

Supply chain practices working paper

Introduction

1. This paper considers a number of practices of grocery retailers in relation to their suppliers that have come to our attention. Evidence of these practices is, primarily, based on submissions from suppliers, the results of a survey of suppliers conducted by GfK for the CC (the GfK report),¹ and material submitted by grocery retailers.

2. We have categorized the practices that have come to our attention according to the way in which they might affect competition. The categories of practices that we look at in this paper are:
 - lack of contractual terms in, and ‘unilateral’ changes to, agreements between grocery retailers and suppliers—see paragraphs 8 to 17;
 - payments by suppliers to grocery retailers in order to obtain shelf space for new or existing products (known as ‘slotting allowances’ and ‘pay-to-stay’ fees) —see paragraphs 18 to 34;
 - the provision of category management and other marketing support services to grocery retailers by suppliers—see paragraphs 35 to 47;
 - exclusive purchasing and dealing agreements—see paragraphs 48 to 59;
 - the stocking of own-brand products by grocery retailers—see paragraphs 60 to 69; and
 - recommended retail prices—see paragraphs 70 to 77.

3. Our approach in this paper is to examine each of these categories of supplier practices separately. However, we recognize that these practices may coexist and their combined effect may be more harmful than the possible effect of each practice considered in isolation.

¹The GfK report is available on our website at www.competition-commission.org.uk/inquiries/ref2006/grocery/index.htm.

4. We have received a number of complaints regarding payments by suppliers to grocery retailers. In some cases, these payments take the form of slotting allowances and pay-to-stay fees, which we discuss below. In other cases, we have been told about requirements for payments, or price discounts, that have been made retrospectively by grocery retailers. We also address this issue below in our discussion of unilateral changes to agreements between grocery retailers and suppliers.
5. A further category of payments between grocery retailers and suppliers are those that are agreed in advance, which can take the form, for example, of contributions to marketing or volume-related discounts. These payments, while representing a lower net price for suppliers, may not in themselves have an adverse effect on competition. However, the ability of grocery retailers to extract these payments from suppliers stems from their bargaining power relative to suppliers, and the strength of grocery retailers' bargaining (or buyer) power is an issue of concern to us. We address this in our working paper on buyer power.
6. We have also received submissions concerning the practices of intermediaries (such as processors, packers, etc) in the supply chain. At this stage, we do not think that the submissions received in this area introduce issues different from those that are covered in this paper.
7. Some of the practices discussed in this paper were also considered by the CC in its investigation into supermarkets in 2000, which led to the establishment of the Supermarket Code of Practice (SCOP). We have considered these practices and their possible effect on competition rather than the effect of the SCOP itself on relations between suppliers and grocery retailers.

Lack of contractual terms and ‘unilateral’ changes to agreed provisions

8. We received submissions from suppliers that highlighted various forms of behaviour which have in common a degree of uncertainty about future trading terms between suppliers and grocery retailers. This uncertainty may be created because there are not well-specified contractual terms regulating trading between suppliers and grocery retailers, or because grocery retailers, we are told, impose changes unilaterally to previously agreed provisions.

Potential anti-competitive effects

9. Such behaviour, enabled by the lack of contractual terms, might harm consumers in different ways. First, the uncertainty for suppliers creates a commercial environment where it may be more difficult to plan and fund investment in product and process innovation. Second, in some cases, investment in new capacity may be conducted needlessly because orders that a supplier expects to receive from the grocery retailer do not materialize.
10. This latter problem is known in economics as a ‘hold-up’ problem. Typically, a hold-up problem arises when two parties (say, a retailer and a supplier) agree to some terms of trade which require one party (say, the supplier) to conduct investment (for example, on dedicated capacity) that it cannot recuperate elsewhere. Following the investment, the retailer may make a new take-it-or-leave-it offer to the supplier who is now in a position to be forced to accept a lower price if it wants to recover at least part of the investment made. Hence, this may lead to lower prices paid by the retailer. However, in the medium to long term this may lead to wasteful investment being conducted and to a reticence to conduct useful investment for fear that the terms will be changed.

Potential pro-competitive effects

11. The risk mentioned in the previous paragraphs of lower levels of investment has to be balanced against the efficiency that may result from leaving open some aspects of agreements between grocery retailers and suppliers and even from imposing unilateral changes. Leaving the possibility for unilateral changes may discipline the suppliers' behaviour beyond what may be formally contemplated in a contract. For example, knowing that the retailer may impose a charge could prevent the supplier from lowering the quality of the goods supplied where not all aspects of product quality and service can be specified in a contract. Similarly, in the context of uncertain demand, leaving open contract terms may allow the supply chain to be more adaptable to changing market conditions.

12. As discussed above, this in turn may lead to opportunistic behaviour from grocery retailers. However, it is possible that reputational concerns may act to prevent grocery retailers from unduly exploiting this freedom.

Evidence on the lack of contractual terms

13. We received some submissions about unilateral changes to contracts and instances of investment being undertaken but orders not subsequently being made by grocery retailers. It is difficult to judge how widespread such behaviour is purely from the number of submissions. We have been told that suppliers are not willing to come forward with evidence for fear of being de-listed or other retaliation by their main customers.

14. Friends of the Earth, however, conducted a survey of farmers with the intention of gaining evidence for our inquiry. This survey was sent to 99 farmers, 33 of which replied. While we are still assessing how the primary sample of 99 was constructed and how representative the results are, we note that several farmers indicated that

they had suffered losses from large retailers' varying previously agreed business terms.

15. One way to assess whether there is a problem is to consider data on the level and rate of change of investment and innovation to assess whether there are signs of a low or decreasing level of investment. This is because suppliers' incentives to innovate and invest may be adversely affected by the lack of certainty regarding future business conditions.

16. The evidence on research and development (R&D) expenditure, which we present in more detail in the working paper on buyer power, does not indicate a reduction in R&D spending in recent years. In particular, the GfK report shows that 80 per cent of suppliers claim to have conducted some form of process or product development investment during the past two years.² Of these, 43 per cent stated that they currently spent more on such investments than they did five years ago, while only 14 per cent stated that they invested less.³ We note also that the four largest grocery retailers all submitted that product and process innovation was important. Asda in particular claimed that suppliers had an incentive to innovate as this allowed suppliers to charge higher prices than they otherwise might be able to. Sainsbury's also told us that it considered product innovation a factor that might improve a supplier's bargaining position. Overall, we have not yet seen clear evidence that the level of investment is decreasing among suppliers as a result of buyers' business practices.

²GfK Report, Chart 58.

³GfK Report, Chart 61.

Provisional assessment

17. Evidence on R&D expenditure does not appear to identify a clear decreasing trend or levels that may be considered low. However, this evidence is based on aggregate data and it is possible that for specific industries, the lack of certainty about business conditions may be adversely affecting competition. We will continue to review this issue, seeking to obtain more detailed data, and we invite firms or individuals operating in sectors where these issues may be relevant to come forward with any such evidence.

Slotting allowances and pay-to-stay fees

18. Slotting allowances are lump-sum fees that are payable for the introduction of a new line to the retailers' shelves. These are usually paid by manufacturers or producers to the retailer on a 'per item per store' basis. A variant of the slotting allowance in which payments are required to keep the product on the shelf are 'pay-to-stay' fees.

Potential pro-competitive effects

19. Slotting allowances for new products may be efficient for two main reasons. The first is new product selection; a manufacturer's willingness to pay a slotting allowance might be taken to signal the credibility of their confidence in the product's sales potential. Similarly, the payment also offers some compensation to the retailer for taking on the risk of stocking the new product. This risk essentially relates to the uncertainty concerning how a new product will perform relative to the stock that it replaces. Slotting allowances may also represent payments for the inventory and stocking costs of new product introduction. In summary, slotting allowances, by compensating the retailer for the risks and the costs of listing new products, may facilitate the introduction of products which retailers may otherwise be deterred from stocking.

20. The second way in which slotting allowances, together with pay-to-stay fees, may increase efficiency is through the auctioning of shelf space. Slotting allowances and pay-to-stay fees may operate as a simple method to determine the most valuable use of the shelf space available.⁴ In this context, the supplier with the most profitable product will be prepared to offer the largest payment for access to the shelf (and hence realization of that profit). This mechanism would help to ensure that those products for which consumer demand is, or is likely to be, higher reach final consumers.

Potential anti-competitive effects

21. We have identified five ways in which the practice of charging suppliers a slotting allowance and/or a pay-to-stay fee may adversely affect competition.
22. First, in attempting to weed out risky new products, slotting allowances run the risk of screening out small suppliers regardless of the sales potential of their product. This is likely where smaller manufacturers lack the same access to capital as their larger rivals. Given a new product with a given risk of failure, it may be easier for a large company than for a small company to raise the funds to pay for the slotting allowance necessary to ensure the product's distribution. If this is the case, the slotting allowance may represent a significant barrier to entry for smaller suppliers.
23. Second, this possibility of exclusion of smaller suppliers may be exacerbated by the possibility of strategic behaviour by larger incumbent firms. In particular, larger suppliers might choose to bid up pay-to-stay fees in order to increase barriers to entry. When the benefit of such a strategy outweighs the cost of its implementation

⁴'Slotting Allowances and the Market for New Products', Mary W Sullivan, *Journal of Law and Economics*, Vol 40, No 2 (October 1997), pp461–493.

the incumbent might rationally pay larger fees than retailers would request in order to protect their partially exclusive position.

24. Third, since slotting allowances are targeted only at new products, it may be that rather than facilitating innovation, as suggested above, they may in fact deter suppliers, both large and small, from innovating. By this argument, slotting allowances simply increase the cost of bringing a product to market. The incumbent suppliers' natural response is then to favour maintaining their existing product rather than introducing a new one which has a slotting cost attached.
25. Fourth, in order to pay a slotting allowance a supplier may increase its price to the retailer, and this price increase will be passed through to consumers.⁵ However, there is also a view that in the long run slotting fees might be expected to make grocery retailing more profitable and therefore will attract more retailer entry. The competitive pressure from these entrants might serve to restrict the retailer's ability to pass the supplier's cost of paying the slotting fee to the consumer.⁶
26. Finally, slotting allowances in the context of a three-part tariff⁷ may facilitate collusion among retailers but at the same time prevent exclusion of retailers. In this context, the effect of slotting allowances on consumers' welfare is ambiguous.⁸

⁵See 'Slotting Allowances and Resale Price Maintenance: A Comparison of Facilitating Practices', Greg Shaffer, *The RAND Journal of Economics*, Vol 22, No 1 (Spring 1991), pp120–135.

⁶Salop quoted on p28 of 'Slotting Allowances and Other Grocery Marketing Practices', www.ftc.gov/os/2001/02/slottingallowancesreportfinal.pdf, Federal Trade Commission staff report, February 2001.

⁷This is made up of the slotting allowance and a traditional two-part tariff that is conditional in the sense that the firms can renegotiate if the market structure does not turn out as expected. For example, if the retailer is not the sole retailer of the supplier's product in the retail market (when it expected to be), then it might renegotiate in light of that change in circumstance.

⁸'Slotting Allowances and Conditional Payments', Patrick Rey, Jeanine Thal, and Thibaud Verge, Mimeo, 16 June 2006, pp1–7, www.csef.it/2nd_C6/Rey2.pdf.

Evidence on slotting allowances and pay-to-stay fees

27. In the GfK report, 27 per cent of respondents stated that they pay slotting allowances either regularly or occasionally while 15 per cent said that they regularly or occasionally pay fees for continued listing (pay-to-stay fees).⁹

28. The four largest grocery retailers (Asda, Morrisons, Sainsbury's and Tesco) were also asked whether they charged slotting allowances and pay-to-stay fees.¹⁰ The number of product categories in which they stated that such charges had been negotiated with either a branded or own-brand supplier is set out in Table 1.

TABLE 1 **Number of grocery product categories in which an allowance/payment has been negotiated (out of a total of 19 categories)**

	Slotting allowances	Pay-to-stay fees
Asda		
Morrisons		
Sainsbury's		
Tesco		

Source: Replies to CC questionnaire.

29. Table 1 shows that none of the four largest grocery retailers reported using pay-to-stay fees. All four used slotting allowances, although to varying extents. We note that this is in contrast to the information we received in the GfK report. One retailer indicated that it had used pay-to-stay fees in a non-grocery category. Furthermore, from the data used to construct the table, there appears to be no correlation between the categories in which different grocery retailers typically use slotting allowances.

30. [redacted] submitted that contracts are often awarded not solely on the basis of the price of the product to be supplied, but can also be based on how much suppliers are prepared to pay for the contract which will allow them to trade with the retailer.

⁹GfK Report, Chart 32.

¹⁰Slotting allowances were defined as 'Discounts from suppliers related to the stocking of the product line in question' (these correspond to what in this paper we term 'pay-to-stay fees'). New product allowances were defined as 'Discounts from suppliers related to the stocking of a new product line' (these correspond to 'slotting allowances' in this paper's terminology).

Similarly, a supplier described how fees were being charged for the listing of new products. It explained that the size of such fees was difficult for a small supplier to bear.

Provisional assessment of competitive effects

31. If slotting allowances had an exclusionary effect, we would expect to see evidence of both reduced innovation and small suppliers being denied access to the retailers' shelf space for those categories where slotting allowances are used. We consider that the following forms of evidence are most relevant to our assessment:
 - (a) supplier submissions regarding the exclusionary effect of such fees;
 - (b) reductions in investment in the relevant sectors; or
 - (c) relative under-representation of small manufacturers in the retailer or product category supplier lists.

32. So far we have received little in the way of submissions from suppliers. In relation to investment, in paragraph 16 we discuss the evidence on R&D expenditure, which does not indicate spending reductions in recent years.

33. In relation to the effect on small manufacturers, according to data supplied by retailers, there has been a net increase in the number of product lines sold through Tesco and Sainsbury's in 2005/06. Further, all the four largest grocery retailers stated that they listed more suppliers than they delisted. This may be indicative of a general increase in innovation, and perhaps of a relative ease of entry, but we note that this is not necessarily specific to those product lines for each grocery retailer where slotting fees are predominant and new product lines may be introduced by

existing suppliers. We also note that Sainsbury's has started an initiative to make it easier for small suppliers to gain access to the market.¹¹

34. We will continue to explore these issues, and in particular whether these payments represent a significant barrier for smaller firms. We will investigate further data arising from the GfK report. We also invite interested third parties to submit any evidence which may help clarifying these issues.

Category management

35. There are different ways for retailers to manage the allocation of shelf space to products. Category captaincy is a particular form of category management in which a supplier (usually a large branded goods supplier) is asked to help a retailer manage the way in which products within a category are presented and sold to consumers, mainly in view of the specific information on consumers' preferences it possesses. We were told by several retailers and suppliers that there were different forms of collaboration between retailers and suppliers that were aimed at optimizing the management of a category by retailers. These might take the form of providing advice on: product range; shelf layouts; pricing; and promotions. In considering the potential effects of such forms of behaviour in the following paragraphs, we refer to category captaincy to include all forms of supplier-retailer collaboration in the management of a category.

Potential pro-competitive effects

36. The superior knowledge of category captains regarding consumer demand may lead to greater efficiency due to the goods stocked being closer to the ones that

¹¹Details can be found on www.supplysomethingnew.co.uk.

consumers would like to purchase.¹² This may directly benefit consumers and result in increased total sales for the category.

Potential anti-competitive effects

37. We have identified three possible ways in which category captaincy may adversely affect competition:

(a) the captain may manage the category to its own benefit and increase its own market power;

(b) the captain may have the opportunity to orchestrate collusion among grocery retailers; and

(c) the captain may have opportunity to orchestrate collusion among manufacturers.

38. In relation to this first adverse effect, we have identified two ways in which a category captain may use its position to increase its market power. First, as part of its role in category planning the category captain might receive from the retailer strategic information on its rivals' plans. This might include information on new product launches, promotions, rebranding and other strategic initiatives. This could provide the category captain with the opportunity to abuse its position by devising a pre-emptive response. This could, in turn, reduce the incentives for other firms to compete with the captain.

39. Second, a category captain may advise on where to place products within planograms¹³ and on the timing and form of promotions. A captain might therefore have the opportunity to induce retailers to allocate to its rivals detrimental shelf locations or a reduced size of placement; it may advise the retailers to conduct

¹²See 'Category Management: The P&G/Gillette decision establishes an important precedent', Simon Holmes, Niamh Grogan and Thomas Heide, *Competition Law Insight*, 25 October 2005, pp12–13.

¹³Planograms are charts used by retailers to organize and implement the way in which products in a category are presented on the shelves.

promotions in a way that does not benefit its competitors; or, simply, attempt to exclude some competitors altogether.

40. The second adverse effect on competition may derive from increased collusion among retailers. Where a supplier acts as a category captain for a number of retailers that represent a significant share of a market, it may be able to facilitate collusion between them. In particular, a supplier may coordinate its recommendations on promotions, ranges or prices so that retailers do not compete as effectively in the sale of the products in that particular category.
41. Finally, category captaincy may also adversely affect competition by leading to collusion between manufacturers. This could happen because of a greater exchange of information between suppliers. For collusion to arise between a number of firms, these firms have to be able to monitor compliance with a tacit or explicit collusive agreement. A category captain who may not find it optimal to use commercially sensitive information that the retailer may provide purely for its own advantage may nonetheless be in a position to coordinate better with its competitors. Alternatively, and more directly, if retailers consult a number of suppliers who are allowed to confer on any recommendations they make (multiple category captains), these suppliers may be better able to monitor each other's actions.¹⁴
42. It should be noted that some of the possible adverse effects that might arise from the existence of category captains could be mitigated in some cases. For example, the introduction of effective 'Chinese walls' between a supplier's category captaincy role and its planning and negotiations departments could in principle deal with the danger that access to competitors' strategic information might be used to gain an unfair

¹⁴This possibility was identified by the FTC. See FTC (2001), p53.

advantage.¹⁵ Equally, retailers might be unlikely to organize their category management in such a way that it allows suppliers to collude to increase the price charged to the retailer. Similarly, retailers may act to prevent the possibility that category captains provide biased advice to exclude rival suppliers.

Evidence on category management

43. According to the GfK report, 32 per cent of the sampled suppliers stated that they undertook some form of category management role, while 48 per cent stated that they helped with marketing.¹⁶ Most respondents to a separate questionnaire that we sent to selected branded good suppliers stated that they were involved in some form of collaboration on marketing and/or category management with at least one major retailer.
44. Most grocery retailers have also told us that they collaborate to some extent with suppliers on marketing and merchandising activities. Some suppliers assist retailers in determining appropriate range and space allocation and promotional mechanics for categories of products, and many retailers share information on category performance with their suppliers. These arrangements do not seem to be more frequent or relevant for particular product categories; rather, they can apply to any product category.
45. Although suppliers might provide market and trend information and give strategic and marketing advice for the development of a category, retailers told us that they did not delegate category management responsibilities to suppliers, and the final decisions on range, marketing and merchandising rested with the retailer. None of the retailers

¹⁵FTC 2001, p51, proposes managerial firewalls as a potential solution to this problem. In response to our questionnaire, a retailer stated that it expected category advisers to operate such Chinese walls.

¹⁶GfK Report, Chart 41.

paid or received money from suppliers providing market information or marketing advice in relation to these services.

Provisional assessment of competitive effects

46. If the use of category captains does indeed lead to the efficiencies discussed above, we might expect to see a lower rate of use of slotting allowances where category captains are employed. This might be observable at either a retailer or a product category level. In contrast, if the anti-competitive exclusionary effects are predominant, we might expect to see both submissions from the marginalized suppliers and some evidence that, in comparison with the same category in different retailers, the category captain is overrepresented in those that he manages.
47. We will seek to explore these relationships and any further evidence that is presented to us in order to establish whether any adverse effects on competition arise from these category management practices.

Exclusive purchasing and dealing agreements

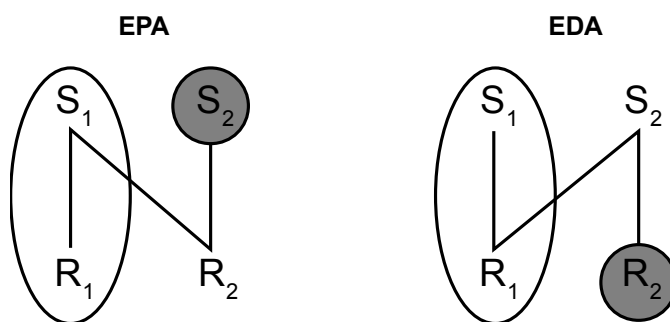
48. In this section we consider both exclusive purchasing arrangements (EPAs) by grocery retailers and exclusive dealing arrangements (EDAs) by suppliers.¹⁷ These arrangements involve either restrictions on the number of retailers that can stock a certain product (in the case of EDAs) or on the number of suppliers that a retailer can source a type of product from (EPAs), and as such have the potential to reduce competition between retailers or suppliers.
49. For a graphical illustration, see Figure 1. In the case of an EDA, the supplier S_1 agrees to deal only with retailer R_1 and not retailer R_2 . This may reduce R_2 's ability to

¹⁷Each of these might be partial (PEPAs or PEDAs) if the agreement specifies, instead of the complete exclusivity certain proportions of space or capacity (or prominence) that must be exclusive to the relationship.

compete with R_1 since it is unable to match R_1 's offer. Alternatively, in the case of an EPA it is the retailer R_1 that agrees to purchase all of its requirements from S_1 , therefore not purchasing any from S_2 . This may reduce supplier S_2 's ability to compete since it cannot reach the consumers shopping at R_1 .

FIGURE 1

EPAs and exclusive dealing agreements



Potential pro-competitive effects

50. EPAs can provide suppliers with security in terms of the demand the supplier can expect for its product over a period of time. This security may allow a supplier to make investments (particularly retailer-specific investments, eg specifications, distribution) that would not be undertaken in the absence of such commitments on the part of the retailer. Other retailers may also indirectly benefit from the creation of such efficiencies in the supply chain depending on the nature of the investment.

51. Exclusive dealing agreements (EDAs) might be a way for a supplier to convince a retailer to provide access to the shelf for its product. In that sense they might work in a similar way to slotting allowances, the exclusivity compensating the retailer for the risk of stocking a new product. In the absence of such an agreement, the variety of new products might in principle be reduced. However, this will not happen if there are other equally effective ways of compensating retailers for the risk of introducing new products, such as slotting allowances.

52. As with EPAs, the exclusivity of an EDA relationship may foster additional investment that would otherwise not be forthcoming. Given the direction of the exclusivity, this refers to investment by the retailer rather than the supplier, for example through increased promotional support. In cases where EPAs and EDAs are combined to form an entirely exclusive relationship, both supplier and retailer may commit additional investment.

Potential anti-competitive effects

53. As mentioned above, by their nature EPAs will eliminate competition in a retailer's stores between rival suppliers of a product. PEPAs will not eliminate this competition though they might restrict it to a point at which, as with EPAs, entry into the supplier market is difficult if not effectively foreclosed. These upstream barriers to entry will, to a large extent, depend on the number of retailers from which a dominant supplier can extract an EPA. The more comprehensive the exclusivity of provision in the market, the more difficult entry will become for competing brands since they will be denied access to consumers.
54. With EDAs, the absence of the supplier's product from rival retailer's shelves reduces competition between different products within the stores of the retailer that is excluded from the agreement. Furthermore, because retailers stock different products, this increases the degree of differentiation between them and consumers may find it more difficult to compare prices for the same product between stores.
55. Furthermore, where the exclusive product in question is what is sometimes labelled a 'must-stock' item, the absence of the product from rivals' shelves may act as a barrier to downstream entry for these rival retailers.

56. It is also possible that, as with exclusive territories, an EDA might enable the suppliers to collude by allocating certain retailers to each brand.

Evidence on exclusive purchasing and dealing agreements

57. The GfK report shows that 35 per cent of suppliers surveyed were asked to enter into an exclusivity agreement and 19 per cent actually agreed to an exclusive dealing contract.¹⁸
58. We were told by several retailers that EDAs tend to cover own-label products developed according to the retailers' specification, and products that the retailer has helped develop or for the production of which the retailer has made investments. We received submissions stating that sometimes, although exclusivity is not required by a retailer, the relationship between supplier and retailer resembles an exclusivity arrangement with a retailer being the sole customer of a supplier and the supplying relationship having lasted for many years. One leading retailer told us that though it did not encourage exclusivity of supply, it might agree to such terms where the supplier had limited production capacity. Another retailer stated that limited period exclusivity agreements might occur where the retailer had helped the supplier develop the product.

Provisional assessment of competitive effects

59. We will explore the extent to which exclusivity provisions may lead to reduced competition between retailers by considering in more detail the types of products that are covered by such agreements (eg whether and to what extent they include must-stock products). We will also consider the extent to which exclusive purchasing agreements may reduce competition between suppliers.

¹⁸GfK Report, Charts 29 and 30.

Stocking of own-label products

60. Many large grocery retailers stock products that are sold under the retailer's own brand name. These products, which we refer to as own-label products, are stocked in numerous categories and are only sold in the retailer's own outlets.

Potential anti-competitive effects

61. We were told that own-label product ranges caused a distortion in competition. It was explained that retailers' privileged positions in receiving information on the plans of branded suppliers potentially distorted the nature of on-shelf competition between own-label and branded products. We were also told that own-label products directly competed with other branded goods and that manufacturers of branded goods find themselves in the position of effectively having to share their marketing plans, new products formulations and launch plans with their competitors nine months to a year prior to the actual launch.

62. It was put to us that because retailers effectively competed with branded goods manufacturers via their own-label products, any abusive practice that was identified towards suppliers should also be seen as an abuse towards a competitor. It was argued that non-cost-related discounts obtained by retailers and other requirements without a corresponding benefit to the supplier [§] qualified as abusive practices.

63. Another issue raised was that own-label competitor versions of a branded product are sometimes the subject of accusations of 'copycat' behaviour through imitating the packaging of brands with the intention of misinforming customers as to the nature and reputation of their product.

Potential pro-competitive effects

64. These complaints over the effects of own-label products should be balanced against the possible positive consequences of their increasing prominence in the UK grocery market. The stratification of own-label products into basics, healthy, kids, organic and premium ranges may have increased consumer choice and competition.
65. Some retailers told us that the provision of own-label products was a response to consumer demand. Between them they told us that they would attempt to source own-label product lines where they found a lack of:
- (a) choice within a product category;
 - (b) price competition between brands; or
 - (c) innovation in the category.

We also consider that retailers may introduce own-label products where there is a lack of brand loyalty or lack of branded provision of a product.

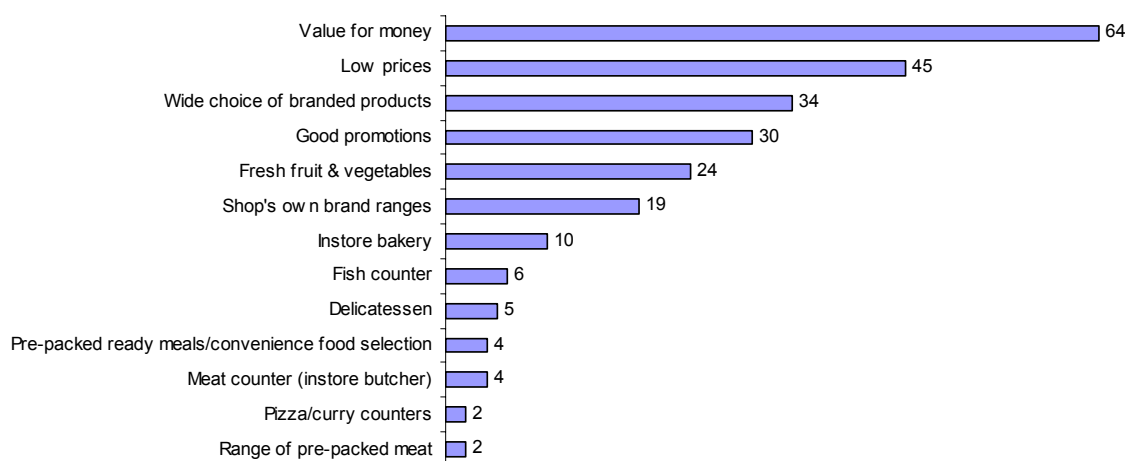
66. Each of the four largest grocery retailers sets its basic own-label prices as the lowest on display. [redacted] pointed out that own-label products offered suppliers a way to increase their sales volumes without investing in expensive branding.
67. The provision of own-label product lines was, we were told, also seen as leading to exclusionary behaviour from grocery retailers. Such retailers may find it optimal to reduce the presence on the shelves of branded goods which may reduce the sales of their branded products.

Evidence on stocking of own-label product lines

68. Some research indicates that consumers attach significant importance to own-label ranges in their choice of supermarket. This is shown in Figure 2.

FIGURE 2

Shopper reasons for choice of main supermarket



Source: IGD Consumer Research 2003.

69. We will consider further the possible anti-competitive effects that may derive from retailers stocking own-label products. In particular, we will analyse further the possibility of retailers having the incentive and the ability to foreclose access to their shelves to brands that may effectively compete with their own-brand ranges. We will seek to draw relevant information on these issues from a more detailed analysis of the data underlying the GfK report and we invite any interested parties to provide us with evidence of such behaviour and its harm to consumers.

Recommended retail prices

70. Resale price maintenance (RPM) is the practice by which suppliers directly or indirectly fix the retail price of their products. Both Article 81 of the EC Treaty and section 2(2) of the Competition Act 1998 refer explicitly to agreements, decisions or practices directly or indirectly fixing selling prices.¹⁹ However, some practices such as recommended retail prices (RRPs) and maximum price ceilings are permitted under certain circumstances (provided they do not amount to a fixed or minimum sale

¹⁹Both of these prohibit agreements, decisions of undertakings and concerted practices that prevent, restrict or distort competition.

price).²⁰ Recommended and maximum prices may lead to similar effects as with RPM.

Potential pro-competitive effects

71. RRP practices may offer a solution (however, not the only possible one) to the problem of double marginalization²¹ since the supplier can set (or indicate) the optimal retail price. The supplier can then set a wholesale price (or a two-part tariff if necessary) to divide the profit between the two parties. Thus the retailer and supplier can avoid making inefficient pricing decisions that may lead to higher retail prices.

Potential anti-competitive effects

72. Possible anti-competitive effects include a reduction in competition between retailers selling the same product. Where double marginalization is not a concern (for example, because the downstream market is very competitive), RRP strategies might be used to prevent downstream retailers engaging in price competition and hence preserve inflated retail price levels.

73. Retailers could also benefit from RRP strategies. If a supplier could monitor whether retailers adhere to a suggested price, it could help inducing some degree of coordinated behaviour among retailers. The increased profits arising from such collusive behaviour could in principle be split between the retailers and the supplier.

74. An alternative possible anti-competitive effect is that RRP strategies reduce competition between suppliers. If a supplier has the ability to control retailers' prices,

²⁰See 2790/99/EC Commission Regulation of 22 December 1999 on the Application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices.

²¹Consider a vertical chain where a monopolist supplier sells a good at a wholesale price to a monopolistic retailer who then resells it to consumers at a retail price. If the supplier has all the bargaining power, it will set a wholesale price to maximize its profits given the demand it faces from the retailer. The retailer will then choose the retail price given the wholesale price. In this setting, two firms with market power at different levels of the supply chain each impose a mark-up on the cost of producing the good (hence the term 'double marginalization'). It turns out that the resulting retail price is always higher than the price that would be charged by a firm that owned and controlled both stages of the supply chain.

then price variations will largely reflect a supplier's pricing decision. This increase in the transparency of the pricing decision makes it easier for suppliers to detect whether a change in the retail price of a competing product is due to the supplier of that product deviating from a tacit or explicit collusive agreement.

Evidence on RRP strategies

75. Most retailers report that RRPs are often circulated by suppliers. Branded suppliers in particular usually provide an RRP. However, all the leading retailers state that they set their own price; in particular, they can price below RRP.
76. The leading retailers submit that price-marked packaging is often required by necessity (for example, on newspapers). However, there is generally scope for deviation from such pre-printed prices. The marked price may create a price ceiling but, for example, Asda has reduced prices on such products, eg Breakaway biscuits. However, this can cause confusion and is likely to reduce the impact of the price cut.

Provisional assessment of competitive effects

77. If RRPs are used effectively to enforce certain retail prices then we would expect to see retailers abiding by those prices. The retailers' responses do not suggest that this is the case. The presence of significant price competition at a retail level may also indicate that suppliers are struggling to enforce retail prices. We will pursue these lines of inquiry further to assess any potential adverse effects of RRP and any other RPM-type strategies.