Agenda, Volume 10, Number 2, 2003, pages 145-162

Buyer Power of Supermarkets

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Over recent decades, the supermarket sectors in many developed economies have become much more concentrated. Nowadays, the largest chains are said to possess and exercise considerable 'buyer power'. In Australia and Britain, governments have established codes of buying practice in response to supplier complaints about supermarket conduct. For those two countries, it is timely to report on recent government initiatives, and to offer some analysis.

This paper examines the market contexts, describes and evaluates some widespread buying practices, considers the difficulties in applying general competition law, describes the provisions of the codes of practice, reports on the early and (seemingly) unimpressive experience with the codes, and suggests ways in which the governments might strengthen them.

To define *buyer power*, it seems best to adopt a direct, operational measure: a firm (or group of firms) has buyer power when, *for like transactions*, it can obtain from a supplier terms that are more favourable (for the buyer) than those available to other buyers. Besides prices, 'terms' refers to contractual conditions that relate to payment, product quality, labelling and packaging, and any associated marketing and promotional activities.

The Market Contexts

In considering whether there is such buyer power, one issue is the proportion of the total supply of a particular product that goes to the largest supermarket chains. Accordingly, it is wise to look at the retail market comprising all 'grocery' stores, regardless of store size.

Using a comprehensive grocery-store category, the Competition Commission (2000:Table 5.6) reports that in 1998-99 the UK's five largest firms had some 69 per cent of the national market measured by turnover. Concentration is much higher in the market for 'one-stop' shopping, a market that is served only by the largest stores. For stores over 2,300 square metres in floor area, the Commission notes that those five firms had 95 per cent of that market.

The all-stores sector in Australia is more concentrated than that in the UK. For 1997-98, the Australian Bureau of Statistics (Joint Select Committee, 1999:Appendix 5) put the national share of the *three* largest chains at 62 per cent, even for a widely defined market comprising all supermarket and grocery items, together with liquor retailing.

Since then, the smallest of those chains (Franklins) has been broken up. Woolworths bought many of the one-stop stores and some of the others (Woolworths Limited, 2001). The *two* largest companies, Woolworths and Coles,

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now seem to have about 58 per cent of the wide market and probably have more than 90 per cent of the Australian one-stop market. Furthermore, most 'independent' supermarkets buy through wholesalers, which have more buyer power than do individual stores.

At the firm level (in both countries), some important economies of scale and scope (especially those found in distribution) favour the large chains, regardless of whether the manufacturer or the chain undertakes the distribution. In recent years, some new companies have entered (notably, in the UK, the 'discounters' Aldi, Netto and Lidl; and in Australia, Aldi). Yet, they have had little impact on the market shares of the big chains. No entrant operates large, one-stop stores — for which the barriers to entry include planning/zoning restrictions, and difficulties in accessing suitable existing sites.

A large supermarket may sell 20,000 or even 30,000 products, which (in the UK) come from about 2,000 suppliers. In contrast, even a large manufacturer often sells most of its output to just a few of the largest supermarket chains. A smaller supplier may sell all its output of a particular product to a single chain (so-called 'solus supply') (Competition Commission, 2000:paragraphs 11.5 and 11.10).

Besides this numerical distinction, there is also a spatial difference. A single store sells its many products in a local area, where there may be little or no competition (between one-stop shops, at least, and particularly in Australia). On the other hand, the owning chain often buys its supplies on a national basis, and may solicit supplies from rival companies (Dobson Consulting, 1999:section 4.3).

Nearly all processed products sold in supermarkets are *branded*. One intention is to assure consumers of a consistent quality that is maintained over successive purchases. One effect is to enhance the market power of the brand-owner, who is usually the supplier. However, supermarket chains commonly develop their own brands. This enhances the market power of the chain, rather than that of the supplier who makes the 'own-label' product, and whose identity is not known to the consumers. Own-label strategies are considered below.

Buyer Power, Market Concentration and Bargaining with Suppliers

When a few supermarket chains account for a large share of all grocery sales, then those chains together generally buy a large proportion of total output in the narrow product range of a specific intermediate market. On the other hand, the supply side (for processed products, at least) can be even more concentrated.

Even so, a supermarket company has an important bargaining chip, namely the threat to 'de-list' one or more products — that is, stop selling those products. This is likely to reduce the profits of both parties. However, a large supermarket company may buy (say) 20 per cent of the manufacturer's output while the relevant products may contribute only (say) one per cent of the buyer's turnover. Thus the *direct* proportional effect of de-listing on the buyer's profits is likely to be much less than the direct effect experienced by the manufacturer. (It is the facility to switch suppliers that gives rise to buyer power.)

Of course, there can be wider effects: if a chain delists a branded product, will customers seek the product at a rival store, and transfer other custom as well? As recognised long ago (Heflebower, 1957:279):

> For many commodities consumers have no strong preference for one brand over several others … The manufacturer of such a line is a beggar at the retailer's office.

This argument becomes stronger as retailing becomes more concentrated. There may be only a single *one-stop* store in a given local area, and a shopper who transfers to another store may incur extra travel and time costs. Provided the first store stocks a rival brand that shoppers regard as a reasonable substitute, it seems that few would transfer.

Even so, in a few cases (Kellogg's breakfast cereals is an oft-quoted example), a product may have such a strong brand reputation that consumers expect to find it in any supermarket. Then, the chain may fear that if it de-lists, a significant proportion of its regular shoppers *would* go elsewhere, perhaps leading to it losing sales of many other products. Because the brand-owner knows that too, the threat to de-list may not be credible. However, the retailer may have another weapon available, namely a threat to de-list any of the supplier's other products that have lesser brand strength (Competition Commission, 2000:paragraph. 2.454).

A large supermarket chain can employ and enhance its buyer power by introducing own-label brands. Such brands account for about 35 per cent of supermarket sales in Britain (Competition Commission, 2000:Table 6.1), but are less important in Australia. Generally, the supermarket specifies the product qualities (Burt, 2000), and can choose where to position its brand on the quality spectrum. By merely placing such products on its shelves, it can sometimes secure large sales, without incurring advertising expenses. Armed with that potential, the supermarket can negotiate low prices in sourcing supplies — perhaps from a manufacturer of a well-established brand that may be willing to supply the own-brand product for fear that otherwise the chain will obtain supply from another manufacturer, who may not have an established brand.

On its own brand, the retailer can make a good profit — in proportionate terms, at least — even when it sells at a price that is lower than that of the well-established manufacturer brand (Competition Commission, 2000:paragraphs 8.141-8 and 2.413). This applies especially when the latter price is elevated in order to fund expensive brand-name advertising. Dobson Consulting (1999:Part I) provides further discussion of conceptual aspects of supermarket buyer power.

Outcomes for Wholesale Prices

Whenever there are few players on *each* side of a wholesale market, price outcomes depend on bargaining, as well as on the underlying cost and demand considerations. If trade of a particular quantity is to be feasible, the highest price

the buyer is willing to pay for that quantity must exceed the lowest price that is acceptable to the seller. Given the concentration in supermarket retailing and in (some) manufacturing, these two price bounds may diverge significantly. The bargaining serves to allocate profit shares.

In selling to small customers, the supplier may obtain a price that gives a rate of profit in excess of a normal (competitive) return. In that regard, the seller may be said to exercise market power. Then, the lowest price the seller will accept when dealing with a large chain may be insufficient to yield a normal profit *on those sales*. In such a case, it may be that most of the supplier's profits arise from sales to its smaller customers.

For the UK, some Competition Commission (2000) data, given here in Table 1, show that for some major branded goods small retailers pay large suppliers as much as 12 per cent more than the prices paid by the largest companies. Even between the *large* chains, the proportionate difference can be as much as three per cent. The Commission believes (paragraph 11.116) these differences go beyond any differences in operating costs; it concludes that the largest multiples enjoy notable buyer power even when dealing with large suppliers.

Two earlier government reports (Monopolies and Mergers Commission, 1981; and Office of Fair Trading, 1985) also found such price discrimination, but thought that the then competition between the larger chains sufficed to ensure that they passed on to their customers much, if not all, of the financial benefits. In its recent report, the Competition Commission concluded that the UK market is ‘broadly competitive’, but did not consider explicitly whether the large retailers still passed on such savings. As retailing concentration increases, the competitive pressure to do so will diminish. (In Australia, concentration may have now reached a critical level in that respect.)

Until recently, the Australian debate on buyer power has rested on anecdotal evidence. The Australian Competition and Consumer Commission (1999:12) notes:

> Retailers are said to earn greater revenue from discounts and allowances than they do from [the standard] margins on product sales. Thus manufacturers experience considerable pressure from retailers for greater discounts and allowances.

Notwithstanding some contrary large-supplier claims, the Joint Select Committee (1999:paragraphs 5.52 and 5.54) concluded that the major chains use their buyer power to extract the best deal possible from suppliers. In addition, the Committee (paragraph 5.57) quoted the evidence of a former independent retailer:

> The trading terms are remarkably different. We are dealing in an industry that works on two or three per cent profit and yet the difference in trading terms is often … as much as five, six or eight per cent.

Table 1: Prices Paid by Large UK Supermarket Groups to Large Suppliers of Certain Major Branded Products, 1998-99

Supermarket group	*Market share (%)*[a]	*No. of identified lines purchased*[b]	*Average price paid*[c]*, as % of average price paid by Tesco*
Tesco	23.0	126	100
Sainsbury	18.7	122	101.6
Asda	12.2	124	102.3
Somerfield	9.8	125	103.0
Safeway	11.5	121	103.1
Morrison	3.9	118	104.6
five other multiples[d]	7.6	66-103	105-111
other retailers[d]	-	about 100	about 107-112

Notes: a Here, the market refers to the turnover of those multiples identified in Table 5.6. This is the widest of the alternative definitions considered by the Commission, and gives the lowest market shares for the large multiples.

b A 'line' is a specific branded product in a specified package size. The data come from returns from 26 large suppliers, and relate to the top five lines of each supplier. For these 130 lines, this column shows the number of lines purchased by each retailer.

c The prices averaged by the Competition Commission are here taken to be the invoice prices, net of discounts (paragraph 11.114). The averaging uses equal weights for each *included* line. Taking Sainsbury as an example, the average price index refers to the 122 lines that are purchased by Sainsbury *as well as* by Tesco.

d These groups are identified in Tables 11.10 and 11.11, respectively.

Source: Competition Commission (2000). The price data (taken from Tables 11.10 and 11.11) was provided by a panel of large suppliers. The market share information is from Table 5.6.

Following a recent attempt to collect systematic data, the ACCC's report (ACCC, 2002:Chapter 5) identifies the standard discounts and the 'funding support' provided by suppliers (ostensibly for in-store promotions and the like) that have to be deducted to arrive at the so-called 'net net' prices. It explains also that in selling to a wholesaler (as distinct from a large retail chain), the supplier

may give some funding support directly to selected individual retailers, rather than to the wholesaler.

Because of these complexities, and especially because of the low response rates to its (voluntary) survey, the ACCC urges caution in interpreting the data. For what it is worth, its report makes it clear that: (1) the survey did not find a striking correlation between size of supermarket chain and buying prices, comparable to that found by the Competition Commission in the UK; (2) suppliers did agree different net prices with different buyers; (3) 'independent' wholesalers sometimes got better terms than the two big retail chains; and (4) the two big chains got the best prices in about 65 per cent of the reported cases. As to the size of the price differences, Charts 5.63 and 5.64 of ACCC (2002) show that in 62 per cent of the cases there was a price difference that exceeded two per cent, and in 36 per cent of the cases a difference that exceeded four per cent.

Thus the extent of price dispersion in Australia is probably much the same as in the UK. In both countries, the pricing deals are complex, and it is unlikely ever to be possible to obtain precise data. It is, however, easier to obtain *qualitative* evidence on the practices of the large buyers. This is considered next.

Pricing and Related Practices in Wholesale Markets

The buying practices of large supermarket chains may be considered under two general headings: prices and other terms that relate to the supply of the goods themselves (considered in this section); and other practices, including those relating to the services that are sometimes rendered by retailers to promote the sale of selected products (examined in the next section). This section looks first at pricing, and then at the other terms. It offers a *qualitative* evaluation of the economic consequences. Though some of the practices seem relatively unimportant in principle, the distributive and efficiency consequences (of any widespread use) are likely to be significant in aggregate.

It is helpful to begin by looking at contractual terms in general. The Competition Commission (2000:paragraph 2.469) notes that 'in the dynamic trading environment of [UK] grocery retailing … full written contracts are rare'. In particular, it is not common for the written contract, if any, to specify the quantities to be supplied. The retailer then chooses and varies the quantities at short notice. However, a chain usually does promulgate standard conditions for delivery arrangements and similar matters.

Much the same general approach obtains in Australia (Joint Select Committee, 1999:section 5.104). That Committee's anecdotal evidence on other aspects of supermarket buying practices suggests that these practices are much the same as in the UK — for which the Competition Commission provides a systematic account that is relied upon here.

Unit prices

When large retailers buy at unit prices that are lower than those available to small retailers, the resulting price differentials may or may not match differences in the unit costs of supply. As noted already, the Competition Commission did find that in the UK, large retailers enjoy a price advantage that exceeds the cost difference.

This price discrimination may facilitate the further growth of large firms at the expense of small retailers — an outcome that does not (necessarily) stem from differences in retailer (cost) efficiency. (Even so, the major influence on past growth must surely have been the attraction to car-owning consumers of shopping in a large, one-stop store.)

Temporary discounting of retail prices

Commonly, a supermarket offers temporary price reductions (‘specials’) on some of the product lines on its shelves. To support such a reduction, the supplier *may* be willing to accept a reduced wholesale price. Where the parties agree on this in advance, and the supplier does not feel coerced, there can be no complaint. Yet, the Commission found that some UK chains imposed *retrospective* reductions in the agreed wholesale prices. This may disadvantage some suppliers relative to others.

Unilateral changes to prices and to related contractual terms

The Competition Commission (2000) found that several of the larger UK supermarkets employed such practices. Three of these practices are noted here:

- Retrospectively seeking or imposing discounts (on previously agreed wholesale prices), especially when the retailer has surpassed a sales target (paragraph 2.495).
- Requiring or requesting compensation from a supplier when the retailer’s profit on a product turns out to be less than it had expected (paragraph 2.496).
- Requiring or requesting a supplier to buy back unsold items (or simply failing to pay for them), when there was no written ‘sale or return’ agreement (paragraph 2.499).

Obviously, all such practices suggest the presence of buying power, which is used to secure a better outcome for the retailer at the expense of the supplier. However, some other consequences are not so obvious, and need to be argued.

After concluding (paragraph 2.458) that the largest supermarket retailers have significant buyer power, the Commission finds that each of the above practices, when carried out by such retailers, 'adversely affects the competitiveness of some of their suppliers, particularly small suppliers, and distorts competition in the supply of groceries between retailers, and between suppliers' (see paragraph 2.494(c), and similar wording elsewhere). According to the Commission such practices distort competition in the *retail* supply of groceries because they

disadvantage those retailers that do not receive the retrospective advantages, and distort competition between *suppliers* because an undue element of commercial risk, that would otherwise rest with the retailer, is transferred to the supplier.

Although many of the practices do indeed transfer some risk from retailer to supplier, the first of the three practices does not necessarily have that effect: when sales go poorly, the supplier receives a higher unit price, and this dampens the revenue variation.

When risk *is* transferred, the supplier gets a poorer deal when selling to a large, powerful retailer. Though this transfer could threaten the viability of a supplier, this seems unlikely for a large manufacturer, as distinct from a small grower.

Some related practices

Without going into a detailed evaluation here, it is of interest to note several other practices that the Competition Commission (2000) found in wholesale markets in the UK:

- Delaying payments to suppliers beyond the terms in the contracts (p. 122).
- Changing quantities or product-quality specifications at less than three days' notice, and without paying compensation to suppliers (p. 123).
- Requiring suppliers to make, and pay for, changes to packaging and labelling (p. 132).
- Requiring suppliers to purchase goods or services from designated companies (p. 134).

It is hard to see how retail chains could engage in these practices without buyer power.

Other Practices in Supermarket Dealing with Suppliers

These other practices can be very varied. As well as direct payments to retailers, they include supermarket pressure on a supplier to participate in in-store promotion efforts and attempts to influence the terms on which the supplier sells to other retailers. Such practices can have adverse effects on suppliers and on competition between retailers.

Listing fees

A listing fee is a supplier payment that a supermarket operator may demand before agreeing to stock the product. Consider the case where the supermarket does not give any undertaking beyond agreeing to stock the product — in particular, the amount and nature of the assigned shelf-space is at the supermarket's discretion.

The UK Competition Commission (2000:paragraph 2.476) found that the larger supermarkets often charge listing fees. Sometimes the fee is required only when the supermarket first stocks a product. On other occasions, the supermarket

may demand payment to continue the 'listing' of a product already on the shelf. On the evidence quoted by the Commission it seems that smaller retailers do not receive such payments. Although the Commission does not say so, the presumption is that the fee is a lump-sum payment; otherwise, the transaction merely has the effect of a price discount (Tom, 1999).

The Commission finds that when retailers with buyer power seek such fees (paragraph 2.476(c)), the practice

> adversely affects the competitiveness of some of their suppliers and distorts competition in the supply of groceries between suppliers, because the multiple engaging in the practice does not necessarily select the best, or most efficiently produced, product, or that preferred by consumers, but to some extent is influenced by whoever is best able to make the payment requested.

The Commission does not present any supporting or clarifying remarks. Accordingly, the claim needs examination here.

Among competing suppliers, the one 'best able to make the payment requested' is the company that makes the most profit — perhaps, profit per unit sold — from supply of the line. In turn, provided the retail market is reasonably competitive, this profitability reflects low costs of production (relative to product quality), or product quality characteristics, and prices, that attract consumers by providing 'good value for money'. On these considerations, it is not clear that the Commission has established its case.

On the other hand, where retailing is not very competitive, a supermarket may be able to trade very successfully by selecting suppliers and products largely on the basis of its own profit margins, and with less regard for consumer preferences — especially when competing brands have similar qualities. Is this the situation the Commission has in mind?

There may be a further factor at work: a retailer may incur significant costs in evaluating and introducing a new product. In that case, there is an efficiency argument for seeking re-imbursement from the supplier. One effect is to transfer to the supplier more of the risk that is attached to launching a new product (Tom, 1999). Of course, this does not justify a requirement for payment of recurrent listing fees. While the cost rationale may be important, the amount of the listing fee may well exceed the amount of the one-off costs. When so, buyer power must be part of the explanation.

Despite the additional cost of seeking a listing fee, a retailer with buyer power may find the device attractive because optimal use of an extra pricing instrument can never be less profitable (and, generally, will be more profitable) than optimal use of the set of pricing instruments that is not enlarged in this way. In particular, payment of a listing fee may substitute for part of the price discount offered to large retailers. This 'disguise' may make it easier in practice for the large retailer to enjoy preferential terms.

In summary, the charging of listing fees rests, at least in part, on buyer power. It may serve to give large retailers a larger share, and the supplier a smaller share, of the aggregate profits that arise from serving the retail market. The supermarket's choice among rival brands may depend on supplier willingness to pay such fees. Yet, where there is little product heterogeneity between suppliers' lines, the ensuing damage to the consumers' interest may be small.

Listing fees that buy favoured supermarket promotion

The UK Competition Commission found that supermarket chains with buyer power made much use of several such practices. In particular, in exchange for a listing fee, the retailer awards favourable shelf location, or more shelf space, or space in more of its stores, or provides advertising or other promotional support. Here, there is especial concern if the payment exceeds the amount of the extra costs incurred by the retailer.

In the Commission's standard mantra (see, for example, paragraph 2.477(c)), the practices adversely affect 'the competitiveness of some of [the] suppliers and distorts competition in the supply of groceries between suppliers'. To explain this, the Commission again goes no further than to say that the supermarket may be induced to buy from the supplier 'best able to make the payment requested' (paragraph 2.476(c)), without (sufficient) regard for consumer preferences, product quality and productive efficiency.

Again, it is important to look at specific possible effects. When providing more shelf-space to the supplier who pays a listing fee, there is (in the short-term, at least) less space available for rival brands. If, however, the fee paid goes no further than matching the direct costs incurred by the supermarket, the practice is efficient, and there need be no adverse effect on competition.

However, an existing supermarket site may be so small as to preclude expansion of the store, and often it is very difficult to find another site. The store's 'direct cost' could then include a scarcity rent for shelf space whose supply is constrained even in the long run. This could result in the crowding-out of another brand for which a listing fee is not paid. Such exclusion could seriously reduce a supplier's profits and might even threaten the viability of weaker brands.

Imposing conditions on a supplier's sales to other retailers

Retailers who sell products at discounted prices sometimes allege that a large supermarket company, anxious to preserve its gross margin, tells a product's supplier that the chain will stop selling that product unless the supplier stamps out the discounting. Such pressure may induce the supplier to put pressure on the discounter, even perhaps to the extent of threatening to withhold supply.

In the UK, the Competition Commission noted one such report, but did not reach an adverse finding (paragraph 2.488). In Australia, on the other hand, the ACCC has instituted several legal proceedings alleging price fixing or resale price maintenance.

One such case concerned bread. In 1996, the ACCC alleged that a Woolworths company (trading as Safeway) had refused to accept further supplies of bread from George Weston (trading as Tip Top Bakeries) to discourage that supplier from allowing discounted pricing of its bread by small retailers at several places in and around Melbourne. In turn (as the ACCC alleged), the supplier had stopped supplies to the discounters. In May 1997, the Federal Court fined Weston $1.25m 'for fixing the price of bread and attempted resale price maintenance'. Yet, in 2001, a court found that Woolworths had not breached the Trade Practices Act in respect of its role in these events. In 2002, the ACCC lodged an appeal against that decision. (See ACCC Media Releases 178/96, 54/97, 329/01 and 28/02.)

In another case, a court imposed a penalty of $900,000 on Weston for attempting to promote a price-fixing agreement between competing retailers in Tasmania. The retailers were Chickenfeed Bargain Stores and a Woolworths company, trading as Purity.

> The conduct in question occurred when George Weston sought to intervene in [a biscuit] price war in an attempt to minimise the amount of a claim by Woolworths to compensate it for meeting Chickenfeed's pricing. (ACCC Media Release 107/00)

Also in Tasmania, the same retailers figured in a (broadly) similar case, resulting in the Federal Court imposing penalties of $500,000 on Colgate-Palmolive for trying to stop the advertising of discounted retail prices for toothpaste and other products that Colgate-Palmolive supplied (ACCC Media Release 119/02).

General Competition Law and Buyer Practices

Both the Australian and British governments have introduced formal codes of buyer conduct, and thereby have revealed beliefs that the general legislation (the UK *Competition Act 1998* and the Australian *Trade Practices Act 1974*) is not likely to be sufficiently effective in this field. This section reviews very briefly the difficulties in applying the general legislation to supermarket buying.

While the prevailing competition law may discourage some abuses of buyer power, any action under that law requires the competition agency to investigate formally, and may require enforcement action through the courts. This can delay a decision, especially if there is an appeal. Meanwhile, subject to any interim measures that are put in place, the retailer's conduct can continue.

As presently written, the competition laws can be applied only when the buyer power is used in a way that amounts to the abuse of a dominant position (in Britain) or the misuse of substantial market power (in Australia). Even the largest retailer may not have the market share usually thought necessary for it to be found to be dominant or to have substantial market power, though this is not so likely in Australia.

Further, even if dominance or substantial market power is established, the conduct can not be prohibited unless it is found to be an abuse of the retailer's market position. Buyer power is exercised in a negotiating context, and it can be difficult to show that the retailer's practices amount to such an abuse. It is not enough that the deployment of buyer power damages the individual supplier. Rather, the conduct must adversely affect consumers — or, under the Trade Practices Act, it must have an anti-competitive purpose. The effects of buyer power on the competitive process are not necessarily adverse — sometimes efficiency is enhanced, and consumers may benefit from lower prices.

Even when a legal breach is established, it can be difficult to devise an effective remedy. Although a practice can be prohibited, the context allows the retailer to find another way of exercising its buyer power (this hampers the enforcement of buyer codes, too, as is shown later). Further, any remedy applies only in the particular case. In contrast, a code seeks to control buyer power *ex ante*, and is applicable to all the retailers in the defined sector.

Finally, actions under competition law result in considerable costs and uncertainties for the parties. For this reason, suppliers may be particularly reluctant to complain, and to provide the authorities with the documentary evidence needed to pursue a case, especially if the supplier fears retaliatory action by a large retailer to which it still wishes to sell. Again, this difficulty arises in implementing a code of practice, too.

It is no surprise, therefore, that there have been very few cases (in any country) where buyer power has been found to be an abuse, and it is hard to see how it can be otherwise. Merger policy has been used to limit the increase in retail concentration and therefore buyer power, but of course that does not control existing buyer power.

The Codes of Buying Practice

In Australia, the Parliamentary report (Joint Select Committee, 1999:Recommendations 3 and 5) proposed an independent Retail Industry Ombudsman, to be appointed and funded by the government, and backed by a mandatory Retail Industry Code of conduct. In its response (17 December 1999), the Government favoured a voluntary code of conduct to foster self-regulation.

In the outcome, a (voluntary) *Retail Grocery Industry Code of Conduct* came into effect in September 2000. Its objectives (Code, section 2) are to promote fair trading, encourage transparency in dealings between supermarkets and their suppliers, and offer a simple dispute resolution mechanism, under which disputes could be referred to the new Retail Grocery Industry Ombudsman (section 10). Although the Committee had said the code should enshrine the principle of 'like terms for like customers', the Government did not agree and the matter is not considered in the code. Both Woolworths and Coles have 'subscribed' to the code.

In Britain, the Competition Commission (2000:paragraphs 2.588-90) concluded that, to stem the adverse effects of certain buying practices, the

Government should establish a Code of Practice and require each supermarket chain having more than eight per cent of a (defined) ‘groceries’ market to give a legally binding undertaking to comply with it (the Commission considered such a market share was sufficient to give a retailer effective buyer power). Under the code, a supermarket would put its contractual terms in writing. The code would provide for dispute resolution, with ultimate recourse to an independent third party who would report any breach to the Office of Fair Trading.

The Government accepted the proposal, and the Director-General of Fair Trading (DGFT) drafted a code, after consulting the parties. The government endorsed the *Code of Practice on Supermarkets' Dealings with Suppliers* in October 2001. In December 2001, the four companies (Asda, Safeway, Sainsbury and Tesco) that each had more than eight per cent of the market signed undertakings.

Details of the codes

Though the two codes have similar provenance and substantially the same overall objectives, there are striking differences in implementation.

While both codes relate to ‘groceries’, the Australian code does not define the term. Instead it offers (in section 4) a precise definition of ‘produce’ (essentially, fruit and vegetables, meat and fish) and a very broad definition of ‘product’ (‘made by a process of industrial transformation … [and] sold in the [retail grocery] industry’). In contrast, the UK code defines groceries (clause 32) as ‘products sold from any retail store in the UK’ including food and certain other product groups, but excluding many categories such as pharmaceuticals and cosmetics, clothing, DIY products, electrical and electronic appliances and kitchen hardware.

The UK code's terms apply equally to all included products. In contrast, the Australian code has a major section on standards and specifications for ‘produce’ (section 5). No doubt this reflects the political concerns that gave rise to this code.

In both codes, the detailed wording tacitly recognises a reality in which supermarkets initiate contract terms and make post-contract determinations, while suppliers respond to those initiatives. The codes' ostensible purpose is to constrain such manifestations of buyer power. Moreover, the UK code obliges the supermarkets (that have given the undertakings) to train their buyers on the code's requirements.

Clause 1 of the UK code requires the supermarket to put its business terms in writing, if the supplier so asks. Australian retailers and suppliers retain ‘the right to determine whether or not [a] contract is evidenced in writing’ (section 6). The latter position may reflect the Australian emphasis on ‘produce’. Even so, if the supermarket were to put its *standard* terms in writing, the remaining writing task (for each contract) concerns only a few parameters such as price, quantity and delivery date, and would require only a modest effort, which need not delay or otherwise impede the trading process.

The Australian code does not refer to any specific buyer practices. This

may reflect the 1998 strengthening of the Trade Practices Act (section 51AC), which deals with 'unconscionable conduct'. The section refers particularly to situations in which the two parties have differing degrees of bargaining power and might help in dealing with supermarket buying conduct. Yet, early experience does not support such optimism.

In contrast, the UK code frowns on a lengthy list of 'undesirable' practices, such as demands for suppliers to reimburse certain kinds of supermarket costs, and supermarket-initiated changes in terms (even of quantities to be supplied) that are made without giving reasonable notice to the supplier. However, the list does not include retailer pressure for discriminatory pricing that benefits large chains at the expense of small retailers.

Further, the use of many qualifiers inevitably creates ambiguity and uncertainty, and may thereby reduce the code's effectiveness. Examples include (all italics added):

- 'a supermarket shall not, directly or indirectly, *unreasonably* require a supplier *predominantly* to fund the costs of a promotion' (clause 14);
- a supermarket shall pay 'within a *reasonable* time, after the date [of the invoice]' (clause 3);
- promotions excepted, new-product lump-sum payments must reflect 'a *reasonable* estimate by [the] supermarket of the risk [it runs] in stocking [the product]' (clause 9).

Though the code gives formal definition to some of the qualifiers, the criticism still stands.

On the other hand, the requirements for prior notice or agreement may have some effect in reducing the incidence of arbitrary post-contract conduct by a supermarket. As noted later, this may deliver efficiency as well as distributive consequences.

Of course, code efficacy depends also on enforcement. When a supermarket and a supplier cannot themselves resolve a dispute, both codes provide for independent third-party mediation — to be carried out by the Retail Grocery Industry Ombudsman (in Australia), and by a mediator appointed by the supermarket (in the UK).

Neither of these third parties has power to impose a resolution. Both are required to report to government. In Australia, the Ombudsman has to produce an annual report and otherwise has to report to the Minister for Small Business on the operation and effectiveness of the code. In the UK, when a mediator is unable to resolve a case, the supermarket must give notice to the DGFT, who can ask the mediator for the details.

Though the direct compliance provisions are very weak, the reporting requirements might serve to inhibit buyer conduct, if suppliers prove to be willing to lodge complaints. In particular, a supermarket might wish to avoid getting a poor reputation. Further, in a concentrated supermarket sector, each large retailer

might see significant private benefit in not adding to the total number of reported, unresolved complaints, lest the government again turn its attention to the sector.

Experience with the codes

It seems unlikely that either code has had much, if any effect, so far. In Australia, the pertinent Minister reported (in Office of Small Business, 2002:30) that 'there were no formal applications for dispute resolution under the Retail Grocery Industry Ombudsman Scheme in 2001'. It seems there have been no such cases in 2002. For the UK, *The Times* (18 February 2003) reported that no supplier had made use of the dispute resolution procedures and the OFT had not received any direct complaints.

On the other hand, the press continues to report (anonymous) complaints from farmers and others about the buying practices of some retailers. *The Grocer*, recognising that suppliers may be unwilling to take the risk of initiating mediation proceedings, contacted a number of suppliers and asked whether their experience in the first six months' operation of the code was that the four largest supermarket chains had changed the way they do business. According to *The Grocer* (7 September 2002) 'The answer is a resounding no'. On 13 December 2002, the *Financial Times* reported the President of the National Farmers' Union as saying that among farmers there is a 'pervasive fear' that complaining to the OFT could lead to retailers cancelling contracts.

It seems safe to say that the code has had less impact than may have been expected by the Competition Commission. This appears to be the verdict also of the (government-appointed) Policy Commission on the Future of Farming and Food. In a wide-ranging review of UK farming, it commented that the dispute resolution mechanism of the code is perceived as being one-sided, and it recommended replacement by a clearly independent mediation service. It also proposed that the OFT should review the code's efficacy after two years' operation; in the meanwhile suppliers and other retailers should be exhorted to adopt the code voluntarily (Policy Commission, 2002:33-4).

In its response (on 12 December 2002), the Government acknowledged the imbalance of power, but explicitly refused to strengthen the code. Instead, the OFT undertook to seek views on the operation of the code, and annually to review and report on its effectiveness. It announced its first review on 17 February 2003.

Conclusions

Retailer buying power can be beneficial if it countervails any market power of suppliers *and* if, under competitive pressures, the retailer shares the benefits with its customers. Clearly, large retailers have stimulated many improvements in supply-chain management; aggressive buying has forced suppliers to innovate, and to seek other efficiency gains. Yet, some buying strategies may *damage* efficiency, as for example when a buyer imposes conditions that raise supplier costs by more than the savings to the supermarket.

Further, some practices may create indirect or long-term effects that may or may not be in the public interest. Supermarkets sometimes secure gains by *ex post* opportunism that breaks contractual agreements. Such unconscionable conduct might eventually have adverse effects on market efficiency, to the extent that it undermines faith in the contractual process and the legal enforcement thereof.

Eventually, aggressive conduct by supermarket buyers may discourage supply and investment. Though it is unlikely to be in the interest of the company to go that far, the short-term incentives facing an individual buyer, whose career interest may encourage aggressive tactics, may not be in line with the long-term interests of the company.

Suppliers may respond to powerful buyers by agreeing to act together, in the hope that this will increase their countervailing power. For example, it may be possible for fruit growers to form cooperatives to establish cool stores for those products that do keep. This could give the growers some market power, stemming from scale and from an ability to ride-out short-term strategic buying.

Whether collaboration is feasible depends also on competition law. Recently, the (Australian) Competition Tribunal granted a limited authorisation to dairy farmers to negotiate collectively over the supply of raw milk to dairy processors. Where competition authorities are concerned about buyer power, they may be able to do more to facilitate supplier cooperation, without undermining government policy on collusion.

The codes of buying practice try to reduce the imbalances in bargaining strength between suppliers and the larger retailers. They depend on supplier initiatives. *If* an 'oppressed' supplier is willing to lodge a complaint, then under the UK code, it may be relatively easy for the mediator to identify any wrongs in the transaction that is the subject of complaint. Besides the distributive consequences, this might bring efficiency benefits, as for example, when it deters arbitrary post-contract changes such that the financial cost to the supplier exceeds the buyer's financial benefit.

The potential of the Australian code seems much less certain. Where the contract is not in writing, it may be very difficult to evidence any 'improper' conduct of the buyer. Furthermore, the absence of specific provisions in the code may make it less likely that the ombudsman will declare the buyer to have sinned.

In neither code will the supplier receive compensation unless the buyer thinks it prudent to accept and act upon the referee's decision. Perhaps the most important doubt concerns the willingness of suppliers to lodge complaints. In both countries, the marked absence of instances of code mediation suggests *either* that there has been no bad conduct, *or* that suppliers think the procedure will bring them no benefit, *or* that suppliers are too frightened to lodge a complaint.

The last explanation could hold whenever a buyer is able to 'punish' a complaining supplier by taking action *outside* the deal that is the subject of complaint. A buyer with market power might so act in order to establish a 'tough' reputation and hence discourage suppliers from lodging complaints.

In Australia, anecdotal evidence suggests that such conduct may be feasible when supermarkets buy produce. On 8 July 2002 (two years after the introduction

of the code), the *Sydney Morning Herald*, in a series of articles on relations between growers and the large supermarkets, quoted one grower as saying

> It only takes a dominant supermarket to not purchase fruit for two days, and the market is full and over-supplied. Then they come in and buy at their leisure because the price will have dropped.

If a supermarket *is* able to withhold *all* orders for a particular fruit or vegetable in that way, how much easier would it be to refrain from buying (directly) from an *individual* supplier who has lodged a complaint about the buyer's conduct?

The extent to which the large retailers pass on to their own customers some of the financial benefits they extract from their use of buyer power depends largely on the effectiveness of retailing competition. The differing levels of retail concentration in the two countries suggest that price competition may be more vigorous in the UK than in Australia. However, this issue has not been addressed here.

In the light of experience so far, the governments may need to consider ways of strengthening the codes. An obvious approach would be to prohibit some of the practices discussed in this paper, while perhaps exempting instances where there is an objective justification for the practice. For example, a practice might be justifiable if it yields benefits to competition and consumers that outweigh any detriments to suppliers. Subject to any prohibitions, retailers and suppliers would be free, as now, to negotiate the supply terms. The effectiveness of this approach would depend upon suppliers being willing to lodge formal complaints should they believe that buyers have infringed the prohibitions.

No doubt, the competition authorities in both countries will continue to keep the sector under review. They should be willing to be pro-active rather merely responding to complaints. Both the OFT and the ACCC have authority to investigate a market to see whether market power hinders competition. Moreover, they should scrutinise very closely any merger proposals, such as the bids for (the UK) Safeway made early in 2003, that would increase retail concentration.

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Dr Martin Howe (formerly Director of Competition Policy, UK Office of Fair Trading) has contributed very greatly to the analysis presented in this paper. Gordon Mills thanks also an editor and two referees for helpful suggestions, and takes sole responsibility for judgements and any remaining errors.