EXPLOITING BUYER POWER: LESSONS FROM THE BRITISH GROCERY TRADE

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I. INTRODUCTION

As in the United States, increased concentration in grocery retailing in Great Britain has raised issues about the buying power of multiple retailers. Whether, and if so how, it prevents, restricts, or distorts competition at the retail and/or producer level to the public or consumer detriment has been the central aspect of concern in a number of formal investigations by the British competition authorities over the last couple of decades. These include the industry inquiries conducted by the Monopolies and Mergers Commission in 1981,1 by the Office of Fair Trading (OFT) in 1984 and 1999,2 and by the Competition Commission in 2000.3 Retailer buying power has also featured in certain merger cases, most notably the recent Competition Commission inquiry into Safeway and the contemplated mergers with Asda, Wm Morrison, J Sainsbury, and Tesco in 2003.4

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2 The 1999 OFT inquiry led to the referral to the Competition Commission for a full monopoly inquiry.


In addition to the formal inquiries on retailer buyer power, the authorities have also commissioned independent studies to examine the topic further. See, e.g., LONDON

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Formal investigations of retailer buyer power are, of course, not unique to Great Britain. Competition authorities elsewhere have conducted industry studies of retail grocery markets (such as those recently conducted in Sweden and Australia), surveyed specific retailer buying practices (e.g., the FTC inquiry into slotting allowances in the United States), and investigated mergers affecting grocery procurement markets (e.g., the European Commission investigations of Kesko/Tuko,5 Rewe/Meinl6 and Carrefour/Promodes7). Organizations, such as the Organization for Economic Cooperation and Development (OECD)8 and the European Commission,9 have conducted more general international studies of the character, scale, and impact of retailer buyer power, which suggests that this issue is of growing concern among developed countries.

This article examines the sources of retailer buyer power and attempts to explain why, in the context of Great Britain, grocery retailers have been able to control supplier-retailer relations to their advantage. This article does not address specifically the public policy aspects of retail buyer power, which has received extensive treatment elsewhere.10 Notwithstanding, given the similar nature and pattern of developments taking place elsewhere, this examination of the British experience may provide lessons for the United States and other jurisdictions where retailer power is also on the rise.

In undertaking this task, the article examines the changes that have taken place in retailer-supplier relations as a consequence of increasing concentration and consolidation in British grocery retailing. It also exami-
ines how these changes have allowed major retailers to gain sufficient bargaining power over suppliers that they are able to negotiate, if not dictate, advantageous terms and conditions of trade. This is reflected not only in the ability of the major retailers to negotiate low prices, but also in their ability to extract other financial benefits, all of which serve to take profits away from suppliers and curtail suppliers’ own ability to exercise market power.

Part II of this article discusses the concept of retail buyer power, including its sources, the forms that it can take, and how retailers exploit it to secure financial advantages. The critical insights offered in this Part relate to retailers’ and suppliers’ relative economic dependency. An individual supplier tends to be far more reliant for its profitability (or indeed survival) on trading with an individual retailer than vice-versa. Suppliers typically are beholden to retailers, which allows the latter to control and shape the terms and conditions of trade in their favor. This is made all the more possible because retailers are not only customers of individual suppliers but also act as their competitors and suppliers. They are competitors to the extent that they promote own-label products in competition with and as a possible replacement for manufacturer branded goods. They are also critical suppliers of the necessary shelf-space and in-store advertising space that producers need to maintain their franchise with consumers. Indeed, retailers occupy an important “gatekeeper” position in this respect. Accordingly, access to shelf-space is critical in ensuring that producers have a “route to market,” while in-store (“below the line”) promotions stimulate product awareness and increase demand for the producer’s goods. It is the combination of suppliers’ dependency on and insecurity about retaining contracts that allows retailers to exploit the interaction of these three roles, leaving suppliers little or no room for maneuver in negotiations. This helps retailers obtain low prices and other financial benefits at the direct expense of suppliers.

Part III of the article examines the primary characteristics of British grocery retailing and the structural changes that have occurred in recent years, which have allowed the major British retailers to enjoy extensive buyer power over suppliers. The Competition Commission extensively charted many of these features in its monopoly inquiry into the super-


11 Maintaining the usual convention, the term “supplier” used in the article refers to a producer supplying a retailer unless it is in the specific context of a retailer supplying services to a producer, in which case it will be stated explicitly using the terms “retailer” and “producer” to clarify the relationship.
market industry in 2000, as well as in its 2003 Safeway merger inquiry. Part III summarizes these findings and also considers why British retailers, more than retailers in other jurisdictions, have been able to exploit supplier dependency so effectively.

Part IV explores in greater detail the impact of British grocery retailer buyer power on prices and retailer-supplier terms of dealing, including the particular methods and practices retailers have employed in recent years to exploit retailer buyer power. As the Competition Commission observed in its monopoly inquiry in 2000, retailers are able to control supplier-retailer relations in a number of different ways that affect more than just prices and discounts.

II. RETAILER BUYER POWER

A. Retailer Rewards from the Exercise of Buyer Power

Retailer buyer power is essentially the ability of leading retail firms to obtain from suppliers more favorable terms than those available to other buyers, or which would otherwise be expected under normal competitive conditions. Buyer power can arise from size differences among buyers (essentially advantages based on scale) and also can arise if there are a limited number of buyers of a certain scale (i.e., “oligopsony”). In practice, this means that large retailers in concentrated retail markets likely will have the ability to obtain low prices from their suppliers, both in a relative and an absolute sense.

Buyer power gives retailers more than just the ability to extract discounts and obtain low prices from suppliers; buyer power also may manifest itself in the contractual obligations that retailers may be able to place on suppliers. These include direct retailer financial benefits that take the form of additional payments or discounts, including “listing charges,” where buyers require payment of a fee before goods are purchased from the listed supplier; “slotting allowances,” where fees are charged for store shelf-space allocation; retroactive discounts on goods already sold; and unjustifiably high contributions to retailer promotional expenses.

Other practices may offer retailers a more indirect financial benefit. For example, buyer-forced application of most favored customer (MFC) clauses, which obligate the supplier not to sell to another retailer at a lower price, guarantee that the retailer will not be placed at a product

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12 Competition Commission, supra note 3.
13 Competition Commission, supra note 4.
cost disadvantage relative to another retailer. Similarly, exclusive supply arrangements deny other retailers access to the supplier’s product, which may allow the retailer to gain a product differentiation advantage over its rivals.

Retailer power may also manifest itself through the ability of retailers to shift the burden of financial risk squarely onto suppliers. Retailers may force sale-or-return conditions on suppliers, demand compensation for product lines that fail to meet expected sales targets, or negotiate retrospective discounts where targets are met. Similarly, the supplier’s cash flows can be hit when the retailer deliberately and consistently makes late payments knowing that the supplier will not discipline such action because of its fear of losing future contracts.14

B. Negotiating Power in Retailer-Supplier Relations

To understand how and why large retailers are able to obtain these financial benefits it is important to appreciate the extent of the bargaining advantage that the retailer has over the supplier in contract negotiations. The definition of buyer power proposed by the Secretariat of OECD is particularly helpful because it focuses on the differences in underlying negotiating power among contracting parties:

[A] retailer is defined to have buyer power if, in relation to at least one supplier, it can credibly threaten to impose a long term opportunity cost (i.e., harmful or withheld benefit) which, were the threat carried out, would be significantly disproportionate to any resulting long term opportunity cost to itself. By disproportionate, we intend a difference in relative rather than absolute opportunity cost, e.g. Retailer A has buyer power over Supplier B if a decision to delist B’s product could cause A’s profit to decline by 0.1 per cent and B’s to decline by 10 per cent.15

This definition highlights the importance of relative economic dependency. It focuses upon the relative damage to each party’s profits that a failure to reach agreement would cause. By delisting (i.e., refusing to stock) a product, a retailer may not suffer much loss in profit if it readily can replace the item with an alternative product from another supplier. In practice, this is likely to be the case because there will be rival suppliers eager to expand their supply to the retailer and acquire greater shelf space. Even if there are few direct rival suppliers, it may be feasible for the retailer to re-allocate the shelf space to a different product category.

14 This may also have a direct profit-shifting effect when it causes the supplier to incur interest charges while at the same time allows the retailer to benefit from earning interest on unpaid invoices.

Thus, the costs of disagreement and a breakdown in negotiations for a retailer might be relatively small.

In contrast, if a supplier has its product delisted or chooses to boycott the retailer, it may find it difficult to make up the lost income by securing additional contracts with other retailers. In highly concentrated retail markets there are few alternative retailers that could take an equivalent volume of product. Also, it is likely that other retailers will have already settled on their supplier contracts and allocated shelf-space accordingly, which provides suppliers with little or no opportunity to secure sales through alternative outlets.\footnote{See \textit{Competition Commission}, supra note 3, ¶ 2.453 (recognizing that if a major product is delisted it would be unable to find additional outlets “because it already had the widest possible distribution”).}

The relative magnitude of a retailer’s intended order size exacerbates the supplier’s greater relative economic dependency. For a major grocery retailer stocking 20,000 to 30,000 product lines at each of its stores, losing a few product lines typically results in a loss of only a tiny fraction of overall sales. However, the supplier whose product line is eliminated tends to experience a relatively greater loss of overall sales. Even the very largest suppliers usually account for only 1–3 percent of a major grocery retailer’s sales, while losing a single contract with one of the top four grocery retailers in the UK would likely mean a loss of sales for the supplier of around ten times this level (i.e., of between 10 and 30 percent) if it cannot find alternative routes to market.\footnote{The Competition Commission examined the number and size of suppliers relative to Tesco, the largest British retailer. The goods supplied by Tesco’s approximately 2,600 suppliers “represented over £9 billion of purchases. The value of most individual suppliers’ sales to Tesco represented, for the most part, a small proportion of its purchases.” Its largest supplier was “responsible for less than 3 percent of Tesco’s total purchases. Only eight suppliers had sales representing 1 percent or more of Tesco’s purchases; the median supplier represented less than one-hundredth of 1 percent.” \textit{Id.} ¶ 2.457. In regard, to the relative dependence of large suppliers on their largest retail customers, the Competition Commission found that on average the top customer accounted for 32.2 percent of a large supplier’s entire UK retail sales (ranging from a minimum of 8.1 percent to a maximum of 100 percent), while the top three customers accounted on average for 56.4 percent of the supplier’s sales (ranging from a minimum of 19.1 percent to a maximum of 100 percent). In respect of sales through large supermarkets (taken as greater than 1,400 square metres), the Competition Commission found that on average 70 percent of sales by large suppliers were made to the top three retail customers and 86 percent to the top five. \textit{Id.} ¶ 11.14 and Table 11.3.}

At these levels of lost sales, and with suppliers typically operating under high fixed costs, losing just one major retail customer may make it extremely difficult for a supplier to cover its costs and earn a profit.

The supplier could have some countervailing negotiating power if withdrawal of its products from the retailer led consumers to switch...
stores to look for its products elsewhere. Indeed, this could apply to so-called “must-stock” products, for which consumers might switch stores if their favorite product in a particular category is no longer stocked. However, in Great Britain consumer loyalty to stores is usually as strong, if not considerably stronger, than consumer loyalty towards individual products.18 As a practical matter, if a consumer’s favored brand is not available in the store because it is temporarily or permanently withdrawn, the consumer will usually opt to purchase a substitute product (e.g., a rival producer brand, an own-label product, or a different product serving broadly the same need) rather than shop elsewhere, especially for one-stop shopping, where the consumer undertakes one main weekly shopping trip.19 In Britain consumers have an exceptional degree of loyalty towards their favored retailer and tend not to shop around for grocery products, but instead consistently rely on one store for most or all of their needs.20 Accordingly, even if the consumer is not prepared to purchase a substitute product, the best that the delisted supplier could hope for is that the consumer will purchase its product elsewhere as part of any top-up shopping, such as at a convenience store.

In this setting, respective market shares mean little. A supplier with a high market share in the supply market will still be economically dependent on a retailer that commands only a modest market share of the retail market because of the supplier’s relative lack of external opportunities. Indeed, the UK Competition Commission is correct in arguing that retail buyer power can be very significant (to the extent of distorting competition) even if the retailer controls as little as 8 percent of the total market.21 The critical issue is that retailers with buyer power can credibly threaten to cause substantial damage to a supplier’s profits if

18 See, e.g., Judith Corstjens & Marcel Corstjens, Store Wars (1999). Store loyalty being generally stronger than individual brand loyalty is noticeable in countries like Britain and France where one-stop shopping is especially prevalent.

19 See Competition Commission, supra note 3, ¶¶ 4.79 & 4.83. The Commission’s survey of consumers showed that 54 percent of respondents “indicated that they nearly always visited the same supermarket for their main grocery shopping, with a further 26 percent reporting that they usually used the same supermarket but occasionally might use a different one.” In terms of the main factors influencing their choice of store for main grocery shopping, 43 percent of respondents indicated the main factor influencing their choice of store was the “ability to get most of the weekly shopping done under one roof” followed by “within easy and convenient reach of home” with 18 percent of respondents. Ranked considerably lower (at sixth, equal) was “products I want always in stock,” chosen by just four percent of respondents.

20 See infra Table 5 (bottom row) and the discussion in Part III.B.

21 See Competition Commission, supra note 3, ¶ 2.458 (“any party with more than an 8 per cent share of grocery purchases for resale from its stores . . . are, for the most part, able to control their relationships with suppliers to their own advantage, whilst the smaller multiples are not able to do so to anywhere near the same extent”).
negotiations break down and its products are delisted. To be effective, the level of prospective damage need not be so high as to bankrupt the supplier. Instead, buyer power should be viewed on a sliding scale whereby the retailer will be able to extract better discounts and more preferential terms the greater is the degree of the supplier’s dependency. All other things being equal, this degree of dependency will be in relation to the share of the supplier’s sales that is accounted for by the retailer. In the British context, this is particularly important because, with industry concentration and consolidation, the top four retailers account for two-thirds of all grocery product procurement and each of the big four (Tesco, Sainsbury, Asda, and Morrison/Safeway) controls well in excess of the 8 percent level recognized by the Competition Commission.

C. Retailers as “Customers,” “Competitors,” and “Suppliers” for Producers

Relative sizes of contracts and relative switching costs only partly explain why retailers increasingly hold buyer power over producers and are able to control the terms and conditions of supply. To understand further why the negotiating position of retailers is so strong vis-à-vis producers, it is important to recognize the multi-faceted nature of retailers as they appear to producers. From the perspective of producers, retailers have three interlinked roles. First, retailers are producers’ customers; they buy their products for resale to ultimate consumers. Second, they act as competitors when they sell “own-label” (otherwise known as “private label” or “store brand”) products in competition with producer branded goods. Third, they are suppliers that “sell” shelf space, either directly through listing or slotting fees or indirectly through requiring lower prices from producers as a condition of stocking, and advertising space, such as through promotional support payments.

The power that retailers enjoy over suppliers is in large part reflected in the extent to which retailers can exercise these three roles individually and jointly to extract value creation or “economic profit” from suppliers.

22 This point is important because other authorities have used higher threshold figures to indicate economic dependence for suppliers, notably the European Commission (EC) adopted a threshold of 22 percent in its merger investigation of Carrefour/Promodes, supra note 8. At this level the EC has argued that a supplier will face a very serious risk of bankruptcy if it loses this amount of business should bargaining break down. However, such an absolute “threat point” should not be seen as the starting point for the exercise of buyer power, but rather more towards its end point where the supplier has no more bargaining (poker) chips to play if the retailer can comfortably replace it and ensure that it does not materially lose sales in the process. For further views on the problems of the EC’s interpretation of economic dependence, see Lexecon, Buyer Power (Jan. 2001), available at http://www.lexecon.co.uk.
In the case of Great Britain, the large multiple retailers have appeared very adept at exploiting these three roles.

1. Retailers as Customers

The major UK multiple retailers typically account for between 10 and 30 percent of a supplier’s total sales, while for the retailers the sales may represent a tiny fraction of their total sales. The scale of these sales and the fact that there are few, if any, alternative means of picking up lost sales from elsewhere means that a supplier cannot afford to be delisted, while the retailer, in contrast, may not suffer if it can readily acquire alternative products from other suppliers. In this situation, bargaining power can lie entirely in the hands of retailers, and suppliers can expect to have terms and conditions of trade dictated to them.

Even the very largest brand producers will find it difficult to avoid the exercise of retailer buyer power. All producers rely on the same few retailers as a necessary intermediary for them to reach final consumers for most of their sales. With no prospect of significant new entry into grocery retailing and no possibility for being circumvented in the supply chain, the major retailers enjoy considerable control over which products are sold to final consumers. Yet, brand producers need the major retail chains (so-called “multiples”) to stock their products in order for them to remain in business. The same is not necessarily true for the major multiples at the individual supplier level, given their ability to substitute brands with other brands as well as with own-label products. Accordingly, economic dependency in the supply chain lies with producers who have to persuade retailer “gatekeepers” to stock their products.

23 See Competition Commission, supra note 4, ¶ 6.72.
24 E.g., id. ¶ 6.32 (showing the median supplier accounts for only 0.016 percent of the purchases made by the leading UK retail grocer, Tesco plc).
25 Clearly, in the case where the supplier provides “must-stock” products the balance of power will be much more even since delisting or equivalently boycotting would equally hurt both parties as both could expect to lose some sales, thus providing both parties with an incentive to avoid damaging contract disputes.
26 For example, even with Internet sales, which in principle might allow producers to reach final consumers without going through a retailer, it is, nevertheless, the major retail grocers that control most on-line sales, as demonstrated by the considerable success that Tesco.com has enjoyed as the market leader.
27 For retailers, there are far more products available (with new ones being continuously launched) than they can possibly stock. Hence, they can afford to be choosy over which ones they want to stock. Retailers will also wish to make sure that they are not over-reliant on a particular supplier, and they may thus deliberately choose to stock rival brands and bring others “into play” (e.g., develop own-labels or offer promotional support to new entrants). This can help ensure that they are never faced with an absolute monopolist supplier or even a supplier that represents more than an acceptable maximum share of the retailer’s requirements of a particular product or product category. Nevertheless, there
2. Retailers as Competitors

Brand producers face an additional problem when retailers act as potential “double-agents” and seek to develop own-label products in direct competition with producer brands while still serving as the brand producer’s customer. The key point here is that retailers have unilateral control over stocking, shelf allocation, and retail pricing. Thus, they are able to promote own-label products at the expense of manufacturers’ brands (e.g., by better shelf placement and judicious use of prices) and there is little direct response that brand producers can make (in view of their inability to control in-store activity or boycott a major retailer.

The threat to a branded goods supplier is twofold: the retailer can, if it so chooses, undermine the supplier’s branded products, e.g., by placing them in less well-located shelf positions, raising their retail prices, or even substituting them for its own-label products (which can be given the appearance of offering better value to consumers). This can afford the retailer a large and credible bargaining lever over the branded goods supplier while allowing it to promote its own franchise with consumers, using own-branded goods to reinforce the retailer’s brand image in consumers’ minds as the “consumers’ champion.”

The threat to undermine and/or replace producer brands if the supplier does not grant certain concessions becomes more credible the greater the ability of retailers to introduce quality own-label products that can compete effectively with the leading brands. Crucially, the major British retailers have excelled in developing both extensive and perceived high-quality own-label product ranges. Indeed, British retailers, as discussed below in Part III, appear to lead the world in such

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28 E.g., Competition Commission, supra note 3, ¶¶ 2.518–2.521 (showing ten of the fifteen main grocery multiple retailers operating in the UK were found to have practiced delisting suppliers of branded products in favor of own-label equivalents).

29 In the UK, there are examples where own-label products have been pioneering (e.g., chilled meals as developed initially by Marks & Spencer), but more usually they are simply attempted copies of established brands. As such, own-label ranges have the second-mover advantage that they can free ride on both the product development (copying existing formulas and packaging design) and, perhaps more significantly, the category development (riding on consumer acceptance through brand promotion) generated by brand manufacturers’ investments in, respectively, research and development (R&D) and advertising. For further discussion of these issues, see Paul W. Dobson, The Economic Welfare Implications of Own Label Goods, School of Management and Finance Discussion Paper, Univ. of Nottingham (1998) (on file with author).
developments, having own-label shares of sales in excess of 40 percent and being able to command prices for these products at little difference from those of corresponding branded goods. In fact, there are very few categories in British grocery retailing where own-label products have not made a substantial impact on the market.

3. Retailers as Suppliers

The third role of the retailer, as a supplier of shelf space and advertising space to the producer, has taken on increasing significance in Britain as the development of one-stop shopping has proceeded without hesitation. Leading producer brands not only have to contend with intense competition from rival producer brands, but also from own-label products and from non-grocery items (as the grocery retailers seek to diversify into non-food products), all of which compete for the same limited amount of shelf space available. As detailed below, most grocery sales in Britain are now made through large supermarkets (with floor space greater than 1,400 square metres). Yet tight planning restrictions in the UK have ensured that these stores are in relatively short supply, which serves as a key barrier to entry and ultimately limits the amount of shelf space nationally available to producers. With only a handful of major retailers controlling these outlets (e.g., the top four retailers now accounting for 90 percent of space in such stores), each is in a position to “sell” its space. This explains the widespread use by British retailers of listing fees, shelf space (“slotting”) fees, promotional support (“pay to play”) payments, specific promotion payments (e.g., for “gondola ends” and funding the cost of “multi-buy” promotions), required discounts for the range or depth of distribution of products, and even mandatory contributions to the cost of store refurbishment or the opening of a new store.

III. CONSOLIDATION AMONG BRITISH GROCERY RETAILERS: IMPACT ON MARKET CONCENTRATION AND PRACTICES

Particular market features have offered the major multiple retailers in Great Britain the prospect of being able to exploit significant buyer

30 This is evident as the large grocery retail chains have increasingly moved into offering additional categories in their stores, including clothing, medicines/pharmaceuticals, books, newspapers, magazines, greeting cards, plants and flowers, stationery, toys, compact discs, video and audio tapes, DVDs, domestic electrical goods, homeware (including soft furnishings), DIY products, and gardening products.

31 See Competition Commission, supra note 4, at 37 and Table 2.2, and taking account of the subsequent merger of Morrison and Safeway.

32 For a full list of practices and requirements made on suppliers, see Competition Commission, supra note 3, at Appendix 13.1.
power over suppliers. To understand this development, the structural features of the British market must be considered, with a focus on the different positions of the retailers in the market and the extent of consolidation in the sector. Comparison with other countries also sheds light on why the prospect of buyer power appears especially strong in Great Britain compared to other jurisdictions.

A. STRUCTURE OF GROCERY RETAILING IN GREAT BRITAIN

Grocery multiple retailers control a fraction of the total number of stores in Great Britain selling grocery products, but dominate in terms of sales. Table 1 illustrates this with a comparison of the number of stores and turnover of grocery multiple retailers with other outlets in Britain that sell grocery products—labeled here as the “impulse” channel—but what can be thought of more generally as outlets that serve the “top-up” shopping needs of consumers. The table shows that grocery multiples account for less than 6 percent of all the stores selling grocery items but account for two-thirds of all grocery sales in Great Britain, highlighting the extent to which consumers rely on the grocery multiples for the vast bulk of their purchases.

The most detailed picture on the structure of British grocery retailing and the operations of the major grocery multiples comes from the 2000 report of the Competition Commission’s Supermarkets inquiry. Table 2 replicates the market share figures that the Competition Commission

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<th>Coverage by Retail Channel, Great Britain (January 2003)</th>
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<td>Total Grocery Multiples</td>
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<td>Total Impulse</td>
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<td>Other impulse</td>
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<td>Total Coverage</td>
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33 Based on figures from ACNielsen, Retail Pocket Book (2004).
Table 2. Market Shares of Main UK Grocery Retailers, 1998–1999

<table>
<thead>
<tr>
<th>All grocery stores</th>
<th>Reference stores</th>
<th>Grocery stores &gt; 1,400 sq. m</th>
<th>Grocery stores &gt; 2,300 sq. m</th>
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<tr>
<td>Tesco</td>
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<td>28.5</td>
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<td>18.7</td>
<td>20.7</td>
<td>24.8</td>
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<td>12.2</td>
<td>13.4</td>
<td>16.8</td>
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<td>Safeway</td>
<td>11.5</td>
<td>12.5</td>
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HHI\textsuperscript{36} 1,324 1,506 1,955 2,223

Weighted HHI\textsuperscript{37} 1,592 1,804 2,314 2,672

Market size (£m) 56,601 51,262 40,949 32,200

Number of stores 7,144 3,927 1,895 1,184

Identified at the time of the inquiry, relating to 1998–1999. It shows the extent to which just a handful of UK retailers control all grocery store sales, but where market concentration is particularly high in regard to sales through large stores, which account for the bulk of consumers’ main shopping. Five retailers account for approximately 90 percent of the one-stop shopping market (based on stores with a net sales area of

\textsuperscript{35} Competition Commission, \textit{supra} note 3, at Table 5.6.

\textsuperscript{36} “Reference stores” refers to stores that meet the conditions specified in the original inquiry reference for the Competition Commission’s investigation. Specifically, “reference stores” are those stores (a) where the space devoted to the retail sale of groceries exceeded 600 sq. meters; (b) where the space devoted to the sale of food and non-alcoholic drinks exceeded 300 sq. meters; and (c) which were controlled by a person who controlled ten or more such stores. The term “groceries” includes food, alcoholic and non-alcoholic drinks, cleaning products, toiletries, and household goods. These “reference goods” exclude petrol, clothing, DIY products, and financial services.

\textsuperscript{37} “HHI” is the Herfindahl-Hirschman index of concentration taken as the squared sum of market shares with the maximum value being 10,000, indicating complete monopoly (i.e., $100 \times 100$).

\textsuperscript{37} “Weighted HHI” is the sales weighted average of HHIs across the 12 regions of the UK.
at least 1,400 square meters) and over 95 percent of sales through
superstores (i.e., stores with a net sales area of at least 2,300 square
meters).

A key point to observe from Table 2 is that with respect to all
grocery stores the HHI appears to be at a moderate level. Even when viewed
in terms of the very largest stores (those that are greater than 2,300 square
meters), none of the top four players have individual shares that exceed
30 percent. Yet these shares do not tell the entire story.

First, the national level figures reported in Table 2 disguise the fact
that at the local level, concentration can be much higher. Even at the
broad regional level, differences in concentration are apparent. At
the postcode level (there are 120 postcode regions in the UK), the HHIs
for reference stores ranged from 959.2 to 4,102, with a weighted average
of 2,135. In regard to consumer choice of supermarket at the local
level, a more appropriate factor may be drive times between stores. The
Competition Commission identified that out of 1,700 reference stores
surveyed, 175 stores were found to have a “monopoly” or “duopoly”
status in local catchments (in respect of 10- and 15-minute drive times
around each of the stores).

Second, there is an evident trend towards ongoing consolidation at
the national level and in the procurement markets more generally. Since
1998–1999, the top five retailers collectively have increased their share
of the one-stop-shopping grocery market. As Table 3 illustrates, the
positions of Tesco, Asda, and Morrison have strengthened at the expense
of Sainsbury, Safeway, and other retailers in the market. The table also
provides projected market shares taking account of the Morrison and
Safeway merger that followed a 2003 Competition Commission inquiry
which permitted this merger but prevented Tesco, Sainsbury, and Asda
merging with Safeway. Indeed, with completion of the Morrison/Safe-
way merger in March 2004, it appears that the top four retailers presently
control in excess of 94 percent of sales through large supermarkets
(greater than 1,400 square meters) in Britain.

38 In the case of reference stores, the regional HHI ranged from 1,266 in East Midlands
to 2,935 in Northern Ireland. For stores of 1,400 sq. meters or more, the regional HHI
ranged from 1,658 to 2,838 (for the same two regions). For further details, see COMPETITION
COMMISSION, supra note 3, Tables 2.2 and 2.3.

39 See COMPETITION COMMISSION, supra note 3, at Appendix 5.2.

40 If restricted to competition between the major parties and with 10-minute drive times,
then 627 out of the 1,700 stores were found to have “monopoly” or “duopoly” status. For
full details, see id. Appendix 6.3.

41 See COMPETITION COMMISSION, supra note 4.
Table 3.

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Tesco</td>
<td>28.5</td>
<td>28.8</td>
<td>29.5</td>
<td>29.9</td>
<td>30.8</td>
<td>31.3</td>
<td>2.8</td>
<td>33.2</td>
</tr>
<tr>
<td>Sainsbury</td>
<td>26.5</td>
<td>26.0</td>
<td>25.1</td>
<td>23.6</td>
<td>22.4</td>
<td>21.9</td>
<td>−4.6</td>
<td>19.4</td>
</tr>
<tr>
<td>Asda</td>
<td>17.1</td>
<td>17.6</td>
<td>18.7</td>
<td>19.8</td>
<td>20.4</td>
<td>21.5</td>
<td>4.4</td>
<td>24.0</td>
</tr>
<tr>
<td>Safeway</td>
<td>12.6</td>
<td>12.9</td>
<td>12.2</td>
<td>13.0</td>
<td>12.7</td>
<td>12.0</td>
<td>−0.6</td>
<td>18.9</td>
</tr>
<tr>
<td>Morrison</td>
<td>5.4</td>
<td>5.7</td>
<td>6.4</td>
<td>7.1</td>
<td>7.5</td>
<td>7.6</td>
<td>2.2</td>
<td></td>
</tr>
<tr>
<td>Others</td>
<td>9.9</td>
<td>9.0</td>
<td>8.1</td>
<td>6.6</td>
<td>6.2</td>
<td>5.7</td>
<td>−4.2</td>
<td>4.5</td>
</tr>
</tbody>
</table>
Moreover, while the key emphasis of the five, now four, retailers listed in Table 3 remains on the one-stop grocery market, these retailers, with the exception of Asda, have recently turned their attention to the convenience store market for top-up or impulse shopping. This has in part been through organic development (opening new stores) but has also involved a number of acquisitions, the most significant of which thus far has been Tesco’s purchase of the 850-store T&S chain. This has blurred the distinction, at least on the procurement side, between the one-stop and top-up shopping markets, which are in effect being brought closer together by the major grocery multiples’ move into convenience store retailing.

Nevertheless, for the time being, it is still the case that specialist convenience-store retailers dominate this particular sector. These retailers are either specialist chains (as the Co-op has become, especially in view of its sell-off of large stores and recent acquisition of the Alldays convenience-store chain) or independent retailers, but which may choose to adopt a common retail brand through membership of a so-called symbol group, like Londis and Spar, or obtain supplies through a buyer group, like Nisa Today’s.

Taken together, it can be seen that the procurement side of the grocery sector in Britain is becoming increasingly consolidated, as suppliers face increasingly powerful integrated large-format store chains, large convenience-store chains, and symbol/buyer groups, all of which operate at the national level. It seems that this trend is likely to continue, especially as the convenience-store sector appears to be entering the same sort of consolidation wave that the main grocery retailing market has gone through in recent years.

A third prominent feature of the grocery retail market in Britain is the extent to which the retailers have sought to differentiate themselves. All the major retailers have put considerable effort into developing distinct retail brands, attempting to distinguish themselves in terms of overall image (“value for money,” “best for fresh food,” etc.), store layout and ambience, customer service, amenities (e.g., toilets, in-store bakery, coffee shop, or nursery/crièche), pricing style (e.g., hard-discount, every day low pricing or high-low promotional pricing), and choice of product range and depth offered to consumers.

44 As yet, the competition authorities have allowed these acquisitions to proceed unhindered. For example, the OFT cleared the acquisition by Tesco of T&S in December 2002, Co-op’s acquisition of Alldays in February 2003, Tesco’s acquisition of certain Co-Op Stores in February 2004, and Tesco’s acquisition of 45 stores from Adminstore in March 2004.
As part of the process of retail brand building, the leading retailers have put particular emphasis on developing extensive own-label product ranges. In contrast to other countries where own-label ranges might be seen simply as cheap, low-quality products, own-label goods in Britain consist of multi-tiered ranges, from basics (so-called “value” lines) to premium goods (e.g., Tesco’s “finest” range), with the latter acting as direct rivals to the major branded goods. This multi-tiered approach, adopted by all the major one-stop shop retailers, has allowed retailers to extend their product ranges in line with their development of larger stores. It is an approach that has also been used as an effective competitive weapon. The basic own-label ranges are a useful counterforce to the threat posed by the 100 percent store-brand “hard discounters,” like Aldi and Lidl, offering limited-line, low-cost, basic items (where this type of retailer remains marginal in Britain). The premium ranges, in turn, are a useful counter to the up-market “repertoire” retailers, such as Marks & Spencer (M&S), operating with 100 percent own-label, premium-priced goods.

Developing successful own-label ranges not only promotes the retailer’s name but can be particularly attractive when it allows the retailer to extend its choice and range proposition to consumers (to cater to a wider range of tastes and household incomes) and so satisfy more consumer needs and thereby discourage shopping around at rival stores. Not surprisingly then, British retailers have put considerable effort into developing store brands as widely as possible and have been successful in almost all major product categories. Nonetheless, there are notable differences in the store brand approach that different retailers have adopted. This is apparent from Table 4, which shows how own-label shares vary across retailers and also across categories.45

The first five retailers listed in Table 4 are the major one-stop shop operators and as such have well-developed own-label ranges across most product categories. Similarly, the larger mid-size operators, Somerfield, Waitrose, and the Co-ops, also demonstrate strong own-label penetration rates, while M&S is 100 percent own-label. The remaining two operators, KwikSave and Iceland, tend to focus more on the sale of branded goods—

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45 Here the penetration rates for different product categories vary due to supply and demand factors. For example, on the supply side, much may depend on the structure of supply (e.g., extent of economies of scale and scope), availability of suppliers, ease of new entry, and the ability to develop innovative products (e.g., chilled ready-to-eat meals) or produce close imitations to the leading brands (e.g., using the same recipe/formula and quality of inputs). On the demand side, goods that require a high level of consumer confidence (baby food, health and beauty products, etc.) generally exhibit lower rates of own-label penetration, as do goods where established brands are perceived as offering particularly strong quality or reliability advantages (e.g., toiletries).
<table>
<thead>
<tr>
<th>Category</th>
<th>Tesco</th>
<th>Sainsbury</th>
<th>Asda</th>
<th>Safeway</th>
<th>Morris</th>
<th>Somerfield</th>
<th>KwikSave</th>
<th>Morrisons Save</th>
<th>Waterton</th>
<th>Lidl</th>
<th>Co-op</th>
<th>All stores</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dairy</td>
<td>33.8</td>
<td>38.6</td>
<td>36.9</td>
<td>24.2</td>
<td>28.3</td>
<td>20.5</td>
<td>2.1</td>
<td>100.0</td>
<td>13.5</td>
<td>15.9</td>
<td>29.4</td>
<td>32.7</td>
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<tr>
<td>Frozen</td>
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<tr>
<td>Bakery</td>
<td>57.8</td>
<td>61.5</td>
<td>63.0</td>
<td>63.0</td>
<td>55.1</td>
<td>56.2</td>
<td>61.5</td>
<td>100.0</td>
<td>31.5</td>
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<td>59.6</td>
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<td>Confectionery</td>
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<td></td>
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<td>Households</td>
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<td>56.0</td>
<td>67.7</td>
<td>76.0</td>
<td>76.0</td>
<td>76.0</td>
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<td>Liquor</td>
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<tr>
<td>Tobacco</td>
<td>21.4</td>
<td>21.1</td>
<td>23.8</td>
<td>28.5</td>
<td>42.2</td>
<td>38.2</td>
<td>34.0</td>
<td>100.0</td>
<td>61.5</td>
<td>61.5</td>
<td>41.9</td>
<td>89.8</td>
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<td>Toilettries</td>
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<td>9.6</td>
<td>11.3</td>
<td>8.2</td>
<td>11.3</td>
<td>1.6</td>
<td>100.0</td>
<td>8.6</td>
<td>8.6</td>
<td>15.3</td>
<td>13.3</td>
</tr>
<tr>
<td>Soft drinks</td>
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<td>36.8</td>
<td>36.9</td>
<td>24.2</td>
<td>8.6</td>
<td>38.2</td>
<td>0.7</td>
<td>100.0</td>
<td>8.0</td>
<td>8.0</td>
<td>8.0</td>
<td>6.1</td>
</tr>
<tr>
<td>Dry grocery</td>
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<td></td>
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<td></td>
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</tbody>
</table>

Table 4. Own-label Value Shares by Category of Leading Multiple Retailers, Great Britain 2002

46 Adapted from ACNielsen, supra note 33 (based on ACNielsen Homescan, 52 weeks ending December 2002).
the former as a so-called “soft discounter,” the latter as a specialist promotional price user but with an emphasis on own-label frozen goods.

With such high penetration rates of own-label goods, British retailers are well positioned to control to considerable effect own-label suppliers and to drive down supply prices (e.g., by playing off one supplier against another and using online auctions to determine contract winners\(^47\)). This, in turn, allows for higher gross margins on these products, especially because retail prices are typically set with reference to the “umbrella price” for the leading brand stocked. This puts pressure on branded goods manufacturers to reduce their supply prices in order to secure shelf space. In this manner, own-label development offers retailers the prospect of a double benefit: increased sales and greater customer loyalty while also obtaining lower supplier prices.

**B. BRITISH GROCERY RETAILING IN AN INTERNATIONAL CONTEXT**

The characteristics and structural features of the British grocery retail sector outlined above go some way towards explaining why the leading multiple retailers are in a position to enjoy buyer power over suppliers. However, this begs the question whether Great Britain is in a unique position or whether other countries are witnessing, or are about to witness, similar consolidation and a similar experience in regard to retailer power.

To a greater or lesser extent, grocery retailing has gone through a revolution in all developed countries in the last couple of decades. Where once retail markets were highly fragmented, consisting predominantly of traditional independent retailers, they have tended to become highly concentrated, driven by a process of organic growth and mergers by leading retailers. The result in many countries has been the marginalization of small independent retailers, restricted to acting as convenience stores, and market domination by a limited number of large-format, multiple-store retailers that attract the bulk of consumer spending mainly through offering the convenience of one-stop shopping.

Yet differences remain. Some of these are highlighted in Table 5, which provides comparisons between Great Britain and four other large EU countries (France, Germany, Italy, and Spain), along with the United States\(^48\).

First, it can be observed that supermarkets, as opposed to other store types, account for a very high proportion of grocery sales in Britain.

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\(^{47}\) For some details on this process, see Dobson, *supra* note 10.

\(^{48}\) For a detailed statistical comparison of the differences and similarities between grocery retail markets within Europe, see Clarke *et al.*, *supra* note 27.
Indeed, over half of all grocery sales in Britain are made through hypermarkets, where consumers tend to undertake one-stop shopping for most if not all their grocery needs. This is an important aspect in regard to buyer power as suppliers will be especially keen to avoid being delisted from such stores and becoming reliant on top-up shopping at smaller stores.

Of the other countries represented in the table, only France comes close to matching this store-size feature of Britain. In the other countries, smaller format stores remain highly significant. For example, in Germany limited-line discounters are prevalent. In Italy and Spain small independent retailers collectively retain a strong position in the market, although this position has eroded over time. The United States exhibits a mix of hypermarkets (such as those owned by the world’s biggest retailer, Wal-Mart) along with traditional, smaller convenience stores and mid-size supermarkets.

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49 Adapted from ACNielsen, supra note 33. Unfortunately, the ACNielsen source does not provide all relevant figures for the United States and it has not been possible to identify directly comparable figures from alternative sources.

50 “Hypermarkets” are defined in this table as supermarket stores with retail floor space greater than 2,500 square meters. It should be noted that this definition is different than that used by the Competition Commission, which defines a hypermarket as a supermarket of 5,600 square meters (60,000 sq. feet) or more of net sales area, with a broad product mix, including groceries.

51 “Loyalty to retailer” is defined as the average amount spent in the retailer per (consumer) buyer as a percentage of the average amount spent across all sources per buyer.

52 This is also the case to a greater or less degree in many other EU countries. For example, ACNielsen, supra note 33, reports that in Austria only 17 percent of consumer...
Second, Table 5 shows that the retail grocery sector in Great Britain is distinctly more concentrated at the national level compared to the other countries shown, with Great Britain ranked first in terms of the share of sales taken by the top retailer and the top five retailers.\textsuperscript{53} Clearly, the fewer the number of retailers operating and the greater their size, the greater the scope for exercising buyer power, as suppliers have fewer alternatives and will be keen not to lose large contracts.

The high concentration figure for Great Britain reflects the fact that large integrated chains, each using a single main fascia (i.e., the same shop name, branding, and style), control most of the market. In other countries, notably France and Germany, the large retail organizations generally are more decentralized; they sometimes operate with several different retail brands; or operate as a collection of independent businesses that are represented by a common umbrella organization (such as being part of a symbol group, e.g., Spar).\textsuperscript{54} In Italy the market remains relatively fragmented; the integrated retail chains have yet to take a major share of the market, as they have done in Spain, where in recent years large chains have gained a considerable amount of ground. Finally, in the United States national concentration is still relatively low at the national level but higher at the regional level. In all these countries, though, concentration appears to be increasing.

Third, and relating to the bottom row in Table 5, consumer loyalty to British retailers is very high. Consumers show a remarkable reluctance to shop around and use more than one retailer for all their grocery needs. Moreover, consumer loyalty is not limited to the top British retailer. All grocery purchases are made through hypermarkets, while for Belgium the figure is even lower at 14 percent.

\textsuperscript{53} Some smaller EU countries, notably Sweden and Finland, exhibit very high concentration levels that exceed those of Great Britain. However, other smaller Member States, like Austria, Belgium, Denmark, Ireland, Netherlands, and Portugal, tend not to exceed Great Britain in respect of concentration levels, at least when looked at on a retail fascia or ownership basis (i.e., excluding the presence of buyer groups representing independent retail businesses). For further details, see Paul W. Dobson, Buyer Power in Food Retailing: The European Experience, OECD Conference on Changing Dimensions of the Food Economy (2003), available at http://webdomino1.oecd.org/comnet/agr/foodeco.nsf/viewHtml/index/$FILE/DobsonPaper.pdf.

\textsuperscript{54} This explains why figures from other sources usually quote higher concentration levels in these countries. For example, Mintel (Food Retailing – UK, November 2003, Figure 10), taking account of the share of retail grocery sales controlled by the five grocery purchasing organisations in 2002, report that the UK had a five-firm concentration figure of 61.6 percent while France had 61.1 percent, Germany 77.9 percent, Italy 30.4 percent and Spain 38.1 percent. For further discussion and interpretation of the different measures and figures relating to concentration in European grocery retailing, see Dobson Consulting, supra note 9.
the major British retailers, particularly the large-format, one-stop shop retailers, demonstrate similarly high consumer loyalty rates.55 There may be a number of reasons for this. First, consumers appear to have a high degree of satisfaction with their present supermarket’s grocery offerings and few consumers would be prepared to switch to another store, as evidenced by consumer surveys.56 Second, for the sake of saving time, consumers appear to find shopping at one large, familiar store for all their needs more attractive compared to shopping at a number of (less familiar) stores.57 Third, as a matter of habit formation and convenience, consumers tend to shop at the main store closest to them.58 Fourth, consumers tend to view the market as being highly localized and are not prepared to travel far, unless they have to, for their main shopping.59 Fifth, and as outlined above, the leading retailers each have sought to craft their own distinct retail brands, through image, ambience, lay-out, customer service, amenities, pricing style, and range and depth of products offered to consumers.

A fourth distinguishing feature among countries is the extent to which retailer own-label goods compete with manufacturer branded goods. As Table 6 shows, the market share held by own-label products is noticeably higher in Great Britain.60

55 ACNielsen, supra note 33, reports that the respective “loyalty to retailer” rates for the leading retailers are Tesco with 67.6 percent, Sainsbury 68.1 percent, Asda 66.1 percent, Safeway 62.4 percent, Somerfield 57.9 percent and the Co-ops 58.7 percent. (No figure is reported for Morrison.) This picture of very strong consumer loyalty to each of the leading store groups very closely matches the Competition Commission’s finding that over half of consumers nearly always shopped at the same supermarket for their main grocery shopping, with a further quarter usually using the same supermarket. See Competition Commission, supra note 3, ¶ 4.79.

56 For example, the Competition Commission reports that in its consumer survey 81 percent of respondents rated their supermarket as “excellent” or “good,” of these respondents the same excellent or good rating was given by 90 percent for their supermarket’s quality, 89 percent for its product range, and 86 percent for its “service.” Competition Commission, supra note 3, ¶ 2.80. Furthermore, surveys carried out by the Consumer’s Association showed that 85 percent of consumers were satisfied with their supermarket’s grocery offer and only 15 percent would be prepared to switch to another if they felt it had a better offer. Id. ¶ 2.81.

57 Id. ¶¶ 4.83–4.84 (showing that in its consumer survey the single most important factor influencing store choice, as chosen by 43 percent of respondents, was “the ability to get most of the weekly shopping done under one roof,” while the leading three leading factors that reduce consumers’ willingness to try out other stores were “lack of easy access by car,” “unfamiliar store layout,” and “others too far away”).

58 Id. ¶ 4.83 (showing that the second most cited factor determining consumers’ store choice was being “within easy and convenient reach of home”).

59 Id. ¶¶ 4.142 & 4.129 (showing that two-thirds of shoppers travel less than five miles and less than ten minutes to do their main shopping).

60 Moreover, the market share being taken by own-label goods has been increasing over time in the UK. Id. Table 6.1 (where TNS Retailer Scannertrack data shows that the proportion of own-label sales increased from 31.9 percent in 1995 to 35.3 percent in 1999).
Table 6.
Market Share of Own-label Products, Various Countries 2001

<table>
<thead>
<tr>
<th>Country</th>
<th>Volume (1) %</th>
<th>Value (2) %</th>
<th>(1) / (2) %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Belgium</td>
<td>36.4</td>
<td>26.9</td>
<td>135</td>
</tr>
<tr>
<td>France</td>
<td>24.3</td>
<td>20.8</td>
<td>116</td>
</tr>
<tr>
<td>Germany</td>
<td>31.0</td>
<td>24.0</td>
<td>129</td>
</tr>
<tr>
<td>Italy</td>
<td>12.8</td>
<td>11.1</td>
<td>115</td>
</tr>
<tr>
<td>Netherlands</td>
<td>20.7</td>
<td>18.6</td>
<td>111</td>
</tr>
<tr>
<td>Spain</td>
<td>23.6</td>
<td>17.0</td>
<td>138</td>
</tr>
<tr>
<td>GB</td>
<td>41.0</td>
<td>39.0</td>
<td>105</td>
</tr>
<tr>
<td>USA</td>
<td>20.0</td>
<td>15.5</td>
<td>129</td>
</tr>
</tbody>
</table>

Yet it is not just the higher level of own label sales in Britain compared to these other countries that is significant. The perceived quality of the own-label products in comparison to branded goods is also important. Here, a consistent feature for other countries is that own-labels’ market share in respect of volume is higher than the market share in value, since private label products are generally sold at a lower price than the average product-line price. However, from Table 6 it can be observed that in Britain the difference between volume and value shares (as indicated by the final column) is considerably less than in other countries. This indicates that in Britain, at least, own-label products are seen as close and credible substitutes to branded goods (i.e., they are not seen as distinctly inferior products in comparable terms to branded goods). This feature, as pointed out in Part II.C above, has a particularly important implication for retailer-producer relations because it provides British retailers with a very credible bargaining lever with which to extract concessions and obtain other favorable terms and conditions from even the most powerful brand producers. The retailers’ threat to shift sales towards own-label goods is a highly plausible one, particularly in view of the growth of premium own-label products as a direct challenge to manufacturer branded goods.

Retailer size may be an important contributing factor in the development of own-label (particularly high quality own-label products), given that the costs of development and promotion of own-label ranges must be dispersed over as much sales volume as possible to be economically

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62 The Competition Commission made the same observation. Competition Commission, supra note 3, ¶ 9.46 and Table 9.7.
viable. Having a high market share might also allow the retailer to exercise power over suppliers to obtain low cost/high quality own-label supplies, perhaps even forcing a branded goods producer to develop own-label products and cannibalize sales of its own brands. Here, the respective size and concentration of the British grocery retailing market would clearly assist retailers in these aspects and may go some way to explaining the higher penetration rates of own-label in Great Britain compared to other countries.

However, there are other contributing factors that help explain why British own-label penetration rates are so high. In particular, the high market share of own-label goods, and their perceived high quality (as comparable to branded goods), reflects the greater development of retailer-specific supply chains in Britain. In this context, the existence of dedicated replenishment systems facilitates the ability to identify suppliers and develop unique or distinct own-label products. Without such systems it is difficult to move own-label products from suppliers’ factories to retailers’ stores. One reason for this is that dedicated products cannot pass through wholesalers whose role is to distribute products to all retailers. A second reason is that, generally, only manufacturers of branded products who seek universal distribution have the economies of scale to invest in distribution systems designed to deliver their products direct to store. The different levels of integration in general achieved by, for example, French and German retailers (Aldi excepted), compared to Britain, may thus be a contributing factor to the lower penetration of own-label products.

A fifth, but perhaps less important, distinguishing feature of British grocery retailing concerns ownership. Unlike most other countries, with the exception of the United States, all the major retailers in Britain are stock-exchange-listed public limited companies.63 In contrast, most, but by no means all, of the major retailers in continental Europe tend to be private companies (usually family owned) or co-operatives. As such, they arguably do not face the same intense pressure of capital market competition as listed companies do in competing for financial capital and satisfying shareholders’ desire for maximized “shareholder value.” Speculative though it might be, it is conceivable that the capital market

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63 This applies to Tesco, Sainsbury, Asda (owned by Wal-Mart Inc), Morrison/Safeway, Somerfield (also owner of KwikSave), Marks and Spencer, and the Big Food Group (owner of Iceland), representing some 87 percent of the UK grocery market. The exceptions (representing only 13 percent of the UK grocery market) are the various Co-ops (i.e., employee/consumer co-operative societies), Waitrose (owned by the John Lewis Partnership), Budgens (previously a listed public company but now owned by the Irish family-owned retailer Musgrave), EH Booth (family owned), and three private continental European players, Aldi, Lidl, and Netto.
competition faced by the major British retailers spurs directors and managers to squeeze whatever profits they can out of their business operations in order to ensure that their positions are not lost through a takeover and/or they are able to cash in on lucrative share options and other stock-performance related rewards. In this case, suppliers are likely to find that they are obvious targets for securing increased profits and, hence, may expect even greater pressure to offer discounts and provide other financial and competitive advantages.

From all of this, we may conclude that there are particular features of the British situation that allow for the prospect of buyer power to be particularly significant in comparison to other countries. This is especially apparent in view of the extent of industry consolidation and concentration, the predominance of superstores and hypermarkets, the unusually high degree of customer loyalty, and the extensive penetration of quality own-label goods. Nonetheless, in the absence of significant regulatory impediments, there appear to be no particularly strong reasons to indicate that over time other countries could not end up in a position similar to that experienced in Britain. Accordingly, it may be just a matter of time before the prospect of significant buyer power is as great in other jurisdictions.

IV. IMPACT OF BUYER POWER ON PRICES AND RETAILER-SUPPLIER RELATIONS

The exercise of buyer power may manifest itself in different ways but the aim will be to secure favorable terms in respect of the prices paid for goods and other terms of dealing that provide the buyer with additional financial or competitive benefits. For the most powerful buyers, this should mean that they are able to obtain preferential terms compared to their smaller retail rivals while controlling their relationship with suppliers in a manner that allows them effectively to dictate the terms and conditions of trade.

64 In a similar way, the wave of privatizations and stock-market listings of former public-owned utilities that took place in Britain in the 1980s was in part based on the notion that exposure to the rigors of full-blown, transparent capital market competition would substantially improve financial performance (as clearly materialized in many cases). See, e.g., Mark Armstrong et al., Regulatory Reform: Economic Analysis and British Experience (1994).

65 By negotiating an increased discount (or equivalent benefit) with a supplier, the retailer has the prospect of both raising its gross margin on the sale of the item as well as being able to use the lower cost of purchase to allow for a lower retail price to attract additional custom, allowing for the prospect of a simultaneous increase in net margins and sales levels, and so, a fortiori, an increase in total profits as well.
A. Effectiveness of Retailer Buyer Power in the British Grocery Trade

Clear evidence that the major multiple retailers in Britain are indeed able to obtain lower prices and preferential terms compared to smaller rivals is provided in the Competition Commission’s 2000 *Supermarkets* report.

In reviewing the prices paid for the top five branded lines of twenty-six large suppliers, the Commission found that “all other [non-major] categories of retailer paid much higher prices than the prices paid by Asda, Safeway, Sainsbury, Somerfield and Tesco. Moreover, all those five multiples bought the goods more cheaply than any other main party . . . Tesco paid the lowest prices.”

Details of the findings on the price differences paid by the main parties are shown in Table 7. Tesco generally secured the lowest prices, followed by Sainsbury, Asda, Somerfield, Safeway, and then Morrison. The other parties paid above average prices. Indeed, some of the price discrepancies among retailers are particularly wide. For example, expressed in terms of comparisons to the price paid by Tesco, a number of parties, notably Budgens, Netto, Waitrose, and Booth, paid approximately 10 percent more—a level which potentially placed them at a serious competitive disadvantage compared to Tesco and other major multiple operators.

Table 7 also shows each party’s respective market share. Here, it is possible to observe the close correlation between market shares and buying effectiveness. The extent of price differences among different parties supports the view that the retailer’s market share is an important factor in obtaining low prices from suppliers, whereby a high market share does not guarantee a low price but substantially increases the chances of obtaining one. In view of this, the buying-effectiveness/market-share relationship could be expected to confer a significant cost advantage on the major multiple retailers that they could then use to undercut the prices of the smaller chains. This could allow such retailers to enter a “virtuous circle” in which using their cost advantage to undercut smaller chains allows them to gain further market share, thereby lowering their relative costs of supply still further and so offer a further cost advantage over small chains which can be exploited by again undercutting their retail prices to take yet more market share away from them,

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66 *Competition Commission*, *supra* note 3, ¶ 2.448.
67 The Competition Commission does not provide any figures on this, but small chains paid 10 percent more than Tesco and it may be presumed that smaller independents paid even more in comparison.
Table 7.
Buying Effectiveness and Market Shares of the Main Grocery Retailers, 1998–1999

<table>
<thead>
<tr>
<th>Number of product lines (max = 130)</th>
<th>Relative buying performance % (average = 100)</th>
<th>% of lines for which average paid prices relative to Tesco's price (average = 100)</th>
<th>Market share in grocery retailing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tesco</td>
<td>96.2</td>
<td>80</td>
<td>100.0</td>
</tr>
<tr>
<td>Sainsbury</td>
<td>97.7</td>
<td>74</td>
<td>101.6</td>
</tr>
<tr>
<td>Asda</td>
<td>97.8</td>
<td>66</td>
<td>102.3</td>
</tr>
<tr>
<td>Somerfield</td>
<td>98.4</td>
<td>65</td>
<td>103.0</td>
</tr>
<tr>
<td>Safeway</td>
<td>98.8</td>
<td>65</td>
<td>103.1</td>
</tr>
<tr>
<td>Morrison</td>
<td>99.8</td>
<td>46</td>
<td>104.6</td>
</tr>
<tr>
<td>Co-ops</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Iceland</td>
<td>101.0</td>
<td>38</td>
<td>105.3</td>
</tr>
<tr>
<td>Budgens</td>
<td>103.6</td>
<td>24</td>
<td>109.4</td>
</tr>
<tr>
<td>Netto</td>
<td>104.2</td>
<td>21</td>
<td>109.5</td>
</tr>
<tr>
<td>Waitrose</td>
<td>104.4</td>
<td>23</td>
<td>110.1</td>
</tr>
<tr>
<td>Booth</td>
<td>104.4</td>
<td>26</td>
<td>111.1</td>
</tr>
</tbody>
</table>

and so on. In principle, this could carry on to the point where it becomes uneconomic for any small retailer to survive in the market.

The “virtuous circle” notion is lent support from the findings of the Competition Commission in its 2003 analysis of large supplier prices in the Safeway inquiry. The Commission observed that Tesco’s price advantage had “widened somewhat” as its market share increased. The Competition Commission also surveyed large and small suppliers in 2003 for their views on whether their trading and negotiating positions had changed over the previous three years. The suppliers generally reported a weakening in their negotiating positions, obtaining less favorable terms from the largest four retailers since the time of the 2000 inquiry, particularly with respect to the two retailers that had picked up the greatest (gross) gain in market share, Tesco and Asda.

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68 Adapted from Competition Commission, supra note 3, at Tables 5.6, 11.9 & 11.10. The following points regarding this table should be noted. The analysis is based on the top five branded product lines for 26 suppliers. The average price is averaged over all parties and is not weighted by turnover. Aldi, Lidl, and M&S do not (generally) stock manufacturers’ brands, so are excluded from the table. The figure for the Co-ops’ average price is averaged over different Co-op groupings, where 100.5 percent was the average with an actual range of 99.6 to 101.5 percent.

69 Competition Commission, supra note 4, ¶ 6.65.

70 Id. Tables 6.8 & 6.10.
Perhaps such observed price differentials are cost-justified. However, the Competition Commission concluded that lower prices were attributable to the exercise of buyer power rather than to operating cost differences, and pointed out that “the major buyers, and indeed many of the other main parties, are large enough to achieve most of the cost savings associated with large orders” and that “operating cost differences will not have played a material part in the price differences achieved by them.”

From the consumer’s perspective, lower input prices, however achieved, are beneficial when they translate to lower retail prices. Nevertheless, consumers may incur a cost if buyer power leads to reduced product choice, reduced quality—by discouraging producer investment or causing suppliers to exit the market—or reduced store choice, such as when small retailers are forced to exit. The point is that buyer power can potentially distort both supplier and retailer competition and it is by no means certain that the eventual outcome will favor consumers even if retail prices are initially lowered.

B. Retailers’ Control over Terms and Conditions of Trade

Retailing bargaining strength is not limited to securing direct price concessions. It also can be directed at obtaining other favorable terms of dealing. As discussed in Part II, these terms can take the form of direct financial benefits at the expense of suppliers or less direct benefits that affect trade with other parties. Both types appear common and have been used extensively by the major retailers in Great Britain. Moreover, it is evident that the terms and conditions of trade dictated by these retailers come in numerous forms and are typically applied as a combination of requirements. They are also applied in parallel, such that several retailers may independently seek the same or very similar terms and conditions. This has given rise to the concern that it is not just individual practices by individual retailers that may have anticompetitive effects (i.e., unilateral effects in isolation), but that there may be cumulative effects arising from the multiple and parallel application of terms and conditions of trade placed on suppliers.

One direct means for retailers to raise income at suppliers’ expense has been through demanding payments or improved terms for access to shelf space. This can cover payments from suppliers as a condition of stocking and displaying their products, a pre-condition for being on the retailer’s list of suppliers, as a requirement for better in-store positioning of their products, or in return for in-store promotion. Such

\[71\] Competition Commission, supra note 3, ¶2.451.
payments may appear to be a straight transfer of profits from suppliers to retailers with a neutral competitive effect. Yet, supplier competition could be distorted. This is because a retailer engaging in the practice would not necessarily select the best or most efficiently produced product, or the one preferred by consumers, but to some extent would be influenced by whoever is best able to make the payment requested.\footnote{Possible distortions to competition may work at three levels. First, there may be a discriminatory effect between own-label goods and branded goods if one category has to pay the fee while the other does not. Second, a possible foreclosure effect may arise if certain brands are able to bid in such a way as to squeeze out rivals, which might be deliberately facilitated by retailers eager to maximize the size of these payments. Third, a competition-dampening effect regarding retail prices may arise when producers are able to raise the prices they obtain to compensate for the one-off payments, which retailers then pass on to consumers through higher retail prices.}

Financial benefits that come at suppliers’ expense can also arise when the retailer imposes charges or transfers costs and risks to suppliers. An example of the former would be a retailer penalizing suppliers and levying charges for problems that might be the retailer’s fault (such as not correctly specifying conditions of supply or adversely affecting product quality through in-store mishandling or poor stock rotation). More commonly, retailers may require suppliers to contribute to market research, store refurbishment, in-store promotions, and special offers (such as for larger pack sizes or multi-buys). Retailers may also seek to impose an unfair balance of risk by requiring suppliers to give overriding or “in anticipation” discounts, pay compensation when product sales or profits were less than anticipated by the retailer, buy back unsold goods, and make payments to cover product wastage. The concern about such conditions and practices is that they may adversely affect the competitiveness of some suppliers, notably small suppliers, and more generally distort supplier competition when it insulates retailers from risk, by transferring an undue element of that risk to suppliers.

Further benefits to retailers may occur through opportunistic behavior on their part, such as making retrospective changes to contractual terms with suppliers. Examples include changing quantities or product specifications without adequate notice, delaying payments to suppliers outside agreed contractual periods, requiring suppliers to maintain a lower wholesale price for subsequently reduced order sizes or after an agreed promotional period, deliberate over-ordering of goods at a promotional price from a supplier, and instigating a promotion on a product without the supplier’s agreement and then requesting the supplier retrospectively to fund the promotion. Such practices may again distort supplier competition, favoring large suppliers that are better able to absorb the added costs. In addition, they may also distort retail competition, particularly

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when smaller retailers have no such advantages in their dealings with suppliers.

Suppliers may also find themselves constrained in other ways. For example, suppliers may be required to use specified third-party suppliers (e.g., for packaging, labeling, and haulage), potentially distorting competition at their own level (by preventing them from seeking out efficient third-party suppliers) as well as directly restricting competition between the third-party suppliers. Furthermore, suppliers may be required to provide information on the supply or pricing of their products sold to other retailers; supply a product exclusively; or refuse to supply a product to rival retailers at a lower retail price, all of which may have an adverse effect on retail competition.

Such practices featured highly in the Competition Commission’s investigation of the retail grocery industry in 2000. In total, the Commission identified a total of fifty-two practices associated with retailer buyer power that when practiced by the major multiple grocery retailers could have potentially distorting effects on supplier and/or retailer competition. These were grouped into eight categories, as shown in Table 8.

<table>
<thead>
<tr>
<th>Category of Practices</th>
<th>Number of retailers engaging in practices (min–max)</th>
<th>% of practices against public interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payments for access to shelf space</td>
<td>8</td>
<td>50</td>
</tr>
<tr>
<td>Imposing conditions on suppliers’ trade with other retailers</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>Applying different standards to different suppliers</td>
<td>1</td>
<td>100</td>
</tr>
<tr>
<td>Imposing an unfair imbalance of risk</td>
<td>12</td>
<td>83</td>
</tr>
<tr>
<td>Imposing retrospective changes to contractual terms</td>
<td>8</td>
<td>75</td>
</tr>
<tr>
<td>Restricting suppliers’ access to the market</td>
<td>1</td>
<td>100</td>
</tr>
<tr>
<td>Imposing charges and transferring costs to suppliers</td>
<td>8</td>
<td>63</td>
</tr>
<tr>
<td>Requiring suppliers to use third party suppliers nominated by the retailer</td>
<td>2</td>
<td>50</td>
</tr>
</tbody>
</table>

Table 8. Supermarket Practices Concerning Relations with Suppliers

73 Adapted from Competition Commission, supra note 3.
The Competition Commission found that the leading five multiples, each with a market share in excess of 8 percent, had sufficient buyer power that thirty (of the fifty-two) identified practices “adversely affect the competitiveness of some of their suppliers and distort competition in the supplier market—and in some cases in the retail market—for the supply of groceries.” The result of the practices was that “suppliers are likely to invest less and spend less on new product development and innovation, leading to lower quality and less consumer choice. This is likely to result in fewer new entrants to the supplier market than otherwise. Certain of the practices give the major buyers substantial advantages over other smaller retailers, whose competitiveness is likely to suffer as a result, again leading to a reduction in consumer choice.” Although the Commission recognized some advantages in buyer power and offsetting benefits, it nonetheless concluded that twenty-seven of the practices operated against the public interest.

While competition concerns were raised for all categories, four of the eight categories accounted for all but two of the identified practices found to be operating against the public interest. However, other practices that principally were part of agreed-upon pricing terms, such as guaranteed and/or incentive discounts and overriders, were justifiable on efficiency grounds because they gave both trading parties mutual incentives to increase the size of the business.

Rather than formally prohibit any of the individual practices, an industry Code of Practice was established at the recommendation of the Competition Commission. The purpose of the Code is to eliminate or at least restrict the practices determined as being anticompetitive, with compliance required of the four largest supermarket groups (each accounting for in excess of 8 percent of the retail grocery market). The effectiveness of the Code has been called into question, however. A recent review of the Code by the Office of Fair Trading revealed “a widespread belief among suppliers that the Code is not working effectively” and that most consultees “believed that the Code had not brought
about any change in the behavior of the [British] supermarkets.” The principal reason for this was that “suppliers, both large and small, were concerned at being de-listed by the supermarkets or being required to trade with them on worse terms if they made complaints.”

Despite the presence of the Code, it would seem that the major retailers continue to enjoy a position of control, and are largely able to set the terms and conditions of trade with suppliers. If anything, with the continued consolidation of the retail grocery sector, their buyer power has strengthened further since 2000, as evidenced by the findings of the Competition Commission’s 2003 Safeway inquiry.

V. CONCLUSION

While differences remain between countries in the nature and structure of grocery retailing, Britain’s experience of an increasingly concentrated retail grocery sector is far from unique. Most developed countries have seen consolidation take place, with a handful of very large chain-store retailers emerge commanding significant shares of national markets. This development has facilitated a marked change in the nature of supplier-retailer relations where increasingly retailers hold the whip hand and supply chains are increasingly retailer-driven.

The chief insight from the British experience, and perhaps a lesson for the United States and other countries, is that as retail concentration increases, the leading retailers will be in increasingly strong positions to exploit the three roles they occupy for producers— as their customers (purchasing and then re-selling their goods), as their competitors (when developing own-brand ranges), and as their suppliers (in the provision of shelf and advertising space).

With increased concentration there are fewer alternative opportunities available for suppliers to gain access to shelf space and obtain the necessary access through to final consumers. This allows the major retailers greater opportunity to exploit their gatekeeper position—controlling the limited available shelf space.

In these circumstances, suppliers are economically dependent on the major retailers. Suppliers operating under high fixed costs simply cannot afford to lose major contracts, as they have little or no prospect of picking up the lost custom through additional orders placed elsewhere. Losing

80 Competition Commission, supra note 4.
such a contract would make it extremely difficult for suppliers to cover costs and earn a profit.

It may be thought that economic dependency works both ways, but this is not the case. A major retailer usually has other suppliers that it can readily turn to if it chooses to delist a supplier, each of which would be only too willing to increase supply and replace a rival. The retailer can also reallocate shelf space in favor of other product lines or extend its premium own-label ranges. Indeed, it will greatly suit the retailer to keep as many alternatives in play as possible to strengthen its bargaining position and ensure that it does not become over-reliant on any one individual supplier.

Producers simply do not have the same opportunities. If they boycott a retailer, they are not likely to be able to pick up additional business from elsewhere (given that contracts for other retailers are already settled). This applies even to the top brand producers, which are placed under intense competitive restraints in a similar fashion to other suppliers.

Retail consolidation, such as experienced in Great Britain over the last decade, only magnifies this imbalance in relative economic dependency, continuously weakening producers’ bargaining positions. Mergers, such as the recently completed merger between Morrison and Safeway in Britain, offer further prospects for exploiting enhanced market share to gain additional bargaining leverage over suppliers to force through further price discounts and/or impose restrictive terms and conditions. Having given away more favorable terms to a merged entity, there will be pressure put on the same suppliers by the other major retailers to give similar discounts. In other words, it is not only the merged entity that is likely to benefit from increased buyer power but its main rivals as well.

Crucially, the benefits from buyer power only lie in the hands of the largest retailers, reinforcing their competitive advantage over smaller retailers and enhancing their power to dictate terms and conditions to suppliers. From an antitrust perspective, and as the British experience highlights, this leads to credible concerns about detrimental effects on competition at both the retail level and at the supplier level.

At the retail level, the *virtuous* circle that the major retailers find themselves in is mirrored by a *vicious* circle that smaller retailers are caught in—smaller retailers face increased price differentials from what might amount to a “waterbed” effect in which low purchase prices for the major retailers force suppliers to charge higher prices to smaller
retailers in order to cover fixed costs. Even when they join together in buyer groups, smaller retailers increasingly find themselves at a competitive disadvantage vis-à-vis the major multiples. If this causes smaller retailers to exit the market, then possible consumer harm may arise that takes the form of reduced store choice and accessibility and possibly higher retail prices if retailer competition were to decline significantly. The UK competition authorities’ opposition to Tesco’s, Sainsbury’s, and Asda’s contemplated mergers with Safeway indicates that the UK competition authorities are sensitive to this concern and prepared to intervene to prevent any additional sharp increases in market concentration. However, the organic growth of the major multiples, and thereby market concentration, continues apace.

At the supplier level, competition may be distorted when small suppliers, in particular, are forced to cut prices to the point that it endangers their continued existence. The longer-term effect of such strong buyer power could be to threaten the viability of even the most efficient suppliers over the long term if suppliers are forced to price at marginal cost and are unable to cover their fixed costs. Accordingly, even large suppliers may be deterred from making product and process investments if buyer power prevents them making an adequate return to cover costs. As a consequence, product quality, variety, and innovation may suffer—all to the detriment of the consumer.