



Competition Competence Report 5/ 2005

## Importance of Buyer Power

Successful competing manufacturers of branded products gain significant market shares. Because of these high market shares, antitrust authorities might reach the conclusion that manufacturers of successful brands are dominant. However, a more comprehensive approach is required to assess dominance. If for example retailers possess buyer power, manufacturers of branded products do not have the possibility to act independently of their customers despite high market shares.

Already in 2002, the Swedish competition authority reached in a study the conclusion that retailers possess buyer power in Sweden. As first competition authority in Europe, the Swedish authority concluded that buyer power of retailers has increased significantly over the years.<sup>1</sup> Other competition authorities – like the Dutch<sup>2</sup> and the Austrian<sup>3</sup> – are currently investigating this phenomenon of increased buyer power too. The OECD<sup>4</sup> and the OFT<sup>5</sup> have conducted similar studies in the past. Thus, the economic assessment of buyer power in competition analysis is gaining importance.

### Definition of buyer power

The OECD defines buyer power as „a situation which exists when a firm or group of firms, either because it has a dominant position as a purchaser of

<sup>1</sup> Konkurrensverkets, Dagligvaruhandeln, Struktur, ägarform, och relation till leverantörer, Konkurrensverkets rapportserie, 2002:6.

<sup>2</sup> NMa Publishes White Paper on Procurement Power, 04-28 / 30-11-2004.

<sup>3</sup> „Sonderbericht Lebensmittelhandel (1. Teilbericht), „Die "Nachfragemacht" von Handelsketten/Filialketten des Lebensmitteleinzelhandels. "Marktmachtmissbrauch"?“ at:

<http://www.bwb.gv.at/BWB/Aktuell/leh1.htm>

<sup>4</sup> OECD, Buying power of multiproduct retailers, 1999.

<sup>5</sup> Dobson/ Waterson/ Chu, The welfare consequences of the exercise of buyer power, OFT Research Paper Nr. 16, 1998.

a product or service or because it has strategic or leverage advantages as a result of its size or other characteristics, is able to obtain from a supplier more favourable terms than those available to other buyers".<sup>6</sup> The definition shows that a dominant position is not required to prove the existence of buyer power. In fact, buyer power results from the ability of a purchaser to influence the terms and conditions of the purchase.<sup>7</sup> The purchaser has the capability to constrain the suppliers' scope of action.

The assessment of buyer power is essential in merger cases as well as in Article 81 or 82 cases. A thorough analysis is required to evaluate the competitive effects of buyer power. "Even firms with a high market share may not be in a position, post merger, to significantly impede effective competition, in particular by acting to an appreciable extent independently of their customers, if the latter possess countervailing buyer power."<sup>8</sup>

### **Competitive effects of buyer power**

Buyer power has considerable effects on the supplier as well as on the market. On the one hand, the existence of buyer power may lead to lower consumer prices; on the other hand, buyer power may result in financial losses for the supplier and may even facilitate brand erosion. Retailers with buyer power are quite keen to weaken strong brands in order to push their own brands (DOB-distributors own brand). This behaviour initiates a downwards spiral which in the end narrows the competitive and economic scope of suppliers' action considerably. Limited financial capabilities result in a reduction of product innovations. Therefore, buyer power can lead to a decrease in consumer welfare.<sup>9</sup> The following sections illustrate the various characteristics and economic consequences of buyer power in a more detailed way:

➤ Risk of brand ubiquity and financial losses

Often, large retailers represent an indispensable distribution channel for suppliers, which is not substitutable at all. If there are no other possibilities to sell to, a delisting causes serious (financial) problems. Regarding delisting, the European Commission assessed in a survey the critical percentage of suppliers' revenues with one retailer. If a

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<sup>6</sup> OECD, Buying Power: The exercise of market power by dominant buyers, Report of the Committee of Experts on Restrictive Practices, Paris, 1981.

<sup>7</sup> OECD, Buying power of multiproduct retailers, 1999.

<sup>8</sup> European Commission, Guidelines on the assessment of horizontal mergers on the Council Regulation on the control of concentrations between undertakings, 2004/C31/03.

<sup>9</sup> Konkurrensverkets, Dagligvaruhandeln, Struktur, ägarform, och relation till leverantörer, Konkurrensverkets rapportserie, 2002:6.

retailer has a share of 22 % in the suppliers' revenues, the business devoted to this retailer can only be replaced with large economic losses or is even not replaceable at all.<sup>10</sup> Below the 22% threshold, a loss of a retailer's business decides on the total profitability of the supplier. Profitability is a critical financial parameter which favours the suppliers' dependence on the retailers' business already at a lower percentage of revenues.

Besides suppliers' financial losses in case of a delisting, the ubiquity of the brand is at risk too. A consumer, who is not able to find "his" brand on the shelf, will rarely shop around just to buy "his" brand. In times of "One-stop-shopping", the ubiquity of the brand is of great importance for the supplier.

➤ Brand erosion

Retailers can introduce DOBs/private labels in order to push brand erosion. Their private labels compete directly with branded products. By contributing to the loss of significance of brands, retailers foster sales of their own DOBs. In addition, retailers can threaten to integrate upstream in order to enlarge their DOB production. Retailers use this warning to obtain more favourable conditions from the manufacturers of branded products. The study of the Swedish competition authority proves the tension resulting from these developments.<sup>11</sup>

Retailers can push brand erosion by buying and stocking lower-priced products during a promotion campaign of the brand manufacturer. Retailers sell these products either later at regular prices or continue to sell them right after the promotion campaign at lower prices.<sup>12</sup> In the former case, the manufacturer of brands is losing margin, in the latter it supports brand erosion, whereby the reputation and the perception of the identity of the brand in the eyes of the consumer is permanently disturbed. In the long term, the economic effects of frequently low-pricing actions by retailers are considerable. They lead, particularly in the case of branded products, to a modified perception by the consumer, which sets off the "chain of

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<sup>10</sup> Europäische Kommission, Rewe/Meinl, M.1221, 3.2.1999, Rn. 101.

<sup>11</sup> Konkurrenserverket, Dagligvaruhandeln, Struktur, ägarform, och relation till leverantörer, Konkurrenserverket rapportserie, 2002:6.

<sup>12</sup> Bell, David/Dreze, Xavier, Changing the channel: A better way to do trade promotions, MIT Sloan Management Review, 2002.

erosion". Studies have proved this brand erosion already.<sup>13</sup> Another interesting development is that national courts identified this risk of brand erosion and decided in favour of brand manufacturers. A manufacturer of brands is entitled to safeguard his brand in the case the brand is at risk to be eroded by the retailer. (Case Peijnenburg/Albert Heijn, 2005).

➤ Decrease of product innovations

Product innovations come almost exclusively from manufacturers of branded products. These innovations are extremely important for the preservation of a brand, because only through a continuous development of a brand its reputation can be maintained and extended. Incentives to investment, which have generally positive economic effects, are significantly weakened by the shifting of the balance of power between manufacturers of branded products and retailers. The effect of a decrease of product innovations would be a diminished offer as well as a generally poorer quality of products in the long-term.<sup>14</sup> That's why in the long term consumer welfare decreases.

## **EE&MC approach on analysing buyer power**

EE&MC examines the existence of buyer power within the scope of a competition analysis adapted to the affected market. EE&MC applies the following set of criteria to assess buyer power:

➤ Structure and concentration on the demand side

Buyer power is positive correlated to the degree of concentration on the demand side: if one or more firms are dominating the demand side, buyer power is more likely. Thus, the degree of concentration on the demand side has to be assessed. Market shares are a first indication. However, the use of concentration ratios (e.g. HHI) is recommended.

➤ Reliance of the suppliers on the retailers

Reliance on a retailer represents another factor that favours buyer power. Therefore EE&MC analyses if and to what extent the suppli-

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<sup>13</sup> Klante, Identifikations- und Erklärungsansätze für Markenerosion, Inauguraldissertation an der Handelsschule Leipzig, 2003. Mela/ Gupta/ Lehmann, The long-term impact of promotion and advertising on consumer brand choice, Journal of Marketing Research, May 1997.

<sup>14</sup> Konkurrensverkets, Dagligvaruhandeln, Struktur, ägarform, och relation till leverantörer, Konkurrensverkets rapportserie, 2002:6.

ers rely on a specific retailer. This analysis entails an evaluation of the switching opportunities of the suppliers (exports, others distribution channels, etc.). In addition, the effects resulting from delisting are quantified.

➤ Sufficiently switch-over facilities on part of the retail

Buyer power is facilitated by likely and feasible switch-over opportunities of the retail. If substitution is easy to achieve, existence and abuse of buyer power are more likely.

○ Operations of DOBs/private labels

Private labels constitute switch-over facilities for retailers. The prediction of private labels' success is determined by analysing consumer price sensibility.

○ Brand switching

In this context, the analysis of brand loyalty is an important issue. If brand loyalty is low, consumers switch between brands often. Thus, the ability to switch-over is substantial too.

○ Brand erosion

An analysis of brand erosion is required. In general, brand erosion favours buyer power. If brand awareness is eroded, brand switching is easier to achieve.

The analysis of the above mentioned criteria is performed by using econometric tools. These tools are quite common in marketing/ brand evaluations. The existence of buyer power is likely if all these criteria are positive.



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