the first stage structures in the market for the procurement of food in Germany were investigated based on a number of criteria. These included market size, supplier and buyer structure, the importance of private labels and the position of food retailers as buyers of the products concerned. The procurement shares of the individual retailers and the conditions of competition were examined both in terms of larger product categories and with regard to seven procurement markets selected from various product categories. The procurement markets selected included sparkling wine, frozen pizza, roasted coffee, jam, red delicatessen sauces, milk and cold coffee beverages (with milk). In the second stage of the inquiry a representative sample of around 250 articles was taken to examine whether and to what

extent the leading retail companies enjoy purchasing advantages over their competitors, and what form these advantages take in individual cases.

The investigative approaches of and experience gained from sector inquiries conducted by other European states were used and developed further in the conceptual design of the sector inquiry. Already since 2004 sector inquiries with different objectives and approaches have been conducted by various European competition authorities. Important information has been gained from these inquiries, most particularly those carried out by the UK Competition Commission in 2008 and the Portuguese competition authority in 2006 and 2010. Some of this information was taken as a basis for the conceptual framework of the empirical econometric part of the Bundeskartellamt's sector inquiry.

Following the two-stage concept of the sector inquiry, ***Part I of the Sector Inquiry*** gives a comprehensive picture of the market structures and conditions in the German food retail sector.

Findings in respect of the sales markets

Following the trend towards concentration in recent years, only a small number of food retailers are active in Germany today. At national level these are mainly the five leading companies: Edeka, Rewe, the Schwarz Group (Lidl, Kaufland), Aldi and – to a limited extent - Metro. The discounter Norma also has a supraregional network of branches. The food retailers Bünting, Tengelmann, Bartels Langness, Globus, Dohle, Coop, Tegut, Jibi and Klaas & Kock are not represented nationwide but have a regional importance and are in some cases also active as leaders of a purchasing cooperation.

A comparison of the food retailers according to important supraregional structural factors (turnover, total sales floor space, outlet density, customer reach, distribution channel concepts etc.) confirms from a national perspective the dominance already identified in the Edeka/Plus case of a clear leading group made up of the companies Edeka, Rewe, the Schwarz Group, and, because of its to a limited extent hard discount concept, Aldi. Metro follows far behind.

The market leaders Edeka, Rewe, the Schwarz Group and Aldi account for well over three-quarters of total turnover achieved with final customers in the German food retail sector. Apart from Metro with a share of over five per cent, all other competitors with shares of less than three per cent (in some cases well below this) have at best a market significance in their regional core distribution areas. The market leader Edeka alone accounts for well over one-quarter of total turnover in the German food retail sector and has a leading market position in many regional sales markets.

The large majority of food retailers are also active nowadays as producers in some product categories of their product assortment. Edeka, which keenly pursues a strategy of expanding its own production, is the most advanced of them in terms of vertical integration.

The typical forms of distribution in the retail food sector - full range, soft and hard discount - differ in terms of diversity of product range (number of products), depth of product range (number of brands per product / ratio of branded products to private brands), product presentation and to some extent also sales floor space. In respect of the representation of the retail companies on the different distribution channels, Edeka, Rewe and the Schwarz Group are the only suppliers which are active both in the discount as well as full range sector (high share of branded products) and are therefore in a position to target all customer groups. In spite of an apparent slight assimilation of the distribution channels, in particular a stronger trend towards the listing of branded products in discount stores and an increasingly diversified private label strategy even in the full range sector, a graduated competitive relationship is still apparent between the distribution channels in the food retail sector even after the conclusion of the sector inquiry. Nonetheless, the Bundeskartellamt still holds the view that the differences between the distribution models are not sufficient to warrant their definition as separate product markets.

In terms of total sales floor space and total number of outlets, the nationally active food retailers form the uncontested leading group but with a distinct hierarchy: Compared with its closest competitors, Edeka has around twice as much total sales floor space and twice the outlet density and is therefore by far the leading supplier in Germany in terms of turnover, sales floor space and the number of outlets. At the same time it should be borne in mind that a comparison with Kaufland, Metro, Globus and Dohle in terms of the number of outlets is only useful to a limited extent because these retailers have generally concentrated on large-scale retail.

The leading retailers Edeka, Rewe and the Schwarz Group in particular are continuing on a course of expansion. Larger sales floor areas are now generally preferred, whereas individual retailers are developing new sales concepts for smaller inner-city locations such as, e.g. modernised forms of corner shops. On their course of expansion the companies, especially the large-scale suppliers are confronted with legal planning restrictions and in some cases problems with local government authorities. The latter seems less of a problem for the large, nationwide suppliers than the small retailers and newcomers to the market.

Companies in the food retail sector tend to pool their demand in purchasing cooperations. At the moment purchasing cooperations exist in the case of Edeka, Rewe, Bünting and Bartels Langness. The purchasing cooperations concluded in recent years involving the two major retailers Edeka and Rewe indicate a new quality of cooperation compared with earlier ones. They tend to be planned for the long term and are enhanced by further structural links. These cooperations extend beyond the mere pooling of purchasing volumes and usually include the adoption of the private labels of the large partner in the product range, a (partial) assimilation of product ranges and (unilateral) territorial protection agreements. Overall it is clear from the form and content of the "new generation" cooperations involving a major food retailer that the main interest of the large partner in a cooperation is mainly to secure long-term and extensive influence on one of the few remaining smaller competitors.

This case-based evaluation is confirmed by examinations in the empirical part of the sector inquiry. The positive effect of the cooperation on conditions for the retailer is usually less pronounced for the large members (the "heads" of the purchasing cooperation) than for the smaller members.

From the perspective of the smaller partners a purchasing cooperation with one of the leading competitors has ambivalent implications for another reason. The large partner negotiates on behalf of all the companies participating in the purchasing cooperation and hence has transparency over a substantial part of its cooperation partner's purchasing conditions and volumes. However, there are increasing indications that the conditions attained are not always passed on in full to the smaller partners. The results of the sector inquiry confirm this estimation. Apart from the loss of independence, this can also lead to direct disadvantages for the smaller cooperation partners when competing on the sales markets because the purchasing prices are of such great importance for the retail trade.

The product ranges offered by food retailers in Germany are changing. Private labels are becoming increasingly important, both in terms of quantity and quality. The extent of their importance, however, depends on the product categories, distribution channels and price ranges of the private labels. Starting out from a fragmented and hardly systemized private label landscape, where the focus of both discounters and full-range retailers was initially to enter the market at a low price level, German food retailers have in recent years developed sophisticated private label systems encompassing a whole range of product categories and price segments. As the owners of the sales outlets the retailers have considerable possibilities to market their own products in the best way possible. Having the power to decide on shelf product placement and operate a promotional campaign policy for branded products is a considerable advantage for the retailers vis-à-vis brand manufacturers. These advantages were confirmed in many econometric models, i.e. the greater influence of private labels led to an improvement of conditions from the retailers' perspective in these model variations. However, the analysis also showed many other effects which is why the extent to which private labels influence the outcome of negotiations between a brand manufacturer and a retailer cannot always be clearly defined.

Findings in respect of the procurement markets

The competition parameters of the retailers on the sales markets as illustrated above form the background for a comprehensive analysis of the procurement markets.

In order to analyse market structures on the food procurement markets in Germany with a reasonable amount of time and effort, a three-stage approach was used in order to obtain a comprehensive picture of the relevant market structures. This included (1) an extensive analysis of seven individual, specially selected *procurement markets*, (2) an examination of the purchasing volumes of the retailers in all *product categories* of the food segment and (3) an examination of the *total procurement volume* of the retailers in the food and non-food I segments.

The results of these examinations show that while each of the procurement markets examined has market-specific characteristics, important cross-market statements can be made about the competitive conditions on the different procurement markets of the food retail trade in Germany.

In defining procurement markets the concept of demand-side substitutability is applied inversely. In defining demand markets all products are therefore to be considered which manufacturers offer or could offer under reasonable conditions without major switching costs. Since no food manufacturer or supplier offers a product range which comprises all or a substantial part of the articles required by the food retail trade, full-line markets do not exist on procurement markets, in contrast to sales markets. Instead individual markets are defined based on identical or related products. Whether certain private labels and branded products belong to a single procurement market has to be assessed on a case-by-case basis.

Ultimately the results of the market investigations conducted in the inquiry predominately suggest that, at least in the case of the seven markets examined, the markets for the procurement of private labels and for the procurement of branded products are separate markets. This applies in spite of the high technical ability to switch production in all the markets examined and irrespective of the size of the shares of private labels and branded products on the overall market. 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. Manufacturers of branded products invest heavily in marketing and distribution in order to increase the brand strength of their products; for this they need higher contribution margins. Private label manufacturers, on the other hand, are not burdened with marketing and distribution costs or only to a much lesser extent. To obtain an order for production from a retailer, price leadership, above all, is important for these manufacturers. It is very difficult to accommodate these different strategies within a company active in product markets with strong brands. In addition, every time a brand manufacturer introduces a private label to the market, it has to consider to what extent the new private label product will undermine the value of its own branded product which has already been established on the market.

However, this separate market definition does not necessarily apply to all procurement markets of the food retail sector. Rather, the results of the sector inquiry have shown that in markets in which a large share of suppliers offer branded products as well as private labels in fairly equal proportion, the separation of the procurement markets is less clear than in markets in which the manufacturers specialise in one of the two segments. Furthermore, in decisions on mergers between manufacturers the Bundeskartellamt has already decided in the past that joint manufacturer markets are to be assumed if there is a close competitive proximity between branded products and private labels. In such cases it makes sense to also define a uniform market for the procurement of private labels and branded products.

In this sector inquiry the geographic definition of the markets was also reviewed conceptually and specifically on the basis of the seven selected procurement markets. This

was also done in the light of objections expressed by food retailers which were of the opinion that the markets should be defined wider. Taking the food retail trade in Germany as a point of reference, the geographic definition of a market is based on where the opposite market side of the retail trade, i.e. the suppliers, is located. For it is these manufacturers that are affected by the competitive behaviour of the food retailers in Germany. Ultimately the sector inquiry has shown that in all the procurement markets examined the food retailers in Germany purchase their goods primarily from manufacturers in Germany. In six of the seven procurement markets examined only less than three per cent of the products are procured from outside Germany. Consequently, the procurement markets examined are to be defined as national because the relevant opposite side of the market is in most cases located in Germany.

In all the procurement markets examined the food retail trade is the most important sales channel for food manufacturers whereas the alternative distribution channels are of minor importance. Depending on the procurement market examined, the food retail trade as a sales channel accounts for between 65% and 90% of the manufacturers' total turnover.

The group of leading food retailers (Edeka, Rewe, Aldi, the Schwarz Group and, to a limited extent, Metro) account for the largest share of total demand (in all the distribution channels including export) across all the procurement markets and irrespective of whether private labels and branded products are considered together or separately. Edeka is the buyer with the largest share of branded product procurement. As regards the procurement of private labels, the discounter Aldi, in particular, holds a prominent position. However, in some of the markets examined Edeka accounts for the largest share of total purchasing volume even in respect of private labels.

If only demand volumes in the food retail channel are considered, the companies Edeka, Rewe, Aldi and the Schwarz Group together account for approx. 85 % of total purchasing volumes in the food and non-food I segment.

The sector inquiry has shown that the general assertion of the Markenverband (Trademark Association), among others, that the manufacture of food and exchange of services with the retail trade are predominantly dominated by small and medium-sized companies, cannot be upheld. Also on the manufacturers' side a heterogeneous leading group of at the most four companies of various sizes account for the substantial part of the goods and services supplied on all the procurement markets examined. The members of this group have specialized primarily on the delivery to customers in the food retail trade and achieve a large proportion of their turnover with these few customers. Specialisation on the (increasingly concentrated) supplier side can reduce the procurement alternatives of the retailers. At the same time the manufacturers also have extremely few alternative sales possibilities (apart from the large retailers). The effect of these concentration processes on bargaining results can therefore only be estimated if both factors are taken into consideration.

According to information provided by the vast majority of manufacturers surveyed, switching or shifting production from or to private labels and branded products is not an alternative although such measures would be technically possible. The arguments which they give against the economic efficiency of such adjustments are mainly the different cost structures and logistic requirements in producing private labels and branded products.

Neither is switching to alternative distribution channels considered by the manufacturers as a realistic outside option. Shifting sales to another distribution channel is either regarded as not economically viable or doubt is cast on the "absorptive capacity" of alternative distribution channels. Even companies already using other distribution channels envisage no further absorptive capacity in this respect. In view of the very low share of overall turnover which alternative distribution channels account for compared with the food retail sector, this assumption is probably correct. In only one market did all the alternative distribution channels together account for 35 % of total turnover; in all the other markets examined the share was much lower. Some manufacturers regard establishing their own direct sales networks as a possible alternative to the food retail trade. However, they also view such a measure very critically due to the high costs involved.

In addition to these findings ***PART II of the Sector Inquiry*** presents a detailed econometric analysis of specific bargaining results in the procurement of food by the German retail food trade.

The purpose of this broad-based econometric examination is to better understand bargaining scenarios and the factors which influence them (independent variables). It can also show which independent variables can affect purchasing terms and conditions. The results can help to further develop antitrust (case) practice and at the same time can be seen as a starting point for a discussion among the informed public and members of the sector on the effects of buyer power.

The object of the analysis in the econometric part are negotiations on conditions for the purchase of branded products traded in the German food retail sector. These form the basis of the analysis. This limitation to branded products corresponds to retailers' core (area of) business. In addition, nearly all the complaints about procurement in the retail trade which reach the Bundeskartellamt concern branded products. Branded products in the food segment are also important high-turnover items. They are also easier to compare with one another and are also easier to assess econometrically than different private labels. Furthermore, in the case of branded products the competition parameters are generally in the hands of the manufacturers. Finally, the "bargaining logic" is different for branded products and private labels. Private labels are usually procured by way of tenders issued by the food retailers (on the basis of fixed recipes), whereas in the case of branded products the food industry conducts annual negotiations with the food retailers. This does not mean that the effect created by private labels is not considered in the econometric analysis. Private labels are actually considered in the assessment of the "competitive environment" of the branded products!

A unique data set was the only possible basis for gaining data for the empirical analysis. Bargaining on terms and conditions of procurement in the food retail sector is done within the internal sphere of the companies concerned which is why there are no reliable secondary data sources.

In the food retail trade a variety of different articles are sold. In the run-up to the sector inquiry it had already become clear that due to the diversity and depth of product lines a detailed analysis of all listed articles and all the procurement markets would be disproportionate or even impossible. For the purposes of the inquiry, therefore, a stratified sample was taken based on the distinction categories "product category", "must-stock item" and "item listed at a discounter". It was also ensured that an adequate number of articles in the sample would qualify as "high-turnover items". In a preliminary investigation stage the Bundeskartellamt determined the statistical population of all listed branded products from which the sample was drawn. With few exceptions the retailers surveyed represent the entire German food retail trade. The unmistakable international product identification code "European Article Number" (EAN) was used to identify and clearly define the articles.

The sample taken by the Bundeskartellamt is representative of the (aggregated) product categories and the various degrees of "relevance to competition".

During the main investigation phase the retailers as well as manufacturers were asked about the results of their negotiations on the individual EAN articles, the switching possibilities of the negotiating partners and the competitive environment. Responses from the manufacturers and retailers were validated in an elaborate process.

On the basis of scientific knowledge, basic models and bargaining theory models were then developed and used in regression methods to econometrically evaluate the data collected. These two "model types" reflect the two major theoretical approaches in competition economics: "Older" literature on competition theory and antitrust practice use monopsony or oligopsony as the framework for analysis. These assume that buyer power is a "mirror-inverted" version of supplier power and are based on the simple relationship between quantities and prices. The "newer" approaches take the results of bargaining theory as their basis and try to illustrate the individual bargaining positions by means of different determinants. This type of modelling allowed for the formulation of hypotheses on the influence of bargaining parameters on conditions. In addition to determining the purchasing volume, the framework model also determines, in particular, the influence of the outside options (purchasing volumes, supply and procurement shares), brand strength, the availability of alternative branded products and private labels and membership in a purchasing cooperation. In the analysis account was taken of the fact that the term "conditions" (in the meaning of economic consideration) is a multifaceted construct which can by no means be limited to "price" only.

In the examination special care was taken that certain elements of the conditions such as deadline for payment and agreements on delivery need to be covered in order to be able to

compare in an unbiased manner conditions between retailers which in some cases differ significantly from one another.

Finally, the individual variables of the model were operationalised, i.e. specific provisions were defined by which the variables or constructs described in the theoretic model were measured in the econometric model.

The results of the analysis were chiefly derived by using fixed effect models. It was verified that the findings were not dependent (to an excessive degree) on individual assumptions and variations of such. The robustness of the findings was analysed by varying the origin of the data, modelling, the operationalisation of independent and dependent variables, the use of control and instrumental variables and estimation models. The complexity of the evaluation and representation of the data created by this variation and the additional time and effort involved serve to place the ensuing discussion about the findings of the sector inquiry on a broad basis.

Findings of the empirical econometric analysis

Purchasing volumes have a decisive impact on the negotiated conditions, which is why the structural advantages of large retail companies are also reflected in the purchasing conditions granted to them. The empirical survey has therefore (not surprisingly) confirmed that in the negotiations between retailers and manufacturers, large purchasing volumes have a beneficial effect on the conditions granted to the retailer. The empirical survey has, however, taken into account that the advantages resulting from large purchasing volumes cannot be viewed in an isolated manner but may also be the result of other efficiencies. But even if the sole focus on purchasing volumes bears, from an econometric perspective, the risk that too little importance is attached to other efficiencies such as economies of scale, one can assume that independent variables in any case lead to more beneficial negotiation results, and thus offer a valuable indicator for a first assessment of how significant a retail company is for its negotiating partners in the food sector.

Turnover shares are an indicator for the outside options open to both negotiating parties. The general principle applies to each of the negotiating parties: the better a party's outside options, the better the conditions that party is able to negotiate. In the vast majority of model variants, the parties' respective turnover shares have a significant impact on conditions; this is particularly apparent in the product-related variants relating to the retail trade. In the empirical analysis of individual cases, however, care should be taken that (a) the turnover shares of both sides are considered so that the reciprocity of the negotiations is accurately reflected and (b) the right reference parameters are chosen, which ought to be as unambiguous as possible.

Not surprisingly, a well-known branded product, which customers expect to find in the assortment of a certain retailer, and the delisting of which would most likely result in a disproportionate decline in turnover for that retail company, has the effect that its manufacturer is able to achieve better conditions. In such cases the manufacturer can use

the strong sales performance of its product to exert pressure in the negotiations with the retail trade. One should take into account, however, that only a few products have the potential to be considered so-called "must-have" items. Only 6% of the products from the representative sample were identified as strong branded goods with a "must-have character".

On account of the manifold purposes private labels fulfil in the different product segments, their relevance for the relative bargaining power of manufacturers and retailers varies depending on the particular circumstances of each case. An unambiguous assessment to this effect would not do justice to the fact that private labels are used for a wide number of reasons. On the one hand they can be used as a means to put pressure on branded products; they can, however, also be part of a complex price differentiation strategy that is the result of a mutual product range and price "architecture" pursued by manufacturers and retailers. The extent to which a private label can influence the conditions negotiated for a branded product also depends on whether the manufacturer of the branded product also offers a private label in the same product segment (and possibly to the same retailer).

Membership in a purchasing cooperation also has an impact on purchasing conditions. While there are individual retail companies that succeed in negotiating favourable conditions without being a member of a purchasing cooperation, the vast majority benefits significantly from a membership in such a cooperation. To what extent, however, depends on the size of the company. Large member companies (the "heads" of a purchasing cooperation), for example, benefit to a significantly lesser extent than smaller members. In addition, there is evidence that the benefits gained from membership in a purchasing cooperation are passed on to a very different extent.

All in all, the sector inquiry has not only produced clear results but also raised a few questions that deserve to be discussed with the interested public after the publication of the inquiry's findings. The sector inquiry has in any case helped to identify the cases in which it is possible or likely that a retailer will achieve a surplus due to its buyer power. Whether this surplus is significant enough to assume that competition has been harmed is impossible to say on a purely empirical basis without a normative reference. This requires for each individual case a comprehensive appraisal of all the independent variables in which the objectives of competition law serve as a normative benchmark. Empirical analysis can be used, however, to define the relevant variables and other effects that have to be considered in the case-by-case assessment. If a retailer has a strong bargaining position with regard to the above variables, it can be concluded that, compared to its competitors, it also enjoys better purchasing conditions (in relative terms). Both the results of the econometric analysis (part II) and the comprehensive assessment of individual procurement markets (part I), clearly reveal the structural advantages which some of the food retailers in Germany enjoy (advantages that go beyond individual cases or markets).

Conclusion and outlook

The sector inquiry examined in detail the market structures and negotiation patterns on the procurement markets of the food retail sector. One of the main objectives of the inquiry was to gain insights for the Bundeskartellamt's future case practice. The following section describes the conclusions the Bundeskartellamt draws from the sector inquiry for its future case practice.

Conclusions from the sector inquiry

The findings of the sector inquiry confirm the Bundeskartellamt's hypothesis that the conditions of competition in the German food retail sector are dominated by a leading group of four nationally active retailers: Edeka, Rewe, the Schwarz Group and Aldi.

Edeka, Rewe, the Schwarz Group and Aldi are leaders in terms of the turnover achieved with final customers, the total sales floor space and the number of stores they operate. Compared to their competitors, they have by far the widest customer reach in Germany. In the case of Edeka, Rewe and the Schwarz Group, this is complemented by a strong presence in all the distribution channels from full-line to discount and a wide range of branded products and private labels in all price categories. The three companies are therefore able to attract customers from all consumer groups in Germany, either with branded products or with their own private labels. In particular Edeka and Rewe have in recent years constantly broadened (to the extent possible) their sphere of influence via mergers and purchasing cooperations, which are further strengthened by structural interconnections.

The four leading retail companies also hold strong positions on the procurement markets. They are by far the biggest buyers and together account for the largest share of the purchasing volumes. This applies not only to individual procurement markets but is also the case with regard to product segments and in terms of total procurement figures. For the analysis of market structures, the sector inquiry examined seven different markets which were the most likely to show different market structures. But even these markets have comparable structures with regard to the number of leading suppliers, demand structures, the significance of alternative distribution channels and other outside options. The market shares of the buyers on these procurement markets are fundamentally the same, regardless of whether one regards product-related purchasing volumes or overall purchasing volumes. In the Bundeskartellamt's view, the competition conditions on the procurement markets that have been analysed in the sector inquiry therefore largely mirror the competition conditions on other procurement markets that were not included in the survey.

For the manufacturers of branded products, the full-range providers Edeka, Rewe and the Schwarz Group constitute a "bottleneck" for the Germany-wide distribution of their products. For the manufacturers of private labels, on the other hand, the discounter Aldi is

the most important buyer, outnumbering the three other members of the leading group, Edeka, Rewe and the Schwarz Group.

In addition, there is a group of smaller food retailers in Germany which hold high market shares in "their" regional markets. In those regional markets where the large full-range providers Edeka and Rewe hold comparatively weak market positions and the discounters are, next to the regional retailers, the leading suppliers, these smaller retailers can be quite significant for the market penetration of a manufacturer's branded product.

In negotiations with the food industry the leading retailers are largely able to use their strong market positions to their advantage. As a consequence they are in a stronger bargaining position than the manufacturers and have a significant structural advantage over their smaller competitors in the food retail trade. This finding confirms the Bundeskartellamt's practice of exercising strict merger control in this highly concentrated market. The Bundeskartellamt is nevertheless aware that the power relations between manufacturers and retailers may be different in markets where supply structures are concentrated to an extent that leaves little or no scope for retailers who want to maintain a multi-brand strategy to change a supplier.

As regards negotiations on the procurement of branded products, the sector inquiry has led to the following conclusions:

Based on the empirically proven impact of purchasing volumes on the terms of procurement, the Bundeskartellamt holds the view that the large retail companies Edeka, Rewe and the Schwarz Group have a structural advantage at the horizontal level (over their competitors) and at the vertical level (over their suppliers). For merger control purposes, the purchasing volume has to have a significant influence on the results of the negotiations between manufacturer and supplier. It does not necessarily have to be the only parameter with an impact on the negotiations.

As expected, the sector inquiry has proved that high purchasing volumes lead to low purchasing prices; this applies notwithstanding the fact that there can also be other reasons why conditions improve with increasing purchasing volumes. In particular the three buyers Edeka, Rewe and the Schwarz Group achieve sufficiently high purchasing volumes in their procurement of branded products. Compared to their competitors, they enjoy further economies of scale and finance which enable them to successfully engage in price competition against competitors with weaker resources and thus strengthen their position on the sales markets. On account of their high (and still increasing) sales volumes, in the view of the manufacturers these retailers hold the function of a "gate keeper" with regard to the market penetration of the manufacturers' products. This feedback effect between buyer power and supplier power leads to a constantly increasing concentration on both the manufacturers' side and the retailers' side.

Even strong manufacturers with high turnover shares in the food retail sector can be faced with strong bargaining power from their customers, if they have even fewer outside options than their customers. This needs to be assessed on a case-by-case basis.

A decisive factor in the assessment of the outside options are the mutual turnover shares of the manufacturer and the retailer. Also of relevance is the competitive environment which needs to be assessed in each individual case. This concerns, for example, the brand strength of the branded product in question and the brand strength of rival products to which the retailer could switch. Finally, it needs to be considered to what extent the manufacturer can resort to alternative buyers from other distribution channels and whether he is able to switch production to the manufacture of private labels at short notice. What matters most in this assessment is that it focuses not only on the outside options of one of the negotiating parties, but instead compares the outside options of both, the manufacturer and the retailer.

The survey of the seven markets selected revealed that in each market there are leading manufacturers with high turnover shares in the food retail sector. The outside options these manufacturers have as alternatives to their large customers in the food retail sector are nevertheless limited, because the significance of alternative distribution channels is comparatively low and the absorptive capacity of smaller retailers is also significantly lower. This finding is supported by the empirical analysis of negotiation results in relation to turnover achieved with sales to the food retail trade. The Bundeskartellamt is convinced that even high-volume suppliers can have relatively weak bargaining power. In such cases the outside options of the manufacturer in the relevant market need to be assessed and compared to the outside options of the retailer. If the retailer has to fear disproportionate revenue losses if a strong branded product is delisted from its assortment, or if it cannot avoid the respective supplier on account of the market strength and brand equity of the latter, one can assume that the bargaining power is imbalanced in favour of the manufacturer.

In the assessment of bargaining power in bilateral negotiations, the brand strength of the products in question is - as in previous case practice - taken into consideration. In particular, there is a need to determine to what extent the products of a certain manufacturer are indeed indispensable for the retail trade.

The sector inquiry has provided evidence that even in negotiations with large buyers, the manufacturer of a very strong brand (must stock) is in a stronger position because the retailer has to expect disproportionate turnover losses if the brand is delisted from its assortment. This has been repeatedly argued by the retail companies. Nevertheless, the Bundeskartellamt has found that only 6 % of the products featured in the representative sample have the necessary brand strength to be considered must-stock items.

In bilateral negotiations between manufacturer and retailer, the bargaining position of the retailer is usually strengthened if he also offers private labels. This, however, depends very

much on the circumstances of the individual case. At the horizontal level, a retailer offering a wide range of private labels usually enjoys a structural advantage over its competitors.

As expected, the empirical survey has shown that the extent to which private labels have an impact on bargaining power needs to be examined on a case-by-case basis. The initial assumption that private labels tend to improve the bargaining position, and consequently the conditions, of a retailer has been confirmed in many cases; there are some scenarios, however, where different effects have occurred. In cases where the manufacturer of the negotiated branded product also produces the private label which could, from a consumer's perspective, substitute the branded product if the latter were delisted, this can even lead to a stronger bargaining position of the manufacturer. In addition, the empirical analysis indicates that sometimes the mutual objective in the negotiation of purchasing terms and conditions between retailers and manufacturers is to enforce a consistent price differentiation between private labels *and* branded products to maximise the overall surplus of both, the manufacturer and the retailer. In such a case, it is possible that the brand manufacturer is able to negotiate comparably good terms and conditions despite the existence of a large number of private labels, because the manufacturer and retailer act by mutual consent or on account of common interests. Finally, the impact a private label has on negotiations also depends on the brand strength of the branded product that could be substituted by the private label: Private labels can only be used to a very limited extent by retailers as rival products for must stock products; equally, the substitution of an "A" brand can be difficult if a full-range retailer has already substituted many branded products with private labels in a specific product category and its customers expect to be offered a wide range of branded products.

Generally, it can therefore be assumed that in a market where the manufacturers of branded products do not also produce private labels in a comparable price segment, a wide range of private labels tends to be beneficial for the retailers. In most of the seven markets surveyed in the sector inquiry, manufacturers either specialised in the production of private labels or in the production of branded products, but hardly in both. In the past, the examination of mergers between manufacturers did not present such a clear-cut picture: While in the production of ice cream the manufacture of branded products and private labels was strictly separated, the leading manufactures in the delicatessen sector produced both, branded products and private labels in almost equal measure.

As regards horizontal relations, the Bundeskartellamt expects a retailer to enjoy a structural advantage over its competitors if it is able to offer (and possibly produce) private labels in a wide range of product categories and price segments. This applies irrespective of the bargaining position of the retailer in the bilateral negotiations with the manufacturers. The range and extent to which a retailer is able to offer private labels proves its capability and willingness to invest in private labels. The three leading retailers Edeka, Rewe and the Schwarz Group all offer a broad range of private labels in all price segments and in part even produce these products via vertically integrated companies. Consequently, they enjoy a

structural advantage over their competitors. In the bilateral negotiations between a manufacturer and a retailer it is likely that the bargaining position of the retailer is improved by its private label activities; this would, however, have to be verified on a case-by-case basis.

From a long-term perspective, the "new generation" of purchasing cooperations which can be regarded as a pre-stage of a merger because of their concentrative elements improve the bargaining positions of the leading food retailers; this is because the structurally enhanced purchasing cooperations with their merging of corporate functions result in a consolidation of the market to the benefit of the leading food retailers.

The findings of the empirical part of the sector inquiry suggest that membership in a purchasing cooperation is more beneficial (in terms of purchasing conditions) for the smaller partner of the cooperation than for the large partners such as Edeka and Rewe. This applies even if the advantageous conditions are not passed on in full by the heads of the purchasing cooperations, indications of which can be found in both empirical data and case practice. For the smaller food retailers the cooperation with a large partner therefore offers a promising option to strengthen their position on the procurement and sales markets while maintaining their autonomy; in this, however, they do not always succeed.

For the large food retailers, such as Rewe, which head several purchasing cooperations, a cooperation with a smaller competitor apparently only leads to a marginal further improvement of their purchasing conditions. Instead, they benefit from the subsidiary agreements that are also part of the purchasing cooperation arrangement. For example, the smaller cooperation partner is allowed to include the private labels of the larger partner in its product range, thus enabling it to offer a private label although its purchase order quantities would normally not be sufficient to warrant its own private label. The inclusion of the private label of the larger partner into the product line of the smaller partner leads to a general alignment of product lines which is in the interest of the large partner and a first step towards a uniform market presence. In addition to the alignment of product lines, further accompanying measures such as unilateral or mutual territorial protection agreements and a validation of the cooperation under company law to the benefit of the large cooperation partner can be preliminary steps towards a subsequent takeover.

Consequences for the future application of competition law

Merger control

In the context of merger control which is to prevent abstract threats, the primary aim is to protect effective competition. A prognosis must be given as to what effect the merger is likely to have on the development of competition structures and whether it is expected to significantly impede effective competition ("toppling" the market).

The sector inquiry cannot make predictions about which mergers that might theoretically occur in the future would have to be cleared or prohibited. This has to be decided in each individual case. As a result of the sector inquiry it can be stated, however, that each acquisition of a food retailer in Germany by one of the large retail companies Edeka, Rewe and the Schwarz Group, requires an in-depth examination of the effects of the planned concentration, also with regard to the procurement markets. This applies to any transactions involving the acquisition of not only individual locations, but networks or parts of networks from companies which exert appreciable competitive pressure on regional sales markets and procurement markets. The analysis of one single procurement market affected can generally be sufficient to examine the prohibition requirements in these markets. This applies all the more as the sector inquiry has shown that competition conditions do not essentially vary in different procurement markets.

For the examination under merger control law the recently introduced SIEC test is the examination standard. The SIEC test does not require the existence of market dominance. It is thus able to prevent restrictions of competition even in those cases where the parties to the merger do not jointly achieve the highest market shares in the markets affected. The prohibition criteria under the test are also fulfilled if a merger eliminates an important competitive force and thus enables the remaining competitors to increase their market power without implicitly or explicitly coordinating their competitive behaviour (non-coordinated or unilateral effects). This closes a gap which has so far made it very difficult to conduct a complete and sound economic analysis of the effects of mergers on the procurement markets. In the Edeka/trinkgut proceedings for example, it had become clear that market dominance as a prohibition criterion does not completely cover those cases in which the members of a leading group do not engage in coordinated behaviour or where coordinated behaviour cannot be proven.

The examination focuses on the criteria discussed in the theory of harm in the full version of the report which essentially include an analysis of the market structure.

Control of abusive practices

As to the control of abusive practices, the sector inquiry assists the Bundeskartellamt in analysing the structures of the procurement market(s) under examination. The sector inquiry provides important insights in particular regarding the problem of identifying those companies that are addressees of the "Anzapfverbot" prohibition, i.e. the prohibition of inducing suppliers to grant a retailer specific benefits without any objective justification. Many indications provided by the sector inquiry suggest that at least the large food retail companies Edeka, Rewe, the Schwarz Group and Aldi are norm addressees under the control of abusive practices.

In the proceedings against Edeka on account of its violation of § 19(1), (2) no.5 in conjunction with § 20 (2) GWB, the Bundeskartellamt developed a multi-level list of criteria based on the insights gained from the sector inquiry in order to establish whether a supplier

is dependent on a retail company. This enables the authority to conduct a comprehensive analysis of the market significance of the potential norm addressee, the market conditions on the specific market affected as well as the bilateral relations between the individual suppliers and their possibilities to switch (see p. 14). This list will also form the basis for analysing the issue of norm addressees in future cases.

After the norm addressees have been identified, it has to be examined in the relevant abuse control proceedings whether the conditions demanded were objectively justified or whether the demand represented an abusive practice.

The precondition for an objective justification would be the receipt of a benefit and that the individual demands are reasonable. The receipt of a benefit demanded can directly result from the reason why it was demanded (e.g. demand of a quantity discount on account of larger purchase quantities in future) or from a benefit offered in return (e.g. demand of a bonus payment for the additional listing of certain products). To establish whether a demand is reasonable the relationship between the extent of the demand and the amount or significance of the respective benefit (given in return) has to be considered.

For a demand to be objectively justified the supplier must be able to verify whether the benefit (given in return) is „*objectively plausible*“. According to the insights gained by the Decision Division into negotiations in the food retail sector, this applies not only to the benefit (given in return); the reason for and the calculation of the demand must be transparent for the supplier as the objective justification or reasonableness of the demand cannot otherwise be assessed.

These aspects illustrate that 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 and in particular the econometric analysis of the negotiation results can provide indications as to which bargaining scenarios, in terms of a potential risk, are more or less likely to result in abuses of a powerful market position. However, such abuses must still be proven in an examination of each individual case.

Purchasing cooperations

Currently two main models of purchasing cooperations can be identified: Firstly, the purchasing cooperations among competitors of approximately the same size which aim at improving their bargaining position vis-à-vis the manufacturers solely by bundling their procurement volumes (PHD, Bunting). Secondly, the "new generation" purchasing cooperations which go far beyond the mere bundling of volumes.

From the perspective of a competition authority, in particular the "new" procurement cooperations involving large companies must be carefully examined by focusing on their effects under competition law. Based on this background purchasing cooperations no longer merely represent a time-limited bundling of purchasing volumes, but must be seen as part of the concentration process taking place on the sales markets with significant long-term

effects on competition. By using purchasing cooperations and the new type of conglomerate contracts as a gateway, the large food retail companies increasingly gain substantial and direct influence on the smaller competitors from which it is almost impossible for them to break free, in particular if the cooperation has lasted for many years. The assessment by the Bundeskartellamt has been empirically underpinned by the sector inquiry. Also from the point of view of the smaller partners in a purchasing cooperation, a cooperation is often an initial step towards the later sale of an owner-operated company to the larger cooperation partner ("succession planning").

If, due to the contractual structure and the general expansion strategy of the powerful cooperation partner which goes beyond the scope of individual cases, a purchasing cooperation contributes to consolidation in the sales markets as well, this must be taken into account in the assessment of the restraint of competition ("abstract threat").

Purchasing cooperations in the food retail sector affect both the procurement markets and the regional sales markets. Depending on the type of agreement, further markets can be affected, e.g. the food wholesale market. As in merger control, the market structures in the procurement and sales markets must be examined to determine whether the restraints of competition resulting from the purchasing cooperation and the ensuing pooling of procurement volumes and other company resources are appreciable, or whether market power within the meaning of the Commission's Horizontal guidelines exists.

With regard to the relationship between manufacturers and retailers and their negotiations on the procurement of food products, the outside options must also be examined. Not only the market structure analysis conducted in the sector inquiry, but also the analysis of different product-related bargaining results refine and improve the method of assessing bargaining power by using different bargaining scenarios.

In any future cases involving the creation of new purchasing cooperations or the extension of existing purchasing cooperations and the participation of a large nationally active buyer, the Bundeskartellamt will carefully examine the effects on the sales and procurement markets. In line with the Commission's Horizontal Guidelines, one criterion for such an examination will first of all be a market share of at least 15% held by the parties involved in the sales and procurement markets affected. In the assessment of the anti-competitive effect achieved by the admission of the smaller partner, not only the quantitative dimension but also qualitative aspects will be analysed. The smaller partner's market position in the regional sales markets will be included in the overall analysis as well as the degree of alignment of the cost structures of the cooperation partners resulting from an assimilation of the product ranges and joint purchasing activities in the food retail sector. Furthermore, agreements which go beyond the mere bundling of purchasing volumes will be taken into account and assessed.

Further important criteria in the assessment of purchasing cooperations are the network effects resulting from the participation in different purchasing cooperations as well as the

weakening of smaller purchasing cooperations whose members have switched to other cooperations. By switching purchasing cooperations the smaller competitors become "transparent" to their larger cooperation partner. For this reason not only mergers, but also purchasing cooperations enable buyers to demand that better purchasing conditions granted to other companies must also be offered to them. After the conclusion of a new cooperation suppliers will have to fear that their partners will confront them with details on different individual conditions from which the previous cooperation benefited. This is why, soon after the first announcement of a new purchasing cooperation, manufacturers often stop negotiating with the smaller partner which intends to switch to a new purchasing cooperation. If this company is still involved in its previous cooperation, this will also result in the previous cooperation having to face purchasing difficulties.

Further discussion

This report provides a detailed look at the aims of the food retail sector inquiry, the method of investigation used, its results and conclusions. This should enable the interested public and experts to understand and comment on each of the issues presented. The Bundeskartellamt hopes that the sector inquiry will be followed by an objective and open discussion of all the issues involved, thus promoting further knowledge in this area.

In the light of the insights gained from the sector inquiry the Bundeskartellamt would particularly welcome (additional) feedback on the following individual aspects:

- Conceptual approach used in the transfer of the concept of demand-side substitutability from the sales markets to the procurement markets with regard to the definition of the product and geographic markets. From the perspective of the market participants: conceptual or practical application problems?
- Current planning law and urban development planning as a legal framework in the location planning process: Market barrier to the internal growth of small and medium-sized food retailers in particular?
- Effects of the diversified private label policy on the power relations between retailers and manufacturers: Concrete case examples for differentiated effect mechanisms?
- Expansion of the food manufacturers' international business activities as an outside option: Significant outside option for escaping domestic buyer power or inadmissible pressure to exit or partially exit the market?
- Negotiation of conditions between trading companies and manufacturers - hard bargaining on the one hand and abusive behaviour on the other: Where is the dividing line?

The Bundeskartellamt considers this report as a basis for further discussion with the market participants, academics, associations and interested political groups. All interested parties have the opportunity to comment in writing on the report until

31 December 2014.

Depending on the content of the comments and the need for further discussion the Bundeskartellamt intends to continue the exchange of views in an appropriate framework. Invitations will be sent out separately.

Gliederung der Sektoruntersuchung Lebensmitteleinzelhandel

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- Handelsdatensatz
- Operationalisierungsvarianten „_n2“
- Operationalisierungsvarianten „_n3“

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- Herstellerdatensatz
- Operationalisierungsvarianten „_n2“
- Operationalisierungsvarianten „_n3“
- Handelsdatensatz
- Operationalisierungsvarianten „_n2“
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