

LEVELLING THE PLAYING FIELD

**COMPETITION POLICY TO ENABLE
INDEPENDENT RETAILER GROUPS TO
BE EFFICIENT AND COMPETITIVE**

by

Professor Paul Dobson

and

CRA International

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**Prepared on behalf of UGAL (Union of Groups of
Independent Retailers of Europe)**

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EXECUTIVE SUMMARY

Independent retailers face a challenging competitive environment, not least because of the growing presence and market power of integrated chain-store retailers. By being members of a group, though, they can pool resources and in principle benefit from economies of scale and scope sufficient to allow them to be efficient and effective competitors. However, this ability is presently restricted: not so much by their own ability or desires, but by legal impediments.

Specifically, national and EU competition policy and law currently restricts the behaviour and relations between members within such groups in ways that are fundamentally discriminatory compared to the freedom enjoyed by wholly integrated retailers. Independent retailer groups are, for example, limited in the control they can exercise over retail prices and promotions, store-level stocking/range decisions, and purchasing requirements of members, thereby affecting group efficiency and the consistency of retail image/offer presented to consumers. They are also subject to stringent market share thresholds, resulting in further restrictions on their behaviour and greater legal uncertainty over their agreements as they grow in size. These restrictions do not apply to fully integrated retailer groups that have been, with few exceptions, freely allowed to grow and increasingly dominate markets, often at the expense of independent retailers.

Independent retailers by their nature may suffer disadvantages over fully integrated store chains. However, at issue is public policy and law that can exacerbate these disadvantages – merely because of the form of association and agreements they use as a means of working together for a common good. Such policy discrimination if not appropriately addressed, may adversely impact retail markets and harm consumers' interests by reducing diversity and plurality in the retail sector, which has for so long been the mainstay and source of retail innovation, entrepreneurship and general competitive drive.

This report examines the extent of the problems and restrictions facing groups of independent retailers in relation to current competition policy and law through an economic study of the subject covering both empirical and analytical aspects. It considers objectively and critically the types of behaviour that should be allowed to groups of independent retailers in order for them to be efficient and be competitive and so best serve the interests of consumers. Attention is focused on four key areas:

- The treatment of horizontal (retailer to retailer) and vertical (central office to retail member) agreements when they jointly occur in mixed agreement structures

- Defining relevant economic markets and guidelines on what behaviours and agreements are acceptable if market shares exceed 30%
- The percentage and time limit on purchasing obligations when used in the specific context of independent retailer groups
- Fixing or limiting retail prices and the use of common prices for promotional purposes as part of joint commercialisation processes

We find that independent retail groups do not require special treatment and unduly favourable policies. They just need a level playing field, with requisite legal certainty over their arrangements, to allow them to achieve sufficient efficiency benefits and consistency in their marketing image to enable them to compete on effective terms. If they can obtain this, then there is a much greater prospect that procurement and retail markets across Europe will remain competitive to the definite and continuing advantage of consumers.

In order to allow independent retailer groups to compete on a (more) level playing field, our analysis leads us to make policy recommendations in the four key areas:

- The set of agreements used by independent retailer groups should be assessed on their collective and overall net economic effect (rather than assessed individually and in isolation from one another) and without regard to the specific legal form (e.g. horizontal or vertical) that specific agreements take
- Retail, procurement and wholesale markets should be appropriately defined in respect of their geographic and product/service scope, but even when critical market thresholds are exceeded, agreements (e.g. on maximum or recommended retail prices) should be allowed when they offer clear consumers benefits and provide independent retailers with pro-competitive and pro-efficiency benefits
- Joint purchasing arrangements (as horizontal agreements) and purchasing obligations (as vertical agreements) should be assessed on their merits and with regard to the nature and strength of the benefits offered, being allowed, even in an unrestricted form without percentage and time limits, where they do not distort or restrict competition to the ultimate detriment of consumers
- Allowing fixed retail prices as either vertical or horizontal agreements in independent retailer groups should be considered for short-term promotional purposes when they are indispensable in providing consumer benefits from advancing inter-group competition, ensuring consistent value-for-money propositions being offered, promoting efficiencies in respect of joint purchasing and joint commercialisation, and where there is no prospect of this engendering collusion to raise prices

REPORT OVERVIEW

1. Background to the Study

The position facing independent retailers in Europe has perhaps never been more challenging than at present. Right across Europe, independent retailers face intense competition from integrated chain-store retailers that are increasingly able to exert both considerable buying and selling power, and in the process consolidate their positions at the expense of independent retailers.

Yet, the difficult competitive environment facing independent retailers is not their only challenge. Public policy and recent legal decisions have undermined or at least not assisted the competitive position of independent retailers. Specifically, national and EU competition policy and law often discriminates against independent retailers because of their organisational and ownership form rather than anything fundamentally related to their competitive behaviour or the structure of the markets in which they operate.

This is particularly apparent in regard to the extent to which independent retailer groups are restricted in their behaviour and relations compared to the freedom enjoyed by wholly integrated retailers. Such groups form so that independent retailer members can take advantage of pooling resources and gaining economies of scale to make themselves more efficient and more effective as competitors. Yet, these groups of independent retailers are largely prevented from using common prices as a promotional tool (on the grounds that it amounts to fixed resale price maintenance – currently prohibited *per se* in the EU). They are also restricted and prohibited in the range and extent of the exclusive purchasing obligations that they can impose on their members (typically corresponding to no more than 80% and/or limited to 5 years).

In addition, there are specific national-level legal and policy aspects that pose a threat and further add to the general air of uncertainty facing independent retailers and their associations. These include the treatment of mixed horizontal/vertical agreements, possible restrictions on agreements when certain market share thresholds are exceeded, and future uncertainty over currently allowed arrangements.

These legal and political issues are all of considerable economic concern because they are serving to undermine the efficiency and competitive ability of independent retailers and thereby impede the competitive process. More broadly, at stake is a societal concern that

such policy discrimination, if not appropriately addressed, may ultimately reduce diversity and plurality in the retail sector, which has for so long been the mainstay and source of retail innovation, entrepreneurship and general competitive drive – and the loss of which would clearly be to the detriment of consumers.

Independent retailers by their nature may suffer disadvantages over fully integrated store chains. However, at issue is public policy and law that can exacerbate these disadvantages – merely because of the form of association and agreements they use as a means of working together for a common good.

This report sets out to examine the extent of the problems and restrictions facing groups of independent retailers in relation to current competition policy and law through an economic study of the subject covering both empirical and analytical aspects. The intention of the present report is to consider objectively and critically the types of behaviour that should be allowed to groups of independent retailers in order for them to be efficient and be competitive and so best serve the interests of consumers.

2. Economic Importance of Independent Retailer Groups

Independent retailer groups vary considerably in their size from one country to another, and from one retail sector to another. In some countries, they represent a very significant competitive force (e.g. ICA in Sweden, Kesko in Finland, and Edeka in Germany) by virtue of their relative and/or absolute size. In other countries, they represent less substantial, though nevertheless still economically important, forces.

Yet in all cases, the important economic role played by independent retailer groups is very apparent in several critical respects. Specifically, independent retailer groups and their members collectively support and promote the following economically desirable features:

- Efficiency – in the provision of retail services and in co-ordinating the supply chain to meet consumer demand and expectations via scale economies from pooling resources
- Innovation – via experimentation and entrepreneurship with retail and support services
- Diffusion – as a channel for spreading new products for the benefit of consumers and as adopters of best-practice techniques and services in retailing and supply chain organisation
- Competition – as a challenge to the increasing dominance of integrated chains, uniquely offering *inter*-group competition (i.e. amongst competing supply systems) and

a degree of *intra*-group competition (e.g. amongst members competing in the same local retail market)

- Diversity – as organisational forms uniquely adaptive to the needs of different communities and localities rather following a rigid national model such as that of a fully integrated chain-store operator, while allowing independent retail entrepreneurs to thrive through access to an efficient supply and retail support system where otherwise as unaffiliated independents they would less certain to survive
- Consumer choice – by being flexible to local needs and serving locations where other retail forms might avoid (such as remote rural areas and socially deprived urban areas)

By their very nature and reason for formation, groups of independent retailers are intended to be pro-efficiency and pro-competitive forces. They involve independent retailers using their collective resources and market presence to build scale economies (e.g. in marketing, procurement, and central services such as training, store planning and visual merchandising) that allow them to operate more efficiently on an individual level. By being more efficient on an individual level, then the independent retailers are better able to compete with other players in their respective local markets. This helps ensure that all retailers (whether independents or integrated chains) are forced to pass on their efficiency benefits to consumers in the form of lower prices and better service levels, and that consumers continue to enjoy choice and diversity from a range of outlet types and the different retail propositions that they have to offer.

Accordingly, the economic well-being and competitive ability of such groups and their individual members take on both considerable economic and social importance.

3. Competitive Challenge Facing Independent Retailer Groups

Independent retailer groups have no scope for complacency in today's rapidly evolving retail environment. They are driven by competitive pressures to improve efficiency and the attractiveness of their retail offer to consumers. This is a challenge that they are generally well placed to meet, so long as they are not handicapped in their ability to compete on like-for-like terms.

However, such groups face an ever-increasing threat from the growing dominance of fully integrated chains in the markets in which they operate. This increasing dominance, and thus

major competitive challenge for independent retailers, can be attributed to a number of factors. Central to these are the benefits derived from the complete vertical and horizontal control that are afforded to fully integrated retailers. It is this aspect, for example, which allows integrated retailers to take full advantage of available economies of scale at store and group level to reduce costs, obtain more favourable terms from buyers, and increase throughput and efficiency within their supply systems. It also key to their marketing advantages, by allowing them to develop and promote a common retail brand, providing consumers reassurance about the consistency of the offer being made such as through common promotional prices, common products and common service levels adopted throughout the store chain.

Taken together, the scale economies and retail brand advantages that integrated retailers enjoy allow them increasingly to take advantage of a “virtuous circle” of growth, where such advantages allow for increased income generation (from increased profitability), that in turn allows for more growth-enhancing investments (such as improving the store portfolio, developing new product lines, increasing marketing effort, and acquiring rival chains), serving to increase market share, feeding through to improved terms with suppliers (vis-à-vis other retailers), allowing for lower costs and greater income generation (from higher margins), and so on.

Of course, it may be possible for independent retailer groups themselves to enter a virtuous circle of growth, so long as they are sufficiently large and have enough scale in the first place. In which case, the prospective benefit for consumers is not only of efficiency benefits entailing lower costs for retail members (e.g. in purchasing products from suppliers) being passed on to them in the form of lower retail prices when *inter*-group competition prevails, but also these benefits are more likely to be secured because general competition will be often augmented by a degree of *intra*-group competition (i.e. where affiliated members compete amongst themselves at the retail level) in a way that would be wholly absent if only integrated chains were present.

Nevertheless, it is integrated chains that are more often in a better position to take advantage of the virtuous circle because of the manner in which they are allowed to co-ordinate their activities in regard to joint procurement and common marketing across their entire chain, compared to the legal restrictions imposed on independent retailer groups limiting this ability. This, together with the generally favourable competition policy towards retail mergers and internationalisation of fully integrated groups, has allowed them to gain a critical advantage over independent retailer groups in many retail markets.

4. Legal hurdles and discriminatory policy treatment

Unlike integrated chains that are completely free to co-ordinate all their activities within their store groups, independent retailer groups are held back by a number of legal restraints and policies in several critical regards. Specifically, because they are members of a group that are linked together by agreements (either explicitly or implicitly), rather than by common ownership as with an integrated chain, they are treated differently under competition law and presently they are subject to rules that limit the nature and extent of any centrally administered control on individual members. Fundamentally, this is about discrimination based on organisational form rather than an economic basis about effects on the market, which serves against groups of retailers that for historical, cultural and commercial reasons work together by means of agreements rather than by direct, single ownership.

The discriminatory legal treatment in regard to permitted vertical and horizontal control is most apparent with regard to limits on essentially pro-competitive agreements on joint marketing and joint purchasing, but more broadly about the legal treatment given to organisations based on a mixture of horizontal and vertical agreements.

Thus, unlike a wholly integrated retailer under single ownership, an independent retailer group's central office (i.e. central administrative function) or wholesale arm cannot dictate the exact or minimum retail price at which goods must be sold throughout the group's stores. Such arrangements are viewed as (fixed or minimum) resale price maintenance and contractually unenforceable under present EU competition law and are viewed as illegal vertical price fixing (and, if used, could result in a substantial fine in most EU member states). Even imposing "retail price ceilings" on members, i.e. dictating the maximum resale price, may not be acceptable practice if the group possesses a high market share (specifically, 30% or more), even when the intention is to ensure that members keep prices low to raise sales levels and benefit final consumers in the process. In such cases, independent retailer groups can be hampered in building consistent retail brands of value to consumers.

Similarly, in regard to joint purchasing, whereas an integrated chain can centrally determine and administer all stocking requirements for all stores in the chain, a central office or wholesale operation for a group of independent retailers is generally restricted and prohibited in the range and extent of purchasing obligations that can be applied to members. It also has little or no control over which products and in what amounts the individual retailer ultimately

chooses to stock from the range on offer. Typically, the allowable limits for purchasing obligations only extend to 80% of goods purchased and for a duration limit of up to 5 years. Such restrictions can result in a loss of efficiency, undermine scale economies in purchasing, and unnecessarily complicate administration and contracting arrangements (thereby raising costs while serving as a business distraction).

On both accounts, the limitations on vertical control (i.e. on retail pricing and purchasing obligations) restrict the efficiency at which independent retailer groups can operate, weakening the ability of independent retailers to act as a critical competitive force and as a counterbalance to the market power of integrated chains, and as a result work against the interests of consumers in ensuring low prices, wide choice and service variety.

However, it is not just simply in relation to vertical agreement regulations that independent retailer groups are hampered and effectively discriminated against compared to the favourable legal treatment offered to integrated chains. The very nature of retailer associations with co-ordination through a central office or wholesale operation implies that within group relations could have both a vertical element (i.e. central office to retailer) as well as a horizontal element (i.e. retailer to retailer in respect of shared benefits). Unfortunately, rather than assessing such arrangements as a whole package, there has been a tendency for competition authorities to view such arrangements as first and foremost as being horizontal (i.e. co-operative) in nature but controlled by a vertical relationship (with the central office as the essential facilitator and co-ordinator). Given the much tighter rules and regulations that generally apply to horizontal co-operative agreements, with concerns over cartelisation and competition avoidance, this has meant that independent retailer groups have been subject to considerably more stringent limits on their size (in respect of allowable market share) and activities (in respect of vertical control) than they would be as simple vertical agreements.

Thus, for instance, a group of independent retailers may be allowed to operate relatively unimpeded only if its (collective) market share is no greater than 15% (as a horizontal agreement), even though its very nature is about promoting efficiency amongst independent retailers to allow them to be more effective competitors – against integrated chains, other retail forms, and amongst themselves. Yet this market share threshold may act as a bar to the level of efficiency that the group can attain – for example in the extent to which it can negotiate discounts from suppliers that can then be passed on to consumers in the form of lower retail prices. In contrast, integrated chains may face no restriction in how much they are allowed to grow, at least through organic growth. Only in respect of mergers and acquisitions might restrictions be imposed, and even here the allowable threshold before

being prohibited might be as high as a 40% share (i.e. the level at which EU case law has tended to view a firm as holding a dominant position in a market).

A market share threshold set at 15% (or indeed 10% or 20% as may apply in some jurisdictions) is both arbitrary and considerably below the level at which anti-competitive concerns are normally raised in relation to vertical restraints (i.e. generally taken as 30% in the context of the European Commission's guidelines on vertical restraints). The market context should take precedence. In situations where integrated chains have significantly higher shares than this threshold, then the competitive ability of the group will be stifled by this restriction (as it will be at a competitive disadvantage compared to these rival groups in respect of negotiating with suppliers and drawing on scale economies). Even when an independent retailer group represents the largest collective body in the market, consideration should be given to the basis on which the group has developed – primarily as a means to secure improved terms with suppliers and as a means of operating with a consistent marketing image. Such means offer direct benefits to consumers when lower purchase costs are translated into lower retail prices and when consistency in marketing provides greater assurance on service reliability and thereby increases consumer satisfaction and overall demand.

More fundamentally, a mixed arrangement of vertical and horizontal relationships should be seen and assessed exactly as that – i.e. a mixed arrangement on which the net economic effect of the combination should be the prime consideration for assessment. Specifically, horizontal elements should neither be viewed in isolation nor taking precedence over vertical elements. Rather, they should be viewed together as an intrinsic package in the makeup of independent retailer groups. In this respect, it needs to be understood that specific vertical agreements may allay any horizontal cooperation concerns, and vice versa, to provide overall pro-competitive outcomes through improving efficiency and competitive positioning.

5. Need for a Level Playing Field

Providing appropriate and clear policies that support or at least do not hinder arrangements for independent retailer groups should not be seen as merely ensuring that diversity or variety of organisational forms is maintained but, much more crucially, that the long-term health and vitality of retail competition is preserved and preferably enhanced.

Unfortunately, as existing competition law hinders such arrangements – either directly by limiting the extent of arrangements or indirectly by causing legal uncertainty as to whether related practices will or will not be allowed. The current framework of legal treatment for independent retailer groups according to their horizontal (i.e. co-operative) and vertical (i.e. trading) nature is therefore (perhaps unwittingly) retarding the efficiency and competitive ability of independent retailers and thereby the competitive process as a whole. This is made all the more problematic by the need for self-assessment by groups in the absence of clear rules and guidelines, providing considerable legal uncertainty over what are usually a complex set of agreements in complicated market settings (often requiring markets to be defined on retailing, procurement and wholesaling bases).

The present discrimination operating against independent retailer groups, compared to the freedom enjoyed by integrated chains, represents a perverse handicap system, whereby those players already at a competitive disadvantage because of their organisational form are handicapped in a way that limits their ability to compete with integrated chains and even stay in business.

Here, it is important to observe that a call for ending or at least limiting such policy discrimination is not about protecting competitors, but rather about protecting competition by ensuring a more even playing field that provides greater opportunity for competition to operate in a manner that can best ensure that consumers are well served by retail markets.

What is required is a suitable change in policy treatment based on recognition of the ways in which current policy is acting to discriminate against such organizations and undermine their efficiency and competitive ability. This does not entail action that is intended to provide independent retailers with undue favourable treatment, allowing them to gain an unfair advantage over integrated chains and other retail forms. Rather, it is concerned with redressing the current imbalance in respective treatment and allowable practices by integrated chains and other forms (notably franchise systems) compared to independent retailers operating as members of a (vertically and/or horizontally controlled) buying and/or marketing group.

6. Specific policy concerns

The report concludes with suggestions for specific policy consideration in four critical areas to allow independent retailer groups to compete on a (more) level playing field with wholly integrated chains and other retail organizations that are not subject to the same binding

restrictions on their horizontal and vertical arrangements. In each of these areas, the consideration is with regard to the context in which the arrangements operate, the efficiency and pro-competitive benefits that can be realised, and the resulting consumer benefits:

A. The treatment of mixed agreement structures

Some groups of independent retailers operate with what can be called a “mixed structure” of agreements, involving elements which are both horizontal (retailer to retailer) and vertical (central office to retail member) in nature. In this situation there is the strong possibility that competition authorities might adopt different interpretations into the nature of these agreements without taking full consideration of their purpose and economic effects. Thus, it is entirely possible that pro-competitive vertical arrangements might be misinterpreted as anti-competitive horizontal agreements, and equally pro-competitive horizontal agreements might be misinterpreted as anti-competitive vertical agreements. This creates the distinct possibility that pro-competitive agreements could be prohibited or that, with legal uncertainty hanging over the arrangements, groups could be deterred from using them.

Consequently, it is important that such uncertainties in legal interpretations, which may seriously handicap groups of independent retailers, are eliminated or least curbed. More specifically, it is necessary to ensure that:

- The purpose and economic role of agreements takes precedence over their legal form in respect of how they are viewed and treated;
- The “double-hurdle” sequential analysis advanced under EU policy and guidelines, in considering first horizontal and then second vertical agreements, should not be used as means to lessen the possibility of groups being allowed to use pro-competitive agreements when these are directed primarily at controlling co-ordination problem undermining group efficiency or competitive positioning;
- In regard to using market share threshold tests, an examination of the horizontal aspects of agreements should not automatically lead to a ban on behaviour that is allowed in the context of vertical agreements (e.g. where market share thresholds are exceeded in a horizontal assessment but not in a vertical assessment);
- Behaviour that is consistent with the improved functioning and efficiency of a group should be assessed on its merits rather than on an assumption that because of its form it is necessarily anti-competitive (e.g. exchanges of information between members to improve the responsiveness of retailers in response to inter-group competition may not amount to anti-competitive horizontal behaviour when inter-group competition takes on

greater significance than intra-group competition in ensuring that consumers benefit from effective competition);

- Authorities should, where possible, assess mixed agreement structures on a full effects basis (rather than the present sequential dual-effects basis) to examine whether the associated cooperative agreements offer efficiency benefits to group members while not distorting, restricting, or preventing supplier and retailer competition to the detriment of consumers – taking the view that if there is no net detrimental effect on either side of the market then all horizontal and vertical control agreements should be allowable (i.e. using as a benchmark the practices that would be used by a single-owned vertical-integrated business undertaking in the same market circumstances).

B. Market definition and guidelines when market shares exceed 30%

With market shares playing a very prominent role in the assessment of horizontal and vertical agreements, market definition takes on special importance. The extent to which practices may or may not be allowed is made all the more complicated by procurement markets differing from retail markets in both the product/service dimension and geographic dimension. Moreover, definitions may be influenced by ongoing changes in the retail environment. In particular, such developments would suggest taking into account the following policy considerations:

- In regard to defining procurement markets, consideration should be given to the extent to which procurements are becoming international rather than simply national in nature, by virtue of the amount of cross-border trade and international sourcing activity taking place;
- In regards to defining retail markets, only where there are very clear differences in market behaviour between different retailer types (e.g. in prices and product ranges) and consumer shopping patterns (e.g. bulk vs. small purchases, commercial vs. private purchases, etc.) should a narrow product/service definition be used;
- Even when critical market share thresholds are exceeded, agreements should be allowed where the benefits for consumers are clearly evident and potentially measurable (e.g. allowing maximum resale prices on advertised, staple and private label items when it is clear that this practice is being undertaken to lower retail prices and enhance the competitive position and retail image of a grouping);
- When critical market share thresholds are exceeded then rather than outright prohibiting an agreement where there may be some anti-competitive concerns, authorities should consider allowing modified agreements (with less extensive coverage or less onerous requirements) that allay anti-competitive concerns (e.g. by

reducing the chance of foreclosure effects), but which still allow for significant efficiency benefits to be achieved (for example, allowing purchasing obligations to groups that exceed the 30% market share threshold so long as the total purchase requirements only reflect a foreclosure of an equivalent share of the total market at a specific level, say a maximum of 30% of the market).

C. Joint purchasing and non-compete obligations

In order to allow independent retailer groups to compete on an equal footing with integrated chains and ensure that policy is non-discriminatory and does not unduly impede efficiency, the following considerations towards joint purchasing (essentially as horizontal agreements) and non-compete obligations (essentially as vertical agreements) appear warranted:

- Independent retailer groups should be able to operate joint purchasing arrangements (as horizontal agreements) when their combined market share exceeds 15% so long as this is required in order to be competitive with other, larger groups of retailers operating in the same markets, and so long as competition in the relevant procurement and retail markets is not thereby distorted or restricted to the ultimate detriment of consumers;
- Purchasing obligations (as vertical agreements) should be seen as acceptable ancillary restraints, when they are linked to the principal objective of the commercialisation under a common brand name and/or are essential for ensuring that benefits from joint purchasing can be fully realised and when this result in consumers receiving tangible benefits (e.g. lower prices);
- The percentage and time limit on purchasing obligations (as non-compete obligations) should be removed when used in the specific context of independent retailer groups so long as this does not distort or restrict supplier competition or reduce effective competition in procurement markets to the ultimate detriment of consumers;
- For common marketing activities by the group, it should be possible to (a) oblige the retailers to order and keep in stock certain core product ranges in quantities appropriate to their regional market; and (b) to participate in advertising campaigns organised centrally by the groups, and usually to take part in campaigns that are national or international (e.g. within the “Euro zone”) with an obligation to charge a fixed common price so long as the promotions are short term (e.g. a two-week duration) and designed to provide clear consumer benefits (e.g. introducing a new or improved product or offering a low price).

D. Joint marketing and retail pricing requirements

In regard to joint marketing and the setting of retail prices, the analysis suggests the following policy considerations:

- Competition authorities should consider allowing commonly set prices (i.e. fixed retail prices that apply across all or some retail members) within *vertical* agreements of groups of independent retailers for a limited number of short-term marketing campaigns based on a limited part of the product assortment (e.g. on private label goods, key brands, and known value items) when they are indispensable in developing and promoting a consistent group image, providing consumers with reassurance and clarity about the value-for-money proposition being offered, advancing inter-group competition while providing efficiencies (e.g. removing duplicated effort in otherwise running separate advertising/marketing campaigns for price promotions).
- Fixed prices should be allowed as indispensable in *horizontal* agreements when they promote efficiencies in respect of joint purchasing (by improving the bargaining position of the group when producers are desiring retail promotions that expose their products widely to consumers) and joint commercialisation (by providing a consistent retail brand image), which cannot be achieved by maximum price obligations or other restraints alone, and when they relate to a limited number of short-term marketing campaigns, over limited product ranges, and where there is no prospect of this engendering collusion to raise prices amongst retail members or in retail markets more generally.

1. INTRODUCTION

This introductory section of the report sets out the background to the present study examining how competition policy can discriminate between different forms of retail groups based on their organisational and ownership structures. It examines the implications that this has on the competitiveness and efficiency of retail groups and subsequent retail market development. In particular, it considers the advantages that are conferred on fully integrated retail groups compared to independent retailer groups that are subjected to legal impediments on their behaviour and thus the potential for retail competition to be distorted. The section ends by outlining the structure and organisation of the rest of the report.

1.A Background to the present study

- 1.1 The position facing independent retailers in Europe has perhaps never been more challenging than at present. Right across Europe, independent retailers face growing competition from vertically integrated chain-store retailers that are increasingly able to exert both considerable buying and selling power.¹ In many instances, integrated chains have been able to use their size and organisational advantages to gain buying and other cost advantages over independent retailers while at the same time exercising their selling power through carefully selected pricing, merchandising and marketing strategies across their stores with the effect of undermining the positions of independent retailers and other smaller competitors. Such strategies are having a considerable impact on retail markets as integrated chain stores continue to consolidate their positions at the expense of independent retailers in many European countries.² The upshot is that a very considerable number of independent retailers have already exited the market in many European Union (“EU”) member states and far more look set to in the coming years if the dominance of the major integrated chains continues unchecked.
- 1.2 Yet, the difficult competitive environment facing independent retailers is not their only challenge. Public policy and recent legal decisions have also in several instances undermined or at least not assisted the competitive position of independent retailers when, as a response to competitive pressures, they have become members of a group seeking to provide them with joint buying, logistics and marketing benefits. This applies to independent retailers as

¹ For instance, see Roger Clarke, Stephen Davies, Paul Dobson and Michael Waterson, *Buyer Power and Competition in European Food Retailing*, 2002 (Edward Elgar Publishing Limited).

² On the rate of increasing retailer concentration across Europe, see Paul Dobson, Michael Waterson and Stephen Davies, “The Patterns and Implications of Increasing Concentration in European Food Retailing”, *Journal of Agricultural Economics*, Vol. 54 (1), pp. 111-126, March 2003.

members of voluntary associations³, symbol groups⁴, retail co-operatives⁵, retail franchises^{6 7}, and straightforward buying groups (which act on behalf of members simply in regard to buying) – where common to each form are contractual relations in lieu of single ownership.⁸

³ Voluntary groups are often wholesaler-led associations whereby independent and smaller multiple retailers become voluntary members (not tied by ownership links, long-term franchises or other long-term contractual relations). These groups might provide different functions to different members. For example, the Nisa/Today's group in the UK supplies and negotiates on behalf of stores (mostly in the convenience sector) that carry the "Nisa" brand name as well as for other groups and small multiples operating under their own fascia, including Budgens, Booths, Londis and Costcutter.

⁴ ACNielsen, *The Retail Pocket Book 2006* (World Advertising Research Center Ltd) defines a symbol group, under the banner of a single group name, as an organisation of independent retailers who buy supplies through a specific wholesaler which are then delivered direct to the store, which in return for buying and marketing benefits the independent retailer gives a percentage of its takings and a fixed amount to the symbol group. Symbol groups exist in a wide range of retail sectors including grocery (e.g. Spar), sports goods (e.g. Intersport), florists (e.g. Interflora), toys (e.g. Toymaster), and electrical goods (e.g. Interfunk/Euronics).

⁵ Co-operatives can take several forms. Most pertinent in the present setting are retail co-operatives where retail operations are separately owned (as typical in many EU countries) but coordinate their buying to seek discounts from bulk buying. Alternative forms are where stores are owned and operated by a (non-for-profit) co-operative society, such as the consumer co-operatives in the UK.

⁶ Retail franchises normally refer to "business format franchises" (as opposed to a "wholesaler-retailer franchise", as might be used to describe a symbol group like Spar). Here, the franchisor grants permission for the franchisee (the independent retailer) to sell its products or services. The franchisor also provides a proven method of trading, plus support and advice in setting up and operating the business (e.g. Benetton, Body Shop and Burger King). While a more recent phenomenon than other independent retailer association forms, franchising has often been viewed as a special case and generally received more favourable policy treatment than these other association forms. Even so, franchisors are limited in the extent to which they can exercise complete control over franchisees. Thus, while a franchisor may be able to impose certain restrictions on a franchisee to protect property rights and ensure necessary investments are made, it cannot legally tie the purchase of inputs to use of the franchise. Equally, while the franchisor may specify the quality of inputs to be used, a franchisee must be free to buy from a third party that can meet the specific standards of the inputs. Also, a franchisor cannot legally determine the prices set by the franchisee, nor impose territorial restrictions that would have the effect of segmenting the EU into isolated national or regional markets.

⁷ As well as business format franchises (as described in the previous note), retail franchises may be defined to include manufacturer "dealerships", whereby a manufacturer grants an independent agent a franchise to retail its goods in a particular geographic area (e.g. a country or region) or to a particular class of customers (e.g. business customers vs. the general public). This is common, for example, in the car sector where specific competition policy and block exemption rules apply to selective and exclusive distribution arrangements involved in car supply and distribution in the European Union. However, we leave aside discussion of such sector-specific arrangements in this report and instead focus our attention on situations where there are a mix of organisational forms where differences in the legal and policy treatment applied to one set of retail groups (i.e. independent retailer groups) differs in an appreciable way from another set of groups (i.e. fully integrated chains) as may apply to most conventional retail markets.

⁸ While the common element is the presence of independent retailers, ownership forms can vary significantly across groups. Thus, for example, it is possible for a relationship to exist where ownership is completely independent between a wholesale function and individual retailers (i.e. in both a vertical and horizontal sense; e.g. as with a loose buying group or voluntary chain). In other cases, the retailers may be separately owned but they jointly own the wholesale operation (e.g. as applied to Kesko in Finland before it became a public-quoted company). In yet other cases, it may be the wholesale operation that owns the stores operated by independent retail entrepreneurs (e.g. the partially integrated model of ICA in Sweden). Alternatively, there may be tapered integration, where for example the wholesale operation owns and manages some stores (as a multiple retailer) but also supplies independent retailers (e.g. Musgrave's wholesale operation in the UK following its acquisition of Budgens' retail group). The key point to note is that there is a very rich diversity of association forms, each explained by its historical development and the market, social and cultural context.

- 1.3 Here, the political and legal environments faced by such independent retailer groups pose considerable uncertainty for them and play to the advantage of their fully integrated rivals. This is in large part because of the way that national and EU competition policy and law often discriminates against independent retailer groups because of their organisational and ownership form rather than anything fundamentally related to their competitive behaviour or the structure of the markets in which they operate.
- 1.4 Thus, for example, whereas wholly integrated chains are free to set common prices across their stores as a promotional tool, independent retailer groups (involving contractual rather than ownership links between retailers and a central office or wholesale function) are prevented from adopting this behaviour (on the grounds that it amounts to fixed resale price maintenance – currently prohibited *per se* in the EU). Similarly, whereby integrated chains can dictate that all their stores make their purchases centrally, associations of retailers are restricted in the range and extent of the exclusive purchasing obligations that they can impose on their members (typically corresponding to no more than 80% and/or limited to 5 years). In both instances, and others as well, such behaviour (if instead permitted) may be economically justified on the basis of securing competitive positions that facilitate increased competition and offer cost efficiencies that would otherwise not be available.
- 1.5 Such discrimination generally applies across the EU. However, at the national level there are a range of specific political and legal aspects that appear to pose a threat and further add to the general air of uncertainty facing independent retailers and their associations. The following examples are indicative:
- In Sweden, the mixed structures of groups of independent retailers (with both horizontal and vertical agreements), have proven problematic in terms of differentiating between the two required analyses, which has resulted in the authorities not permitting certain behaviours (including pricing arrangements) that are authorised in the framework of vertical agreements (since horizontal agreements are adjudged prior to consideration of vertical agreements).
 - In France, the DGCCRF (Direction Générale de la Concurrence, de la Consommation et de la Répression des Fraudes) has indicated that relationships that involve a large number of vertical agreements may be treated in the context of mergers or concentrations.
 - In Finland and Sweden, where independent retailers have (almost uniquely) managed to remain the key competitive force in retail markets, the positions of their associations

are under scrutiny by the national competition authorities and current legislation provides few clear answers as to what behaviour and what types of agreements would be authorised when the market share threshold of 30% is exceeded.

- In Germany, the authorities unofficially allow certain behaviours (like purchasing obligations and fixed pricing during promotions) but could at any time put into question the legality of these agreements (following entry into force of EC Regulation 1/2003).
- In Ireland and France, the legal protection afforded to small and independent retailers from below cost selling by the major multiple retailers has ended, respectively with the rescinding of the Groceries Order in Ireland and amendments to the *Loi Galland* in France, opening up the danger that multiple retailers might (surreptitiously) seek to use predatory pricing to eliminate competitors.
- In the UK, and despite widespread calls over the past several years, the authorities have been slow to initiate a formal investigation into the convenience store sector, where many independent retailers operate, even though large integrated retailers have rapidly consolidated the sector through mergers and acquisitions and are able to exercise anti-competitive pricing behaviour in the form of local price flexing combined with below cost selling to undermine the viability of the remaining smaller retailers (i.e. those that not already been forced out of the market in recent years).⁹

1.6 These legal and political issues are all of considerable economic concern because they are serving to undermine the efficiency of independent retailers and in the process hand over or at least extend competitive advantage, and thereby market power, to integrated chains. This, in turn, may undermine not only the positions of independent retailers but also of competition more generally. Specifically, increased power for the integrated retail chains may offer consumers some short-term benefits, where price competition has been intensified to the point that retailers have resorted to using below-cost selling on many products either as a tactical strategy to undermine competition or as the only means of (short-term) survival. Yet, in the longer term, there are very reasonable concerns about greatly consolidated markets where consumers face considerably reduced retail choice and where large integrated retailers can ultimately exploit their market power through raising pricing to the detriment of consumers (once effective competition has been eliminated). More broadly, at stake is a societal concern that a lack of diversity and plurality in the retail sector, which has for so long been the mainstay and source of retail innovation, entrepreneurship and general competitive drive, may

⁹ Now, though, and only after very long and protracted process, has the UK's Office of Fair Trading has referred the retail grocery sector (including supermarkets and convenience stores) to the UK's Competition Commission for a full-scale investigation.

detract from the current vibrant state of most retail markets and impede future development, thereby harming economic prosperity for that sector, and by association the economy at large.

- 1.7 Accordingly, the resilience of independent retailers and their ability to compete on effective terms with integrated chains appears crucial for ensuring that economic welfare is maintained. Independent retailers by their nature may suffer disadvantages over integrated chains. However, it is essential that public policy and law does not exacerbate these disadvantages merely because of the form of association and agreements they use as a means of working together for a common good.
- 1.8 To determine the full extent of the problems and restrictions facing independent retailer groups in relation to current competition policy and law, UGAL (Union of Groups of Independent Retailers of Europe), representing the main groups of independent retailers across Europe¹⁰, has commissioned Professor Paul Dobson of Loughborough University in association with CRA International (“CRA”), an economics, business and finance consultancy with particular expertise in the field of competition economics, to conduct an economic study of the subject covering both empirical and analytical aspects.
- 1.9 The empirical part of the study is intended to gather the necessary information in order to determine the precise nature of existing independent retailer groups’ activities and agreements as well as the economic context in which they are applied. To this end, a questionnaire study has been undertaken and administered by CRA International to gather primary-sourced data from retailer associations. At relevant parts of the main report, details of this study are summarised. Full details of the questionnaire study are contained in the three appendices attached to this report. These separately provide details of the questionnaire, the means by which the study was undertaken, and a full review of our findings.
- 1.10 The analytical and core part of the study builds on the information and understanding from the questionnaire study, along with other data and information obtained from direct interviews with individual retailer associations and secondary-sourced (i.e. desk-based) information. The specific aim of the analytical part of the study is to consider objectively and critically the types of behaviour that should be allowed to groups of independent retailers in order for them

¹⁰ Established in 1963, UGAL (L'Union des groupements de détaillants indépendants de l'Europe) is the European association that acts as an umbrella organisation for the main groups of independent retailers in the food and non-food sectors. Currently, UGAL represents about 33 groups and associations of groups in Europe gathering together more than 323,000 independent retailers and craftsmen who realise a retail turnover of more than €496 billion and manage more than 456,000 sales outlets. These groups represent a total employment to some 3,477,000 people and realise a wholesale turnover of more than €222 billion.

to be efficient and be competitive. While the report covers a wide range of issues, four key areas receive particular attention:

- First, the separate treatment of horizontal and vertical agreements when they jointly occur in mixed agreement structures (with concerns about pro-competitive vertical arrangements being misinterpreted as anti-competitive horizontal agreements, and equally pro-competitive horizontal agreements being misinterpreted as anti-competitive vertical agreements)
- Second, defining relevant economic markets and guidelines on what behaviours and agreements (e.g. on setting maximum or recommended resale prices) are acceptable if market shares exceed 30%
- Third, removing the percentage and time limit on purchasing obligations (as non-compete obligations) when used in the specific context of independent retailer groups
- Fourth, fixing or limiting retail prices and the use of common prices for promotional purposes as part of joint commercialisation processes

1.11 With this background in mind, we move on in this introductory section of the report to consider the central aspects of developments in retail markets, looking specifically at market concentration and the growing dominance of integrated retail chains, the competitive challenge facing independent retailers, the economic and social advantages of independent retailer groups, the legal obstacles hindering independent retailer groups, and the corresponding critical areas for policy review. The final sub-section details the structure of the remainder of the report.

1.B Market concentration and growing dominance of integrated retail chains

1.12 Retailing is big business in Europe. The retail sector in the European Union (“EU”) consists of some 3.3 million retail establishments, generating annual sales in excess of €1.9 trillion, creating more than €350 billion in value-added, and employing some 15.5 million people (representing almost 10% of all employment in the EU).¹¹ As a sector that affects the lives of

¹¹ Eurostat, “Retail trade in the European Union”, European Communities, 2006.

all citizens, accounting for a third of all consumer spending,¹² its performance takes on significant social as well as economic importance.

1.13 While it remains the case that the number of small, independent retailers is large, over the past couple of decades this number has declined significantly as retail markets have become steadily more concentrated with the emergence and continual growth of very large integrated chains.¹³ Many of these chains are extremely large, having extensive national and even multi-national presence. The world's largest company, Wal-Mart Stores, may be an extreme case, employing 1.6 million people and with global sales of \$312 billion, but it is not alone in possessing a commanding presence in the markets in which it operates. Each of the world's top twenty retailers has an annual turnover in excess of \$35 billion, while sales for the world's top 250 retailers totalled \$2.84 trillion in 2004.¹⁴ In many developed countries, and across retail sectors, it is often just a handful of very large multiple chain groups that jointly control most sales. With the rise of these chains, retail markets have become increasingly concentrated. For example, in grocery retailing (which represents the largest retail sector, making up 40% of all retail sales), the top five retailers on average account for half of all grocery sales across the different member states of the European Union.¹⁵

1.14 Several economic and social factors have driven this move towards concentration. Perhaps most notable amongst these are:

- (i) more relaxed planning regulations allowing for the development of superstores and hypermarkets (superseding and dominating small store formats);
- (ii) IT development facilitating the transition from supply-push to demand-pull supply chains (putting retailers increasingly in the driver's seat in respect of controlling supply chain relationships);
- (iii) the development of retail brands to rival producer brands in respect of their connection and bond with consumers in the sense of being viewed as trustworthy, reliable, and offering good value; and

¹² Mintel, "European Retail Handbook – October 2004", Mintel Group, 2004.

¹³ Precise numbers for Europe as a whole appear difficult to obtain; not least as there is no consistent census of retailing conducted on a regular basis across EU member states. However, the picture of declining numbers of independent retailers and increasing concentration in favour of integrated chain store retailers is consistent with a number of studies. See, for example, European Commission, *Green Paper on Vertical Restraints in EC Competition Policy*, Brussels: COM (96) 721 Final, 1997; and Dobson Consulting, *Buyer Power and its Impact on Competition in the Food Retail Distribution Sector of the European Union*, prepared for the European Commission DGIV (IV/98/ETD/078), 1999 (<http://europa.eu.int/comm/competition/publications/studies/bpifrs/>).

¹⁴ Deloitte, "2006 Global Powers of Retailing", Deloitte Touche Tohmatsu, 2006.

¹⁵ IGD, "European Grocery Retailing 2005", Institute of Grocery Distribution, 2005.

- (iv) barriers to trade falling in the EU and the move to a “Single Market”, encouraging international retailers and ultimately pan-European retailers to emerge.

1.15 In many instances, it has been fully integrated chains that have been able to take advantage of these developments to maximum effect. They have been able to achieve this by:

- (a) their often larger initial scale, providing them with a resource advantage (e.g. in respect of having in place sophisticated systems for store planning, recruitment and training, marketing, etc);
- (b) having a retail concept (i.e. format, brand name, supply base, etc) that can be replicated across markets or suitably modified to account for different local tastes or laws in one region compared to another;
- (c) access to superior funding, either in respect of having a stock market listing (and so being able raise public funds by issuing shares) or by having a large existing asset base (and so be able to borrow on more favourable terms);
- (d) greater speed of decision making, having just a single executive board with full management and operational control over the entire organization; and arguably
- (e) political clout, either at the national level through links with political parties (such as being donors or sponsors) and central government departments (e.g. through public board membership or representation on government bodies) or at the local level by having closer ongoing links with developers and planners (as part of their store opening programmes) and with local councils (in respect of their positions as key employers and investors in the local area)

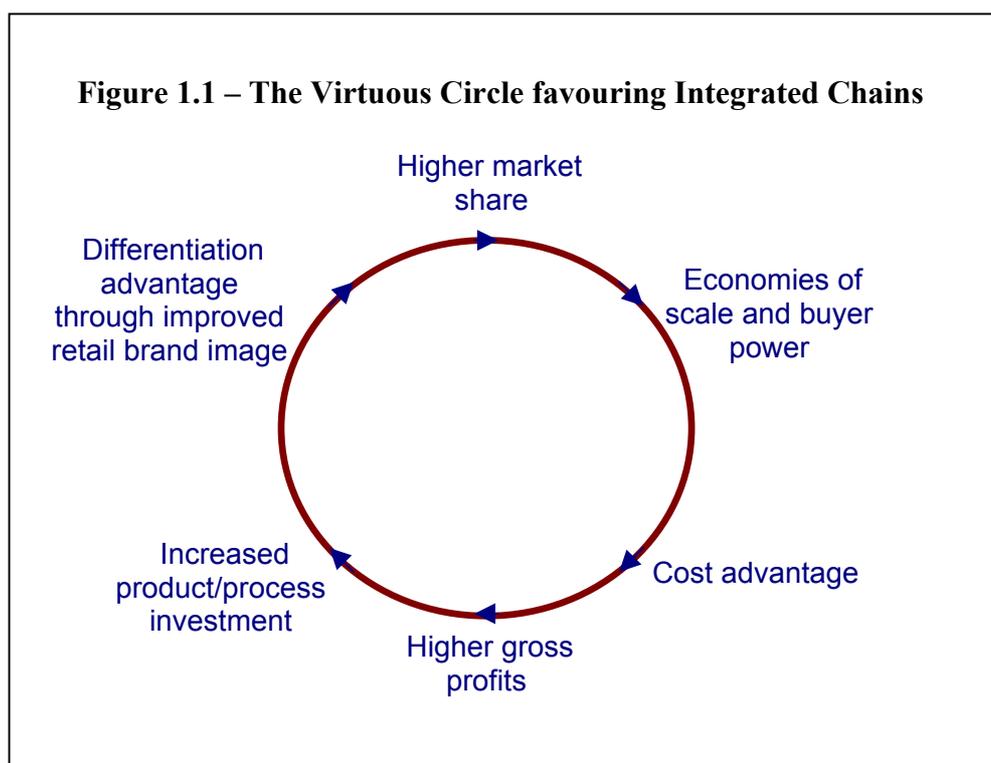
1.16 Yet, when stripped to its bear essentials, the two ingredients that have allowed integrated retail chains to grow continuously and consolidate markets over time are:

1. Economies of scale advantages – arising at the *store-level* (especially for larger stores where fixed costs are more easily covered and labour productivity is higher in respect of sales per employee), at the *chain-level* (where integrated logistics and store-replenishment systems can be implemented to cut costs, with better storage, less wastage and more timely deliveries, and where purchasing economies are available from large orders with suppliers), and at the *organisational-level* (where economies exist in respect of central staffing, planning, recruitment, and training)
2. Marketing advantages – arising from having a common brand (i.e. store fascia), facilitating consumer recognition, familiarity and trust, while assisting in giving the store group an identity that can make it stand apart from rivals – principally when this is backed up by unique service or product offerings (such as through own-label

goods, further projecting the retailer's brand image), along with consistency of the offer (in respect of consistent product and service quality, pricing, and marketing)

- 1.17 These two elements have worked together to allow integrated chain retailers to enjoy the benefits of being in a “virtuous circle” or “upward spiral”. This comes about when a national or regional market share advantage held by an integrated chain can be used to magnify efficiency differences between itself and smaller rivals, allowing for superior returns which can then be invested in building up differentiation advantages, fuelling yet further growth in market share.
- 1.18 Specifically, being in a “virtuous circle” of growth presents an integrated retailer with a potentially self-sustaining mechanism that provides competitive advantage over smaller rivals. Thus, once a high market share is acquired it allows efficiency gains to be made through reaping economies of scale and increased buyer power which leads to high gross profits (through superior profit margins and higher volumes) which can then be ploughed back into the business in the form of investments in product and process innovation (e.g. own label goods and improved logistical support) to improve quality and so provide a differentiation advantage, which in turns allows the firm to increase its market share, and so on. This argument is illustrated diagrammatically in Figure 1.1.¹⁶

¹⁶ For more details and implications for competitive advantage, see Paul Dobson, Ken Starkey and John Richards, *Strategic Management: Issues and Cases*, Blackwell Publishing: Oxford, 2004. For an alternative diagrammatic representation showing the links between growth and improved margin through buyer power, economies of scale, competitive pricing and the product/service mix, see Peter McGoldrick, *Retail Marketing*, 2nd edition, McGraw-Hill: Maidenhead, 2002 (pp.43-44). In regard to competition policy cases and analysis, the virtuous circle arguments have featured in market inquiries, e.g. see Competition Commission, *Supermarkets: A Report on the Supply of Groceries from Multiple Stores in the United Kingdom*, Cm 4842 (Oct. 2000), available at http://www.competition-commission.org.uk/rep_pub/reports/2000/446super.htm#full). It has also featured in merger cases, e.g. see Competition Commission, *Safeway plc and Asda Group Limited (owned by Wal-Mart Stores Inc); Wm Morrison Supermarkets PLC; J Sainsbury plc; and Tesco plc: A Report on the Mergers in Contemplation*, Cm 5950 (Sept. 2003), available at http://www.competition-commission.org.uk/rep_pub/reports/2003/481safeway.htm#full). The upward spiral argument is featured extensively in the European Commission's analysis of the *Rewe/Meinl* merger (Case No IV/M.1221, *Rewe/Meinl* Decision 99/674/EC, 1999 O.J. (L274)), principally in relation to how retail market share and buying advantages may go hand in hand.



- 1.19 A natural follow-up question is to ask how did one particular retailer, compared to another, enter this fortuitous position in the first place? The answer would seem to be down to history. For instance, at some point in its past the retailer found a different market position in the first place that had sufficiently strong appeal to consumers in respect of its value proposition, which then allowed it to build up over time both cost efficiency and improved product quality and delivery. Yet, and specifically in regard to integrated chains, a strong element of opportunism might have also played an important role. For example, the chain might have expanded its store network rapidly when planning policy was especially lax, while focusing on a middle market position (where the bulk of consumers lie), and so allowing for significant market share gains, reinforcing its buying advantage compared to rivals. Once the initial market share advantage was in place then the virtuous circle could prove self-sustaining, so long as economies of scale and buyer power put the retailer at a relative cost advantage and investments in quality or extending its store network provided it with a differentiation advantage. These advantages would be further magnified if smaller competitors were then inhibited in their growth by barriers to expansion (e.g. due to tight planning restrictions limiting new store openings or being prevented access to key suppliers due to exclusivity contracts held by the dominant retailers).

- 1.20 Can the virtuous circle break down and the differential advantage between large and small retailers be narrowed? If the circle/spiral does break down, then this would seem more likely to be because of the retailer not undertaking the right investments in cutting costs and increasing its customer appeal.¹⁷ The secret to maintaining dominance appears to be that once in the virtuous circle you must never stop using it. For if investment is not undertaken then differential and scale advantages can be lost to rivals, and once this happens the virtuous circle reverses to become a vicious circle of declining (relative) market share and declining performance. Otherwise, once a market leading position by an integrated chain is built up, then it will be difficult for smaller retailers to challenge this, especially working on their own. By grouping together, though, to build up their own scale advantage (e.g. in respect of buying and marketing), then there is a greater chance that small retailers can stay in play and may even prevent leading integrated chains ultimately taking complete control of retail markets.
- 1.21 All of this means that unaffiliated independent retailers have little chance of survival unless they are fortunate enough to hit on a sufficiently distinct market niche (e.g. in catering to a particular class or type of customer with a sufficiently unique service or product proposition) that they are not in direct competition with the leading chains. In reality, this is unlikely to apply to all but a very limited number of retailers where the leading chains are not prepared (e.g. because it is a distraction from their core business) or bothered (e.g. because the potential returns are so small) to target them. For the vast majority of unaffiliated independent retailers, though, their position will simply deteriorate as they are placed at an increasing competitive disadvantage, with the result that they will be eliminated one by one until they have all but disappeared.¹⁸

¹⁷ This is a trap that even (once) highly successful retailers can fall into. For instance, from the being the first British retailer to record annual profits in excess of £1 billion (equivalent to €1.5 billion) in the mid-1990s, Marks & Spencer witnessed a collapse in its profits by the end of the 1990s. This was attributed to not having the right product at the right prices and failing to push new product development in the right direction, causing Peter Salsbury, then CEO, to admit “ We lost touch with our customers and forgot about the competition” (as quoted in “Marks and Spencer: Food for Thought”, *The Economist*, 10 July 1999). For some retailers, this may be a temporary blip in performance (which may well apply to Marks and Spencer as it has improved its profit and growth performance more recently). For others, it may be the start of a long-term decline and loss of competitive advantage. For example, the Co-ops (consumer co-operative societies) in the UK have seen their market-leading 15 per cent share of the UK grocery trade held in 1970 fall to less than 4 per cent by 2003.

¹⁸ See, for example, Peter McGoldrick, *Retail Marketing*, 2nd edition, McGraw-Hill: Maidenhead, 2002 (p. 44) on the cycle of decline, associated with the vicious circle that many independent and weaker multiple retailers may find themselves in. Here it is observed that a weak bargaining position and an absence of scale economies depletes margins, makes it necessary to raise prices and/or economize on products and services. This leads to decline and further weakening of the organization’s position, and so on.

- 1.22 In such circumstances, grouping together (to obtain scale benefits in buying and retail support services¹⁹) may offer the only hope for independent retailers to survive and act as a viable and crucial competitive force to challenge the dominance of integrated chains, provide consumers with a genuine and lasting alternative source for buying goods, and ensure that competition remains effective to the public good. In the absence of an effective group emerging to take on the leading integrated chains in a more even competitive battle, then not only will independent retailers suffer (and their demise more certainly be sealed), but consumers will also suffer when it adversely affects their choice and variety on offer (i.e. when retail concentration is higher than it would otherwise be with the presence of the independent retailer group).
- 1.23 Of course, it is not impossible that the efficiency gains offered by forming a group may offer affiliated independent retailers the possibility of themselves jointly entering a virtuous circle of growth. Then the prospective benefit for consumers is not only of efficiency benefits entailing lower costs for retailers (e.g. in purchasing products from suppliers) being passed on to them in the form of lower retail prices when *inter*-group competition prevails, but also that these benefits are more likely to be secured because general competition can be augmented by *intra*-group competition (i.e. when affiliated members compete amongst themselves in the same local retail markets) in a way that would be wholly absent if only integrated chains were present.²⁰

¹⁹ For instance, as McGoldrick notes (*Id.*, p. 287), by banding together into “buying groups”, independent retailers may achieve a number of cost efficiencies and savings derived from (i) *economies of scale* – in buying, marketing, product testing, branding, operations, legal and personnel services; (ii) *economies of replication* – in operating systems, product assortments, designs and layouts; and (iii) *economies of scope* – combining product ranges to achieve the optimum mix, and access to promotional vehicles beyond the scope of individual members. For some details on the range of services offered by buying groups, based on a survey of UK groups, see S.A. Shaw, J.A. Dawson and N. Harris, “The characteristics and functions of retail buying groups in the United Kingdom: results of a survey”, *International Review of Retail, Distribution and Consumer Research*, Vol. 4 (No.1), pp. 83-105, 1994. On the operational aspects of these buying groups, see S.A. Shaw and J.A. Dawson, “Organisation and control in retail buying groups”, *Journal of Marketing Channels*, Vol. 4 (No. 4), pp. 89-103. Furthermore, we can note that the level of required commitment and participation is generally taken a stage further with membership to a “symbol”, “voluntary” or “affiliation” group (e.g. SPAR). In this case, there may additional benefits to members (i.e. beyond that achievable by being just a member of buying group). McGoldrick (*Id.*, p.53) lists the possible advantages to individual retailers from such group membership to include (1) access to loans and financial support to develop, extend and/or refurbish stores; (2) group buying power to obtain better prices from suppliers; (3) benefits gained from access to own-brand products and a group retail image; (4) increased turnover due to lower prices, group marketing expertise and promotion support; (5) leading to reduced selling costs as a percentage of turnover; (6) improved labour productivity through higher turnover and better administrative systems; (7) improved space productivity through advice on space allocations, merchandising and display; with all benefits leading ultimately to (8) improved profitability and return on capital.

²⁰ Vertical control is unlikely to be complete even with partially integrated independent retailer groups, so that stores within the same group may still compete with each other in local markets when there is scope for individual outlet owners to make self-interested decisions regarding at least some dimensions

1.24 Indeed, some groups of independent retailers (as purchasing groups, symbol groups or co-operative groups) have managed to hold their own against competition from integrated chains and remain as some of the largest organisations in retail sectors in Europe. For example, Table 1.1 lists the top 20 European retailers by group turnover, of which 7 are defined as co-operatives or symbol groups. At the national level, such groups continue to hold leading or at least strong positions in several EU member states (notably, France, Germany, Denmark, Sweden, Finland, Italy, Spain and Greece). Also, at the individual retail sector level, these groups hold significant positions across a range of countries (e.g. Spar in grocery, Euronics in electrical goods, and Intersport in sports goods) or across a range of sectors within the same country (e.g. Kesko under various arrangements in grocery, DIY/hardware/agricultural, clothing, footwear, sports goods, general electricals, computers, optical goods, and cars).

Table 1.1 - Top 20 European Retailers, 2004

Ranked by turnover						
Rank	Company	Home market	European turnover (€bn) ^{1,2}	No. of European countries	% sales in Europe	Ownership
1	Carrefour	France	62.8	13	86	Public
2	Metro	Germany	55.3	24	98	Public
3	Tesco	UK	45.7	8	91	Public
4	Rewe	Germany	40.8	13	100	Co-op
5	Edeka	Germany	32.9	5	100	Co-op
6	Lidl & Schwarz	Germany	32.6	19	100	Private
7	Intermarché	France	32.0	8	100	Co-op
8	Aldi	Germany	31.2	10	87	Private
9	Auchan	France	28.7	8	95	Private
10	Leclerc	France	24.1	6	100	Co-op
11	Spar International	Netherlands	23.5	21	86	Symbol
12	Wal-Mart	US	23.3	2	10	Public
13	Sainsbury	UK	22.0	1	100	Public
14	Casino	France	19.4	3	84	Public
15	Morrison/Safeway	UK	18.1	1	100	Public
16	Tengelmann	Germany	16.9	12	63	Private
17	Ahold	Netherlands	13.9	10	27	Public
18	Migros	Switzerland	13.2	3	100	Co-op
19	El Corte Inglés	Spain	12.4	2	100	Private
20	Système U	France	12.1	1	100	Co-op

Notes: Data are as at year end 2004 – based on IGD Research. “Ownership” is defined by ACNielsen and may not necessarily accord with how groups perceive their own ownership form.

Source: ACNielsen, *The Retail Pocket Book, 2006 Edition* (World Advertising Research Centre Ltd)

of pricing, stocking and retail service levels, giving rise to a certain degree of intra-group competition. These circumstances can allow for the presence of both inter-group and intra-group competition.

1.C Competitive challenges and legal hurdles facing groups of independent retailers

- 1.25 For small, unaffiliated independent retailers, then, the future looks bleak in most retail markets. With the leading integrated chains reaping such substantial advantages from the virtuous circle, it is not so much as whether unaffiliated independents can stay in business, but how long they can stay in business.
- 1.26 Unaffiliated independent retailers have to contend with the enormous disadvantage in respect of not being able to enjoy any economies of scale or strong marketing image – unless they are very fortunate to have a strong, loyal customer base willing to support them regardless of their competitive disadvantage. Even for those that presently have such support, it may only be a matter of time before it is lost when the efficiency disadvantage becomes too great and prices rise and services suffer as a consequence.
- 1.27 For groups of independent retailers, though, their prospects are better if they can pull on their collective resources and market presence to build scale economies (e.g. in marketing, procurement, and central services such as training, store planning and visual merchandising) that allow them to operate more efficiently on an individual level. By being more efficient on an individual level, then the independent retailers are likely to be better able to compete with larger players in their respective local markets. This helps ensure that all retailers (whether independents or chains) are forced to pass on their efficiency benefits to consumers in the form of lower prices and better service levels, and that consumers continue to enjoy choice and diversity from a range of outlet types and the different retail propositions that they have to offer (i.e. all-round consumer benefits from lower prices, improved quality, and greater choice in the absence of dominant positions).
- 1.28 Thus, the survival of small retailers by forming groups to enhance their competitive offer and so improve their chances of survival and prospering, is not only important in ensuring that competition in markets does not become too one-sided in favour of dominant integrated chains, but that consumers continue to benefit from a choice and variety of services and products on offer, both in the short term (in respect of the available retail offers) and in the long term (where healthy competition can be expected to act as a spur for new product and process innovation).

Vertical control in retail groups

- 1.29 Of course, vertically integrated chains by their very nature already enjoy such scale benefits. However, integrated chains enjoy another important source of economic benefit: complete control over their operations at chain-level and individual store-level. This means that an integrated chain can arrange and link up all the business functions (i.e. from procurement, supply logistics, marketing, merchandising, and store operations right through to sales to end consumers) in a highly efficient manner. This, in turn, means that the integrated chain has complete control over all aspects of the retail proposition both centrally (such as marketing, product range choice, and store design to reflect the overall retail image) and locally at the individual store-level (to tailor decisions such as prices, category depth, and service levels to cater for local market conditions).
- 1.30 In contrast, independent retailer groups are currently limited in the extent of their control. Independent retailers, by their description and character, will desire a degree of autonomy in making decisions that apply to the operation of their own stores – the very reason they are independent rather than fully integrated. However, for many aspects, independent retailers may like to give up some element of their freedom as they recognise that centrally taken decisions can benefit them and their customers. For instance, they may jointly benefit by pooling resources and overcoming so-called “free rider” and “prisoners’ dilemma” type problems²¹ that might otherwise arise from independent decisions²². In this way they can jointly enhance the consistency of the retail offer, provide greater assurance on service reliability to consumers and thereby increase consumer satisfaction with the shopping experience. Nevertheless, because they are members of a group that are linked together by agreements (either explicitly or implicitly), rather than by common ownership as in an integrated chain, they are treated differently under competition law and presently they are

²¹ Specifically, a “free-rider” problem occurs where independent decisions give rise to a situation where each party will have an incentive to under-provide a service or reduce its investment or effort when other parties have already provided such services, investments or efforts in the situation where the party derives a spill-over benefit from these. With all parties thinking and behaving the same, then all will tend to under-provide or under-invest compared to the joint optimum level. In a related vein, the “prisoners’ dilemma” refers to a situation where independent decision-making leads to each party looking myopically only at its own interest and not taking appropriate account of joint interests, with the result that destructive competition may result (e.g. in marketing to each other’s customers with the intention of “poaching” customers, rather than sufficiently focusing on marketing to their own existing customers). Both problems are thus related to coordination failures, where the parties would be jointly better off if only they were able to coordinate or make decisions in their joint rather than self interest. For further explanation and discussion on these aspects, see Simon Bishop and Mike Walker, *The Economics of EC Competition Law*, 2nd edition, Sweet & Maxwell: London, 2002; and Massimo Motta, *The Economics of Competition Policy*, Cambridge University Press: Cambridge, 2005.

²² For example, with independent decision-making, individual members may fail to account for “externality effects” (i.e. effects on other members of the association arising from their own decisions), and where individually rational decisions may not be collectively rational, leading to problems such as under-investing in staff training, store amenity and developing private-label lines.

subject to rules that limit the nature and extent of any centrally administered control on individual members.

Legal treatment of vertical agreements for independent retailer groups

- 1.31 In some cases, competition law is sufficiently flexible and amenable that it does not hinder groups of independent retailers to any significant extent (e.g. format design and visual merchandising). However, in regard to other aspects, competition law does restrict the extent to which a group can make and implement centrally determined decisions. This is most apparent with pricing. For instance, a group's central office (i.e. central administrative function) or wholesale arm cannot dictate the retail price at which goods must be sold, or the minimum price that they can be sold for. Such resale price maintenance arrangements are contractually unenforceable under present EU competition law and are viewed as illegal vertical price fixing (and, if used, could result in a substantial fine in most EU member states). Even imposing "retail price ceilings" on members, i.e. dictating the maximum resale price, may not be deemed to be an acceptable practice if the group possesses a high market share (specifically, 30% or more), even when the intention is to ensure that members keep prices low to raise sales levels and benefit final consumers in the process.
- 1.32 These restrictions on a group's pricing control, even when this is clearly intended to aid competitive positioning and benefit consumers (e.g. in respect of preventing high prices and promoting brand consistency), are in stark contrast with the extent of allowable vertical control and market behaviour exercised by integrated chains. Here competition law freely allows integrated chains to centrally determine and administer all prices in all stores within the chain regardless of whether this is to the benefit of consumers (again in respect of preventing high prices and promoting brand consistency) or to the detriment of consumers (such as raising prices to consumers in those areas where the chain's outlets face little local competition), so long as pricing is neither deliberately predatory nor exceptionally exploitative in nature.²³
- 1.33 A similar concern relates to the treatment of purchasing obligations. An integrated chain can centrally determine and administer all stocking requirements for all stores in the chain, i.e. dictating product availability and amount supplied at each individual store. In contrast, a

²³ Such freedom on fixing prices may also extend to joint ventures between producers combining their distribution facilities in the context of horizontal cooperation agreements if it is viewed as indispensable for achieving efficiency benefits and does not represent any significant danger to overall competition (e.g. when there are significantly larger competitors in the market). For an illustration of the Commission's thinking, see the example at point 156 of *Guidelines on the applicability of Article 81 of the EC Treaty to the horizontal agreements* (OC C 3, p. 2, 06/01/2001).

central office at the wholesale level for a group of independent retailers is restricted in the range and extent of purchasing obligations that can be applied to retail members and has little or no control over which products and in what amounts the individual retailer ultimately chooses to stock from the range on offer. Typically, the allowable limits for purchasing obligations only extend to 80% of goods purchased and for a duration limit of up to 5 years.²⁴ This creates two obvious problems. First, free-riding activity cannot be controlled so effectively (e.g. retailers refusing to stock special promotional products or obtaining delisted products from other wholesale operations, thereby undermining the bargaining position of the group as a whole). Second, independent retailer groups are deliberately established as an ongoing relationship for the benefit of members and consumers (not least in respect of ensuring consistency of brand image and member participation), so a duration limit undermines retailers' commitments to a particular group and complicates administration and contracting arrangements (thereby raising costs and serving as a business distraction).

- 1.34 On both accounts, the limitations on vertical control (i.e. on retail pricing and purchasing obligations) restrict the efficiency at which independent retailer groups can operate, weakening the ability of independent retailers to act as a critical competitive force and as a counterbalance to the market power of integrated chains, and as a result work against the interests of consumers in ensuring low prices, wide choice and service variety.

Legal treatment of mixed arrangement structures

- 1.35 However, it is not just simply in relation to vertical agreement regulations that independent retailer groups are hampered and effectively discriminated against compared to the favourable legal treatment offered to integrated chains. The very nature of retailer associations with co-ordination through a central office or wholesale operation implies that within group relations could have both a vertical element (i.e. central office to retailer) as well as a horizontal element (i.e. retailer to retailer in respect of shared benefits). Unfortunately, this has given rise to a tendency for competition authorities to view such arrangements as first and foremost as being horizontal (i.e. co-operative) in nature but controlled by a vertical relationship (with the central office as the essential facilitator and co-ordinator). Given the much tighter rules and regulations that generally apply to horizontal co-operative agreements, with concerns over cartelisation and competition avoidance, this has meant that independent retailer groups have been subject to considerably more stringent limits on their size (in respect of allowable market share) and activities (in respect of vertical control) than they would be as simple vertical agreements.

²⁴ See Articles 5a and 1b of *Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories vertical agreements and concerted practices*.

- 1.36 Thus, for instance, a group of independent retailers may be allowed to operate relatively unimpeded only if its (collective) market share is no greater than 15% (as a horizontal agreement), even though its very nature is about promoting efficiency amongst independent retailers to allow them to be more effective competitors – both against integrated chains and amongst themselves. Yet this market share threshold may act as a bar to the level of efficiency that the group can attain – for example in the extent to which it can negotiate discounts from suppliers that can then be passed on to consumers in the form of lower retail prices. In contrast, integrated chains may face no restriction in how much they are allowed to grow, at least through organic growth. Only in respect of mergers and acquisitions might restrictions be imposed, and even here the allowable threshold before being prohibited might be as high as a 40% share (i.e. the level at which EU case law has tended to view a firm as holding a dominant position in a market).
- 1.37 A market share threshold set at 15% (or indeed 10% or 20% as may apply in some jurisdictions) is both arbitrary and considerably below the level at which anti-competitive concerns are normally raised in relation to vertical restraints (i.e. generally taken as 30% in the context of the European Commission’s guidelines on vertical restraints). The market context should take precedence. In situations where integrated chains have significantly higher shares than this threshold, then the competitive ability of the group will be stifled by this restriction (as it will be at a competitive disadvantage compared to these rival groups in respect of negotiating with suppliers and drawing on scale economies). Even when an independent retailer group represents the largest collective body in the market, consideration should be given to the basis on which the group has developed – primarily as a means to secure improved terms with suppliers and as a means of operating with a consistent marketing image. Such means offer direct benefits to consumers when lower purchase costs are translated into lower retail prices and when consistency in marketing provides greater assurance on service reliability and thereby increases consumer satisfaction and overall demand.
- 1.38 More fundamentally, a mixed arrangement of vertical and horizontal relationships should be seen and assessed exactly as that – i.e. a mixed arrangement on which the net economic effect of the combination should be the prime consideration for assessment. Specifically, horizontal elements should neither be viewed in isolation nor taking precedence over vertical elements. Rather, they should be viewed together as an intrinsic package in the makeup of independent retailer groups. In this respect, it needs to be understood that specific vertical agreements may mitigate any horizontal cooperation concerns, and vice versa.

- 1.39 A prime example is the role of maximum resale prices, which prevents individual retail members from exploiting any local monopoly power they may jointly hold when rivals (e.g. integrated chains) are absent from certain locations in which they operate (e.g. remote rural locations). It needs to be borne in mind that these are normally about vertical control (to prevent overpricing and thereby underselling), and not about horizontal agreements with the intention of co-ordinating to raise prices (as they might be classified by some competition authorities).²⁵
- 1.40 Equally, though, fixed common retail prices required on retail members may have an important role to play in joint commercialisation processes and the development of a brand image among retail members that facilitates trust and assurance in the mind of consumers in support of value-for-money propositions, facilitating more informed decisions for consumers and generally encouraging demand (and therefore offering significant consumer benefits). Such benefits may be recognised in relation to an assessment as a horizontal agreement (when consumer benefits flow from joint commercialisation activity). But when assessed as a vertical agreement, this behaviour would be seen as an example of fixed resale price maintenance and therefore prohibited under EU regulations, regardless of the market share controlled by the parties (even if this were below the normal *de-minimis* level) and regardless of whether this practice would be indispensable for the purpose of securing joint commercialisation benefits.
- 1.41 The point is that labelling or typecasting independent retailer groups as merely instruments for horizontal agreements misses their real economic value when they offer efficiency benefits in respect of vertical relations – generating lower prices and better terms from suppliers that can be passed on to consumers and improving the quality and consistency of the retail offer to the benefit of consumers. Equally, perceiving groups of independent retailers that may seek to operate common retail prices as merely using vertical agreements for the sake of eliminating intra-group competition and dampening inter-group competition through fixed resale price maintenance (which is *per se* prohibited under EU law), misses the real economic value of such behaviour when it offers efficiency benefits in respect of joint commercialisation processes through horizontal agreements.

²⁵ Indeed, when maximum resale prices are in the nature of a horizontal agreement between retail members (such as within a retailer co-operative) it may have very clear pro-competitive and consumer protection purposes, e.g. in allowing advertised promotions to state maximum prices and ensure that all retailers keep to this (i.e. do not individually raise prices and thus undermine the legitimacy and reputation of the price promotion campaign).

The economic and social role performed by independent retailers

- 1.42 Whether it is a failure by competition authorities to fully understand the required behaviour within groups to make them effective and operate in a pro-competitive manner, a general wariness against small, independent retailers pooling resources to form groups, or broader concern that this will open up the possibility of allowing bigger businesses to use the freedoms granted to groups (of smaller retailers), the result is that competition law in a number of clear instances discriminates against such groups compared to the freedom that wholly-integrated chains enjoy in respect of vertical and horizontal control by a central organisation over individual stores in a chain.
- 1.43 In facing these legal obstacles (which appear as discriminatory treatment), it may seem reasonable to ask the question why should the independent retailers not simply accept this legal position and instead integrate to become wholly-integrated chains themselves? Posing such a question, though, misses the point about the important and valuable economic and social roles played by independent retailers, in particular their contribution to entrepreneurship, organizational diversity, experimentation and innovation. In addition, independent retailers have a vital role to play in ensuring that consumers continue to be well served and enjoy variety and choice while at the same time ensuring that integrated chains are kept keen – particularly as retail markets consolidate.
- 1.44 First, establishing an independent retail operation is often the way that many entrepreneurs begin in business. These entrepreneurs can design and experiment with different retail concepts and different product mixes, working with different business models to see which prove successful. Such experimentation can promote new methods of operation and new services to target existing consumer demand more effectively, as well as open up the prospects for new, latent demand to be served with the arrival of new services or new product mixes.
- 1.45 Second, independent retailers may go where integrated chains avoid, such as serving rural and socially deprived urban areas. In such instances, independent retailers may be more prepared to accept the associated low returns and greater business risks than would vertically integrated chains (even though this entails each independent retailer taking the business risk entirely by itself, as opposed to an integrated chain sharing the risk across its store network). For consumers in these areas, an independent retailer may be their only effective source catering to their retail needs. Yet, even in areas where choice exists, independent retailers may provide local consumers with something different and thus of value to the offering by outlets of integrated chains. For example, independent retailers typically have greater flexibility to

adapt their retail offer to cater for specific customer needs in a given community (such as stocking locally produced goods, providing credit to regular shoppers, offering additional services like home delivery, and adjusting opening hours to suit local needs).

- 1.46 Third, the presence of a vibrant independent retail sector serves as a competitive force to ensure that integrated chains must compete intensely for the custom of shoppers, encouraging them to innovate and generally improve their offer. This is particularly important as retail markets consolidate, with integrated chains becoming both larger and fewer in number (as mergers and acquisitions continue) and where otherwise competitive intensity might be lessened.
- 1.47 With a rich and diverse retail sector, consumers are offered greater choice and a range of different value-for-money retail service propositions. Equally, though, suppliers are offered a variety of routes to markets, which may take on considerable economic importance when it opens up greater possibilities for new suppliers, with perhaps new products, to emerge and compete with existing suppliers. Accordingly, the substantial presence of independent retailers, and a lack of dominance by any single (integrated) group, may hold the key to ensuring that both demand and supply opportunities are fully realised to the economic good.
- 1.48 Thus, ensuring the efficiency, competitive resilience and ongoing development of independent retailers should be seen as an integral part of the good functioning of retail markets, and certainly not as some anachronism that has no role to play in modern retailing.

The purpose and role of independent retailer groups

- 1.49 Yet, the fate of independent retailers depends very much on the continued existence of other independent retailers. The reason for this is that they invariably share the same, common source of supply. This is especially the case where supplies go through a wholesale operation as opposed to direct supply from producers. Whereas it used to be common in many markets for all retailers (both independents and integrated chains) to use wholesalers for the purpose of obtaining supplies, wholesale operations have in many instances fallen into decline. The reason is two fold. First, as integrated chains have become larger they have increasingly taken over and integrated the wholesaling function for their own needs, dispensing with the use of separate wholesalers, and instead dealing directly with producers and coordinating all their logistical support through their own warehousing or regional distribution centre network (though often using third-party logistics and road haulage companies for the actual storing and delivery of goods to stores). Second, and following on from the previous point, as the independent retail sector has shrunk so has the remaining wholesale sector.

- 1.50 This decline of wholesale operators poses a significant problem for independent retailers; with declining size, wholesalers lose efficiency. So, as more independent retailers exit, wholesalers become less efficient in comparison to the operations of large and growing integrated chains. As a consequence, wholesale costs rise and less competitive supply terms are available from producers, placing remaining independent retailers at an increasing competitive disadvantage vis-à-vis large integrated chains. At some point, the loss of scale efficiencies for independent wholesalers will mean that independent retailers will no longer be able to obtain supplies on a basis that allows them to survive in the face of integrated chains operating on much better terms. If such a “tipping point” is reached then the independent wholesale network may break down and independent retailers face extinction in the absence of a viable supply source.
- 1.51 The point here is that wholesale operations are the lifeblood of independent retailers. As independent wholesalers become less efficient then so do independent retailers. Pooling resources to form an independent retailer group with its own wholesaling function may be the only way for independent retailers to avoid this problem and ensure their own survival.
- 1.52 With the backing and support of an efficient wholesale operation then independent retailers have a better chance of being able to compete on more effective terms with integrated chains. This is especially so if the independent retailer group advances from being merely a buyer group and wholesaling function to become a marketing function as well. Then, independent retailers can benefit from a common, marketable identity that will enable them to offer a retail brand image to compete with that offered by integrated chains.
- 1.53 This is in keeping with how many groups of independent retailers have developed over time. At the outset, the purpose of these groups was mainly to provide their members with better purchasing conditions. Many groups, though, have subsequently extended their role. Today, the objective pursued by many groups is essentially to bring their associated retailers the technical and material resources in the field of marketing and the know-how to contend with the competition and develop efficient retail and distribution businesses, in order to respond effectively to the expectations of consumers.
- 1.54 Thus, through the combination of an efficient supply route and common marketing arrangements, independent retailers may be able to gain efficiency and compete with integrated chains on comparable terms, thereby helping to ensure that effective competition prevails in retail markets.

1.D Critical areas for policy review

- 1.55 If policymakers wish to see effective competition prevail in retail markets then they need to recognise the economic and social advantages that groups of independent retailers can offer and ensure that legal obstacles that might simply hinder their ability to compete effectively to the good of consumers are not maintained. Specifically, providing appropriate and clear policies that support or at least do not hinder such arrangements for independent retailers should not be seen as merely as ensuring that diversity or variety of organisational forms is maintained but, much more crucially, that the long-term health and vitality of retail competition is preserved and preferably enhanced.²⁶
- 1.56 However, existing competition law, in the ways discussed above, does hinder such arrangements – either directly by limiting the extent of arrangements or indirectly by causing legal uncertainty as to whether related practices will or will not be allowed. The current framework of legal treatment for independent retailer groups according to their horizontal (i.e. co-operative) and vertical (i.e. trading) nature is therefore (perhaps unwittingly) retarding the efficiency and competitive ability of independent retailers and thereby the competitive process as a whole.
- 1.57 Indeed, the present discrimination operating against independent retailer groups, compared to the freedom enjoyed by integrated chains, represents a perverse handicap system, whereby those players already at a competitive disadvantage because of their small size are handicapped in a way that limits their ability to compete with large integrated chains and even stay in business.
- 1.58 Here, it is important to observe that a call for ending or at least limiting such policy discrimination is not about protecting competitors, but rather about protecting competition by ensuring a more even playing field that provides greater opportunity for competition to operate in a manner that can best ensure that consumers are well served by retail markets.
- 1.59 What is required is a suitable change in policy treatment based on recognition of the ways in which current policy is acting to discriminate against such organizations and undermine their

²⁶ Specifically, this argument is based on the view ensuring the removal or avoidance of discriminatory policy treatment is not about protecting competitors, rather it is about protecting competition. It is about policymakers and legislators ensuring fair conditions of competition when undertakings cannot (legally) do it for themselves. This is recognised, but in this instance clearly not yet applied, in regard to point 47 of *Guidelines on the application of Article 81(3) of the Treaty* (OJ C 101, p. 97, 27/04/2004).

competitive ability. This does not entail action that is intended to provide independent retailers with undue favourable treatment, allowing them to gain an unfair advantage over integrated chains. Rather, it is concerned with redressing the current imbalance in respective treatment and allowable practices by integrated chains compared to independent retailers operating as members of a buying and marketing group.

- 1.60 The purpose of this report is to set out precisely those areas where policy attention is required. This is in both the respect of ending policy discrimination (vis-à-vis the freedom that integrated chains enjoy) that serves against consumers by preventing behaviour and agreements that if permitted would be in their interests, and in clarifying the market circumstances and conditions where practices (and their precise form) should be allowed (given the present legal uncertainty facing most groups).

1.E Outline and structure of the report

- 1.61 The remainder of the report is structured as follows.
- 1.62 Section 2 considers the nature of groups of independent retailers, looking at their presence in the European context, how the groups are organised and structured, their economic role, and the competitive challenges and legal obstacles that they face. In particular, it is evident that groups of independent retailers have multiple roles to offer for the benefit of consumers: they can be forces that support and promote efficiency, innovation, competition and diversity. However, it is also clear that certain aspects of current competition policy and law may prevent groups from fully developing these roles and thus restrict the benefits that they can offer consumers.
- 1.63 Section 3 examines vertical restraints policy in the European Union. It discusses the role of vertical restraints for groups of independent retailers within the general context of understanding the economics of vertical restraints. The section reviews and critically assesses current EU policy, identifying areas where existing policy may be serving to prevent efficiencies being realised and pro-competitive practices stifled, and as such not working in the best interests of consumers.
- 1.64 Section 4 examines more specifically current policy towards groups of independent retailers. It considers the current policy and legal frameworks operated within the European Union, the treatment of mixed structures involving horizontal and vertical agreements (as typically

characterising independent retailer groups), and relevant market definition and critical market shares (in both procurement and retail markets). The section also considers in detail the fundamental aspects relating to the economic purpose of most independent retailer groups, namely joint purchasing and the role of purchase obligations and joint commercialisation and the role of retail pricing requirements.

- 1.65 Section 5 concludes the report and offers a number of policy recommendations in order for independent retailer groups to receive a more appropriate legal treatment. These cover the joint treatment of horizontal and vertical agreements; guidelines for groups whose market share exceed the relevant market share thresholds for particular arrangements (specifically, exceeding 15% for horizontal agreements and 30% for vertical agreements); the possibility of removing the percentage and time limit on purchasing obligations; and the use of common or maximum retail prices for promotional purposes.

- 1.66 Two appendices provide supplementary material relating to the questionnaire study conducted on groups of independent retailers to gather information on their nature, organisational structure, internal relationships, arrangements used, and the impact of current national and European competition policy on their operations.

2. The Nature and Economic Role of Groups of Independent Retailers

Groups of independent retailers vary considerably in their organisational and ownership forms, displaying a rich variety of retail models applied to different retail markets in different EU member states. While differences exist, there are common features as well. The purpose of this section is to consider the nature of groups of independent retailers, looking at their presence in the European context, how the groups are organised and structured, their economic role, and the competitive challenges and legal obstacles that they face. In particular, it is evident that groups of independent retailers have multiple roles to offer for the benefit of consumers: they can be forces that support and promote efficiency, innovation, competition and diversity. However, it is also clear that certain aspects of current competition policy and law may prevent groups from fully developing these roles and thus restrict the benefits that they can offer consumers.

2.A Groups of independent retailers in Europe

- 2.1 While there has been a number of studies covering the nature, structure and changes in retailing over recent years, much of the attention has focused on the development of integrated chains, especially their international spread and increasing market domination in many sectors.²⁷ Considerably less attention has been given by researchers to the role of independent retailer groups and their impact on (and equally how they have been impacted by) developments in retailing. This is most apparent in regard to European developments in general (i.e. beyond national level studies). As a result, there is a relative dearth of information and analysis (and thus broad understanding) of the role of independent retailers groups, the many forms that they take, the nature of their arrangements, and the impact of competition policy and legal restrictions facing these groups across Europe as a whole.
- 2.2 Accordingly, as a first step in our study, and to provide informed insights, we set out to gather information on a wide array of different independent retailer groups, operating in different

²⁷ For example, with regard to the grocery sector, see Andrew Seth and Geoffrey Randall, *The Grocers: The Rise and Rise of Supermarket Chains* (Kogan Page), 1999; and Andrew Seth and Geoffrey Randall, *Supermarket Wars: Global Strategies for Food Retailers* (Palgrave MacMillan), 2005. In the case of non-food, much attention has focused on large-format integrated retailers known as “category killers” – e.g. for an American perspective but with relevance to Europe, see Robert Spector, *Category Killers: The Retail Revolution and Its Impact on Consumer Culture* (Harvard Business School Press), 2005. Even with regard to general retail strategy, the focus has tended to be on large integrated retailers as opposed to other retail forms, e.g. see Jonathan Reynolds and Christine Cuthbertson (eds), *Retail Strategy: The View from the Bridge* (Elsevier Butterworth-Heinemann), 2004. This also has been the main focus in the examination of European retail grocery trade developments provided by Roger Clarke, Stephen Davies, Paul Dobson and Michael Waterson, *Buyer Power and Competition in European Food Retailing* (Edward Elgar Publishing Limited), 2002.

markets, and in different countries. For this purpose, we undertook a questionnaire study of members of UGAL, as the pan-European association that acts as an umbrella association for the main groups of independent retailers in the food and non-food sectors. The questionnaire was originally sent out to around 150 different organisations identified to us by UGAL as representing independent retailers (and in some cases covering other providers and artisans directly supplying consumers) – of which 28 were direct UGAL members and the remainder were indirect members (as independent retailer groups represented by three direct member associations²⁸ – with an overall response rate of slightly over 25% (representing a broad spread of retail sectors across a broad range of EU member states). The questionnaire and full details of the analysis of responses are respectively contained in Appendices A and B at the end of this report. This section of the report draws on the findings of the questionnaire study, along with interviews conducted with individual groups, to provide insights on the organisational structure and composition of groups, behaviour and practices used by the groups, and the key issues and challenges facing groups.

- 2.3 To give a flavour of the range and size of groups contacted, Table 2.1 shows the direct member UGAL for a range of size measures, and showing how they have developed over the previous five years.²⁹ The table shows a wide disparity in sizes – the largest groups being apex associations representing a number of individual retailer groups (e.g. ACS, FCA, IFDE, and ZGV). Other large groups include international associations (e.g. Spar, Intersport, and Euronics), as well as some large, national or multi-national groups (e.g. mainly those in the grocery or general merchandise sectors like Edeka, Systeme U, ICA, Kesko, and Conad). The smaller groups tend to be nationally operating specialist groups.

²⁸ Here, direct UGAL member associations are a mix of apex organisations acting as (national) associations representing the interests of a number of different independent retailer groups (e.g. ZGV, FCA, SOCR and ACS), and (nationally or internationally operating) individual organisations (e.g. Kesko and ICA). Some of the individual groups may be members directly of UGAL as well as indirectly through a broad association (e.g. EDEKA as a direct UGAL member, as well as indirect representation through ZGV). The individual groups of independent retailers represented by three large UGAL member associations (namely, ZGV, FCA, and SOCR) were also asked to complete the questionnaire.

²⁹ Considerable caution should be given to many of the figures on changes in the five-year period (1999-2004). Very large swings (positive or negative) are very likely to be attributed to different means of measuring the size characteristics (e.g. whether they include/exclude unaffiliated members, relate only to owned stores, and whether coverage is sector specific) rather than any real marked change in the position of the association/group.

Table 2.1 – Size Characteristics of various UGAL Members (2004)

ORGANISATION	Retail turnover		Wholesale turnover		Retailers		Point of sales		Employment	
	€ million	5 yr % Δ	€ million	5 yr % Δ	Number	5 yr % Δ	Number	5 yr % Δ	Total (2)	5 yr % Δ
1 3E	476	7.0	150	n.k.	320	8.5	355	-6.3	3,210	-13.2
2 ACS	20,200	n.k.	6,000	n.k.	4,000	n.k.	32,000	n.k.	300,000	n.k.
3 ADEG	1,635	4.1	711	-1.4	676	-33.8	845	-27.1	5,800	-26.3
4 AIS	n.k.	n.k.	619	14.6	272	-1.4	621	2.1	22,800	n.k.
5 ANCD	395	9.6	217	13.9	695	-7.3	758	-6.4	3,950	3.9
6 ANCECO	29,000	n.k.	8,000	n.k.	28,150	n.k.	30,250	21.0	120,000	18.8
7 ASEDAS	30,000	n.k.	20,000	n.k.	16	n.k.	18,000	n.k.	190,000	n.k.
8 COOP-CODIS	525	65.6	401	109.9	186	-36.1	255	-20.3	2,600	44.4
9 CONAD	7,086	21.5	5,160	44.5	2,500	n.k.	2,899	0.3	34,000	-2.9
10 EDEKA	23,140	20.0	18,500	10.3	3,803	-29.1	8,513	-22.5	219,872	37.4
11 EDEKA DK	1,030	185.1	620	194.4	700	122.2	880	179.4	2,200	22.2
12 EUROACTIV	n.k.	n.k.	546	n.k.	3,000	n.k.	3,896	n.k.	5,000	n.k.
13 EURONICS	9,191	n.k.	4,200	n.k.	5,535	n.k.	8,687	n.k.	40,300	n.k.
14 EXPERT INTERNAT.	8,000	-50.0	4,000	-60.0	2,500	-66.2	3,400	-54.1	19,000	-45.7
15 FCA (1)	22,628	n.k.	7,413	n.k.	20,681	n.k.	25,020	n.k.	139,060	n.k.
16 GARANT Schuh Mode	3,500	n.k.	1,000	n.k.	4,600	n.k.	6,550	n.k.	2,000	n.k.
17 ICA	8,500	-5.6	7,146	15.9	1,506	-20.7	1,700	-52.4	40,000	8.1
18 IFDE	79,569	-15.0	22,231	-38.5	54,200	85.4	80,076	45.6	612,000	10.3
19 INTERSPORT IIC	7,334	22.2	3,321	290.7	3,121	-4.9	4,809	1.7	56,000	1.8
20 KESKO	8,600	30.5	5,581	-8.7	1,313	-28.0	1,924	-8.3	45,000	31.2
21 ÖGV	2,400	122.1	1,090	112.9	9,678	-53.4	9,678	-53.4	11,500	n.k.
22 RGDATA	n.k.	n.k.	n.k.	n.k.	n.k.	n.k.	4,000	n.k.	4,500	n.k.
23 RPN	5,400	-28.0	3,600	6.7	5,600	n.k.	9,400	-10.5	31,450	-21.4
24 SIGMA	1,995	12.1	1,187	14.9	2,556	0.3	2,556	0.3	15,000	-1.3
25 SPAR Internat.	27,578	n.k.	23,089	n.k.	14,892	n.k.	14,892	n.k.	215,000	n.k.
26 SPORT 2000 Internat.	4,035	53.7	2,017	443.7	2,000	4.1	3,111	19.2	26,250	31.3
27 SVAZ OBCHODU	2,046	n.k.	846	n.k.	2,173	n.k.	6,065	n.k.	34,674	n.k.
28 SYSTEME U	14,690	58.7	7,713	53.8	836	6.9	849	8.6	55,000	n.k.
29 TECAR Internat.	n.k.	n.k.	205	n.k.	1,300	n.k.	13,000	n.k.	35,000	n.k.
30 TEXMODA	125	-7.4	19	n.k.	46	n.k.	106	n.k.	1,000	n.k.
31 ZEDACH	1,100	n.k.	800	-25.9	5,500	-29.7	135	-19.6	9,500	n.k.
32 ZEV MARKANT	1,604	n.k.	1,018	n.k.	1,128	-18.1	2,822	-2.3	14,938	-11.5
33 Z.G.V.	174,354	132.5	65,365	63.4	140,138	27.4	158,509	20.1	1,160,428	179.6
Average	17,108	33.6	6,961	66.1	10,113	-3.9	13,835	0.7	105,365	14.8
Standard Deviation	34,275	58.7	12,552	124.0	26,051	44.6	30,114	47.0	225,522	47.4

Key: "5 yr % Δ" denotes percentage change over the last five years (1999-2004); italics indicate estimations; "n.k." denotes value not known; (1) indicates only non-food (FCA figures including food are €93bn retail turnover, 25,030 retailers, 30,060 points of sale, and 385,250 employees); (2) denotes retailers included

Source: values and calculations based on information available at www.ugal.eu

- 2.4 As a prelude to summarising the findings from the questionnaire study in the next three subsections, it might be useful to consider an example of one independent retailer groups, to provide a taste of (and thus appreciate and gain some insight) into the kind of relations, organisation and structure used by an independent retailer group. In this regard, Illustration 2.1 (boxed below) summarises the Conad system operating in Italy – which in European terms can be viewed as a mid-sized independent retailer group providing joint purchasing and retail branding for members.³⁰ In practice, no two independent retailer associations are exactly alike – not least in respect of size (e.g. contrasted with the larger associations like Edeka, Systeme U, and Spar International, or smaller specialist non-food buying groups), the range of services provided (from plain buying groups to symbol groups or vertical chain systems like Kesko), and ownership structure (ranging from retailer-owned cooperatives, wholesaler-led voluntary associations, to mixed ownership public limited companies). The Conad system may differ from other groups in particular respects (and the example should certainly not be taken as necessarily representative of any other specific group). Yet common to most groups, and illustrated well here, is a typically complex set of relations that arise on multiple levels. Nevertheless, as with most other independent retailer groups, this case shows how through sensible organisation and management these complex relations can be effectively handled to produce benefits for retail members through a disciplined and well-structured democratic organisation.³¹

Illustration 2.1 - The Conad System

Formed in 1962, Conad's original role was as a national-level purchasing group to operate on behalf of associated retailers in Italy. Over the years, the Conad distribution system (consisting of three vertical levels: National Centre; Cooperatives; Associated Outlets) has changed to become a system of distribution companies responding to the consumer, through organising the common supply and purchasing of foodstuffs and other consumer goods, as well as any other service required to eliminate all forms of intermediation and improve members' business activities to the consumer's benefit.

The present Conad system is made up of retail companies, grouped under 8 separate regional cooperative companies. Each cooperative works from a distribution centre supplying its own associates as a wholesaler, as well as granting the use of the CONAD brand. The cooperatives also manage their own outlets, through a controlling company, either exclusively or jointly with their associates. In addition, they are owners of sales outlets that they do not manage but which they rent to companies of associated businesspeople (i.e. independent retailers). Overall, there are some 2,900 branded retail outlets divided into four channels (Conad supermarkets, Margherita local stores, Leclerc/Conad

³⁰ The choice of Conad as a case for illustration is purely as a representative organisation showing the kind of relations, ownership issues, behavioural and contractual aspects that apply generally to other independent retailer groups. There are many other equally useful examples of other independent retailer groups that could have been used to illustrate the same points. Equally, there are cases which are distinctly different (e.g. the vertical chain system of Kesko and quasi-vertical chain model by ICA, both involving stock-market traded shares).

³¹ For further details relating to Conad and discussion on the effects and implications of present competition law for the organisation, see ANCD/Conad, *Competition Law: La Nuova Disciplina Europea Sulla Concorrenza*, Quaderni 12, 2004 (www.ancd.it).

hypermarkets, and Discount stores), plus supply to unaffiliated food stores. Conad retailer turnover amounted to €7bn in 2004, giving the group a market share of around 9.4% (and thereby the number two position behind Coop Italia) in the Italian retail grocery trade.

The cooperatives authorise the use of the logo brand products to those retailers who accept a series of special obligations (e.g. to take an appropriate private label assortment, respect the promotional campaigns, etc). Purchasing loyalty is maintained through a system of discounts on the prices of goods. In some cases, there are minimum purchasing requirements (to ensure efficiency in order and delivery sizes). Retail price setting is left to members, but there is a system of suggested prices between the cooperatives and the members.

As well as their wholesaling and store management and ownership roles, the regional cooperatives also carry out all the basic transport and logistical support, through distribution centre companies. The cooperatives are, in turn, associates of CONAD Central, together with smaller companies and consortiums, usually controlled, exclusively or jointly with the same cooperatives.

The central CONAD consortium, on behalf of the associates, is the central negotiator for the supply contracts with the producers. The national consortium also carries out other services, including quality controls, conditions and negotiating the contracts for purchasing the private label products, the setting up of certain initiatives for promoting a particular product for the retailers of associated cooperatives, and national advertising campaigns under the CONAD logo. The consortium is also the owner of the brand name and through its decisions gives the cooperatives the mandate conceding its use to the retailers in defined areas. Know-how and other aspects regarding store management and the CONAD image are also provided.

National CONAD also has the task of surveillance regarding following the development and fulfilment of objectives at a local level by the associate cooperatives of the sales and marketing strategies decided at a national level.

Above the operational levels, at the apex of the organisation, the national consortium and the cooperatives belong to ANCD – the national association for union representation – where the strategic decisions for the system are taken. ANCD deals with institutional relations, carries out political union activities, deals with national training and manages the pensions and integrated health insurance provision.

As with many other independent retailer groups in Europe, while the arrangements may be viewed as representing horizontal agreements amongst retailer members (competing at the same level as the big integrated retail chains), in fact the strongest relations in Conad system occur vertically, between the consortium and the individual cooperatives and between these and their retail members. Here, the cooperatives are companies autonomous from their associates, none of whom can control them either exclusively or jointly, but instead organised on a democratic and cooperative basis. Thus, the cooperative is positioned, for its own members, as a wholesale supplier or as an administrative centre to collect and coordinate purchasing orders. The basic owners of the Conad distribution organization are the retailer members who make up the cooperative and who make up the governing organ of their common company, with the cooperatives governed by a retailer member assembly, and in turn the National Conad Consortium is governed a board made up of representatives from the territorial cooperatives.

The agreement between the enterprises and their cooperative is, however, much more involved than the mere re-sale of goods, and is similar to a franchising agreement where the retailer is the affiliate and the co-operative the co-ordinating body. The cooperative provides its brand, logo, know-how and assistance in distributing products that it sells and delivers to its affiliate. Moreover, through other associated companies, it provides other services to its members, for example, technical, financial (leasing, etc), human resource management, computer services and training, and legal and administrative services.

In sum, the CONAD system is made up of horizontal and vertical agreements aimed at providing its various member companies, that are legally distinct, a uniformity of strategic guidelines, of sales policies and a shared external image and favourable supply terms to allow retail members to compete effectively in the market and serve consumers well.

Source: based on material provided by ANCD/Conad and secondary published sources

2.B Organizational structure and composition of groups

- 2.5 As evident from our questionnaire survey (detailed in Appendix B), the structure, functioning and organisation differ widely among associations and groups of independent retailers.³² For example, some associations simply represent groups of independent retailers, other organisations represent retailers directly, and yet other organisations represent both groups and individual retailer members. With regard to the functioning of the association or group, the central office is often organised by an executive board (usually including elected retail members) or management aided by an advisory council, in other cases it is organised by working groups. In practice, it appears that there is widespread heterogeneity in the organisation and structure of associations/groups, each differing according to the market, legal and historical context in which they operate.
- 2.6 In regard to ownership and ultimate control of associations/groups, we found a variety of different ownership/control modes. Generally, we found that organisations are owned by their members or by associates. For example, this can entail independent retailer members owning their central organisation (i.e. the central office function) or at least being direct shareholder and members of the organisation. At a different vertical level, though, it could be wholesale cooperatives owning their central organisation. Nevertheless, there are other organisation/ownership models present, such as stock corporations, trade associations with no commercial links between members, and vertical chain operating systems.
- 2.7 As might be expected with such diverse structure/ownership patterns, we found notable differences in how the central office function of the group is managed. For most cases, the central organisation is managed by an executive board or management aided by an advisory council. A number have a permanent secretary, while others have decisions taken in working groups. Most associations/groups have permanent staff or management staff dealing with the day-to-day operation of the organisation, generally indicative of the independent retailer group taking on more roles than joint purchasing, such as joint marketing activities, management of logistics and providing other services to members.

³² The word “association” is used in Article 2 point 2 of the “Regulation 2790/1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices” whereas the businesses concerned prefer to use “groups of independent retailers”. For the sake of clarification and solely for the purpose of this report, we use the term “group” to refer generally to a single organisation representing a common set of independent retailers. We use the term “association” to refer generally to apex or higher-level organisations that represent different groups of independent retailers or serve a strategic/political role for a specific group of independent retailers. We realise that in practice, the terms “association” and “group” may be used interchangeably.

2.C Behaviour and practices used by groups

Types of agreements between organisations and independent retailers

- 2.8 Our questionnaire survey revealed that coordination between the groups or individual retailer members represented takes place in various ways besides explicit contractual agreements. These include voluntary service offers, gentlemen's agreements, and regulation of the relationship in the organisation's statute. Voluntary service offers include the transfer of know-how, information services, lobbying and/or training.
- 2.9 For those groups that use contractual arrangements between themselves and their independent retailer members, the nature and content of the contracts appear to be very diverse, ranging from mandatory price negotiations to various marketing agreements. One of the most common arrangements related to inducing retailers to concentrate a certain percentage of their purchases (usually around 80%) from one supplier (in order to ensure central purchasing efficiencies). Other contractual arrangements allow the group (specifically, the central office) to retain the right to a store's location (so to allow for control over future store planning and growth of the store network). In addition, some groups have brand licensing agreements in place. Other groups set up framework agreements, which serve as a basis for individual agreements between retailers and suppliers. In these cases, the central office of the group provides essentially a facilitating service, rather than engaging in joint purchasing (which is more typical).
- 2.10 Many groups also appear to have price recommendations in place (perhaps through a suggested schedule or menu of price points that retailers may wish to use, rather than a specific suggested price for a specific product). Nearly all price recommendations relate to suggested prices or maximum resale prices. Some groups limit price agreements or recommendations only to certain brands (e.g. private label or exclusively supplied branded goods) or promotion goods (where some control is needed to ensure a consistent retail image across the group and ensure that consumers obtain the advantages of low prices for key products), or only applied to selected retailers (for the purpose of common retail branding).
- 2.11 Overall, the most common contractual agreements appear to relate to marketing/promotions and exclusive purchasing. Other contracts may exist in relation to certain legal forms of resale price maintenance (typically suggested prices or maximum retail prices; more rarely fixed or minimum prices and then always in relation to short-term promotions for strictly limited numbers of products), license agreements (e.g. retail brand/fascia agreements),

benchmarking contracts, exclusive territorial requirements (though allowing for passive selling into other territories), and obligations to purchase a minimum amount.

- 2.12 The majority of contracts appear to be mainly vertical in nature, between a central office function and independent retailer members, and not between individual retailer members (as a horizontal arrangement). Furthermore, for the majority of groups surveyed, it is not a condition of membership that all independent retailers have to adhere to all agreements.
- 2.13 In general, agreements appear to be a mix of voluntary agreements and binding contracts. Among the mandatory agreements, the most common appear to relate to promotions and advertising, followed by exclusive purchasing and minimum purchasing obligations.

Benefits and necessity of agreements

- 2.14 The consistent view reported in the responses to our questionnaire was that the chief benefit of the agreements relate to the cost savings they create for members. Cost savings result from economics of scale in purchasing, logistics and marketing. These cost savings are passed on to the consumer in the form of lower prices and a larger choice of products. The agreements, and the cost savings they create, are considered to be necessary for independent retailers to compete against the often much larger integrated chains they face in their retail sectors. They allow retailers to survive and prosper, thereby reducing concentration and contributing to the level of competition in the market and level of retail choice available to consumers. Besides cost savings, commonly listed benefits of the agreements used include joint marketing as a means of achieving a well-recognised retail brand and unified store image. Also, groups see maximum pricing as means of ensuring low prices for customers because retailers are free to set lower prices but are prevented from setting higher ones.
- 2.15 In general, the questionnaire responses that we received argued that it is indispensable for independent retailers to cooperate and pool their resources and bargaining power in order to be able to compete effectively against integrated chains. For example, obligations to purchase are viewed as critical to ensuring that the lowest prices are received from suppliers. Similarly, franchise-type agreements (e.g. over store fascia and retail branding under a common logo) were deemed necessary for the existence of same-branded retail operations.
- 2.16 In the absence of agreements, greater costs and higher purchase prices may be expected for independent retailers. The estimates of these higher costs we received from our questionnaire pointed to extra costs due to higher purchase prices of 1% of gross turnover or up to 5% - 20% of costs (the lower end being for larger retailers, the top end for the smallest retailers).

In general, the extra costs were considered to relate primarily to higher purchase prices, fixed costs of negotiation and lower economies of scale.

2.17 Apart from higher purchase prices and the costs of individually negotiating and contracting with suppliers, a number of additional reasons for higher costs facing unaffiliated retailers (i.e. in the absence of benefits from being part of an independent retailer group) were also cited:

- Increased costs from advertising and marketing (possibly as high as an additional 70% for advertising costs);
- Having to buy more from regional suppliers (by not have the bargaining clout or scale to deal with national or international suppliers);
- Having to resort to selling brands which are less well known to consumers;
- Facing the disadvantage of not operating as an established retail brand (widely recognised by consumers);
- Having to operate with a smaller choice of products, including choice of imported products; and
- Availability of detailed business information.

2.18 In the absence of an independent retailer group to provide these benefits to retailers, the expected impact of consumers was seen as resulting in a reduced choice of products and higher prices, along with a long-term decline in the number of independent retailers. Also, it was observed that any exit of retailers would be likely to hit particular communities badly, especially in rural areas where retail choice is already limited.

2.D Key issues and challenges facing groups

Nature of competition

2.19 Our questionnaire survey showed that independent retailer members compete in several areas, including the level of service and choice as well as on prices. Competitors are viewed as other retailers in general, but most significantly integrated retailers, with the most significant challenge posed to small-format independent retailers being hypermarkets and discounters. Respondents indicated that their independent retailer members find it increasingly difficult to compete with the aggressive pricing policies of integrated chains (including the perception that these competitors use below cost selling to undermine their positions). Nevertheless,

compared to unaffiliated independent retailers, who are not members of any group or association, the consistent view expressed was that independent retailers as members of a group were in a significantly better position (albeit with some limitations) to compete with integrated retailers.

- 2.20 Regarding cost efficiency, compared to integrated chains, respondents indicated that independent retailers are generally less cost efficient because they do not benefit from the same extent of economies of scale that benefit large integrated chains, especially in purchasing. Another factor contributing to the relative cost inefficiency of retailers compared to integrated chains was considered to be retailers' higher personnel costs due to their higher level of service and fewer possibilities to balance staff requirements.

Issues relating to national and European competition policy

- 2.21 Respondents to our questionnaire reported that there are several practices which are currently prohibited but which should, in their view, be allowed; for example, common pricing for promotion goods (and thereby permit some equity with integrated chains) and allowing international agreements between groups of independent retailers (so that they procure more effectively on an international basis). Furthermore, some respondents stated that certain pricing and purchasing practices, which are allowed for integrated retailers, and extensively used by multinational operators, should be allowed for groups of independent retailers (e.g. control over retail prices and exclusive purchasing obligations).
- 2.22 Other areas of expressed concern relate to the manner in which agreements are assessed. Some respondents noted that (under the EC treatment of vertical agreements) a market share threshold of 30% is too low to ensure that the efficiency benefits of agreements can be fully obtained. It was also argued that market definitions should also take into account the purchasing/wholesaling market and not just the relevant retail market in the general treatment of retail groups. A further issue raised was the evaluation of horizontal aspects in an agreement, with concern that these should not influence the evaluation of vertical agreements (as typically these are prejudged if horizontal agreements are in place). Another concern expressed relates to problems posed by a lack of legal certainty; for example, regarding the extent to which a vertical central unit with a market share exceeding 30% may use maximum pricing.
- 2.23 More generally, respondents took the view that present regulations and policy guidance do not give sufficient weight to the economic reality facing independent retailers, appearing to hamper rather than assist their ability to compete on effective terms with integrated retailers.

Independent retailers and their groups appear to be discriminated against because of their organisational and ownership form, and not because of their competitive behaviour and their impact on the markets that they serve.

2.24 As a consequence of present regulations, restrictions and prohibitions, groups noted that there were a range of services that they were unable to offer their members and so detrimentally affected their members (and consumers as well) in particular ways: e.g.

- Fixed prices for end-consumers (which may harm the consistency of the retail offer and make it more difficult for independent retailers to compete with integrated chains, to the detriment of consumers);
- Purchasing of branded goods in the most inexpensive national market (which prevents independent retailers being able to compete on the same terms as multinational integrated retail chains, and generally prevents them serving their local customers with products at the lowest possible price);
- Parallel trading (which, again, prevents independent retailers being able to compete on the same terms as multinational integrated retail chains, and generally prevents them serving their local customers with products at the lowest possible price); and
- The use of purchase obligations (which prevents the group from being able to negotiate the best possible terms with suppliers for the benefit of retail members, in the process serving to place independent retailers at a competitive disadvantage and make retail prices higher than they would otherwise be).

2.25 In addition, there were other services cited by groups that were unable to provide members due to European competition rules and/or specific national regulations including factoring, 100% purchasing, common advertising, internet sales, and central buying on a European scale.

2.26 It was also apparent that different restrictions apply in different national jurisdictions. Accordingly, some groups could benefit from certain practices in some countries, while other groups in other countries were prevented from using the same practices. Differences across countries were noted in regard to the treatment of common pricing, environmental regulations, restrictions on selling goods below cost, group exemptions, and the extent of regulation towards large volume distributors.

2.27 Furthermore, there were a number of concerns expressed about future treatment and possible challenges from competition authorities that might affect the range of scope of benefits which

groups could offer members. Examples cited included the collective size (i.e. turnover) of their independent retailer members (given existing competition policy rules and its focus of specific market share thresholds), restrictions on international trading agreements for groups, lowering of 80% of purchase commitments rule for groups with high collective market share, competition rules which are too strict or too unclear, and the possible discontinuation of the use of a pricing index in one country.

- 2.28 Overall, the most significant impacts on the operation of groups of independent retailers in relation to existing European and national policy were seen by questionnaire respondents to arise from (1) the restrictions/prohibitions on agreements for common retail pricing, (2) the market share and turnover limits applicable to vertical and horizontal agreements, (3) the unequal policy/legal treatment of groups of independent retailers compared to integrated retail chains and other organisational forms, (4) restrictions on the use of purchasing obligations, and (5) the treatment of mixed arrangement structures involving both horizontal and vertical agreements (where assessment is typically made by examining effects in isolation rather than being considered collectively).

Costs and benefits of retailer independence

- 2.29 Faced with both challenging market and legal/regulation environments, favouring integrated retailers and other retailer forms (like business format franchising) we were interested in why independent retailer members wished to remain as independents. The most frequently listed reasons were independence, freedom and entrepreneurship. The questionnaire responses indicate that independence is often seen as a value in itself. Reasons relating to tradition and cultural and community drivers were further mentioned.
- 2.30 However, respondents also noted that fully integrated firms have several advantages that their members do not have. The advantages of fully integrated retailers include:
- Internal financial balancing through appropriate capital substitution;
 - Better communication (e.g. benchmarking figures which allow integrated firms to learn about best practices) and shop design (with a consistent approach, but if necessary adapted to best suit local conditions);
 - Full control over retail prices with the possibility to set the same prices for branded products across all stores, or varying them according to their perceived local needs; and
 - More leverage when purchasing products by being able to better guarantee certain levels of sales and provide guaranteed levels of in-store promotion.

- 2.31 Even so, most independent retailer groups indicated the greatest problem they faced was not in terms of single-owned integrated chains being inherently more efficient (as they could, if allowed, offer their members the same level of efficiency benefits), rather it was restrictions and regulations that hampered their own efficiency and competitive ability. If they were allowed greater freedom and flexibility in the services and agreements that they could operate then they felt that they would be more efficient operators, be better able to compete with and challenge the positions of integrated retailers and other retail forms, and so serve consumers better through improved service quality, greater choice and lower prices.

3. Vertical Restraints Policy in the European Union

This section examines vertical restraints policy in the European Union. It discusses the role of vertical restraints for groups of independent retailers within the general context of understanding the economics of vertical restraints. The section reviews and critically assesses current EU policy, identifying areas where existing policy may be serving to prevent efficiencies being realised and pro-competitive practices stifled, and as such not working in the best interests of consumers.

3.A Role of vertical restraints for groups of independent retailers

- 3.1 While at the time of their creation, many groups were ostensibly a horizontal collaboration for the purpose of joint purchasing and representation, independent retailer groups have typically developed over time through vertical arrangements between individual members and a central administrative function, involved in purchasing, marketing and other activities, operating on their joint behalf. As such, these arrangements typically cover a range of vertical agreements that are intended to condition or restrain the behaviour and actions of both the central function and individual members with the intention of improving their mutual ability to compete and be efficient in both procurement and retail markets. For example, contracts may exist between the central function and individual members that dictate how each side must conduct key aspects of its business, such as the product assortment that the retailer should use and the maximum prices at which goods should be sold to consumers.
- 3.2 Such vertical agreements are intended to promote benefits for the parties concerned (for example, ensuring a consistent retail offer and image to enhance demand and improve negotiating positions with suppliers). Nevertheless, they may have implications for external parties (principally, customers, suppliers and/or competitors) that adversely impact on their economic well being, perhaps because their own behaviour or choices are thereby limited or they suffer from a direction reduction in their own welfare (e.g. income). In the latter regard, there may be concerns about restraints serving a sufficiently strong anti-competitive purpose that they outweigh the positive private benefit that the contracting parties attain, with the net result that economic welfare and market performance decline (e.g. higher final prices, reduced output, and restricted product/service choice for consumers).
- 3.3 As independent retailer groups increasingly rely on vertical agreements for generating efficiencies and allowing their members to compete more effectively in retail markets, the policy treatment towards their use of these agreements takes on special importance. In view

of this, we consider in this section the economics of vertical arrangements and the general policy treatment for these arrangements in the European Union. We begin by outlining the reasons for why vertical restraints are used, their role in promoting efficiency and their effects on competition (which may be pro- or anti-competitive effect). We then consider and take a critical perspective on current EU competition policy, the rules and guidance offered by existing regulations and case law, and the relevant tests to be used in assessing net economic effects.³³ As such the discussion in this section represents an important prelude to our discussion of specific policy treatment towards independent retailer groups taken up in the next two sections of the report.

3.B The economics of vertical restraints

- 3.4 The appropriate policy treatment for vertical restraints has long been a contentious subject. Vertical restraints are essentially restrictions on the freedom of behaviour for one or more undertakings resulting from a vertical agreement between trading parties. The central problem is that while vertical restraints may serve to prevent, restrict and/or distort competition, they may equally offer efficiency improvements (e.g. through reduced costs or improved quality), and thus the net economic effect is *a priori* ambiguous in most cases where market power is or might be an issue.³⁴
- 3.5 Clearly, where the anti-competitive effects of a restraint outweigh any efficiency benefits, then societal welfare³⁵ would be improved by the restraint being prohibited. Otherwise, the vertical agreement should be permitted. Unfortunately, pinning down precisely the conditions where the net *economic effect* is or is not anticompetitive is far from straightforward and it is not possible to rely solely on the *contractual form* of restraint as effectively every type can in

³³ For an extended discussion of the economic and policy issues summarised in this section of the report, see Paul W. Dobson, “Vertical Restraints Policy Reform in the European Union and United Kingdom”, LUBS Research Series Paper 2005:2, Loughborough University, 2005.

³⁴ Where market power is absent it can usually be assumed that vertical restraints will have no significant detrimental effects on competition. However, competition authorities may still make exceptions and, as particularly relevant in the next section of the report, they may adopt a tough stance on all vertical pricing fixing arrangements as well as other arrangements when they are industry-wide or at least very common, regardless of the industry’s structural features (e.g. all firms having low market shares).

³⁵ The term “societal welfare” is treated here as synonymous with *economic welfare*, which is generally taken as a weighted sum of *consumer surplus* (i.e. the amount above the actual price that a consumer would willingly pay if necessary to consume the units purchased) and *producer surplus* (i.e. the level of economic profit in the sense of the largest amount that could be subtracted from the supplier’s revenue that would still induce the provider to offer the product). In practice, competition authorities may be expected to give greatest (if not all) weight to consumers’ interests (e.g. adopt a “consumer welfare standard” as opposed to a “total welfare standard” when consumers’ and firms’ interests appear to be in conflict).

principle exhibit both anti-competitive and efficiency-enhancing effects, indicating the need for case-by-case analysis.³⁶ In this regard, economics has a critical role to play in determining the overall impact of a vertical agreement.

- 3.6 The importance of determining appropriate policy treatment for vertical restraints cannot be underestimated. It is not an exaggeration to suggest that most ongoing trading relationships involve one or more vertical restraints. For simple, one-off, arms-length transactions, it is quite possible that the terms and conditions of trade may be no more than a simple contract specifying the price, quantity, and timing/nature of exchange/provision of the traded goods/services. However, with ongoing or repeated exchanges, it is usual for contracts to have additional terms and conditions, in part to encourage compliance with the terms of the contract, as well as to counter potential opportunistic behaviour (i.e. to ensure parties keep within the intention or spirit of the contract). For example, there might be incentive and/or penalty clauses or detailed specification of behavioural requirements in order to avoid potential moral hazard problems, where one party's behaviour is not fully observable by the other party (i.e. where monitoring becomes problematic).
- 3.7 In many instances, contracts may make extensive use of terms and conditions that collectively amount to several vertical restraints simultaneously applying. Moreover, not all the terms and conditions will necessarily be about ensuring compliance and overcoming potential problems in the supply or use of the traded goods or services. Some, whether intentionally or inadvertently, may affect the behaviour of one or both trading parties in a manner that adversely affects the economic outcomes of the markets they respectively operate in. However, this is only likely to arise where market power is an issue and where vertical restraints serve to magnify or exacerbate competition problems. It is with regard to tackling these instances, and distinguishing them from the vast bulk of cases where restraints do not harm competition, that competition policy towards vertical restraints policy is generally framed.
- 3.8 In considering the net economic effects (whether pro-competitive or anti-competitive) of an individual or number of restraints, we start by considering the economic role played by vertical restraints and their effects on the economic performance of markets.
- 3.9 Vertical restraints can, in principle, occur at any stage of the supply/distribution process for a product or service. They are intended to restrict the actions or place an obligation on the

³⁶ Specifically, a potential welfare trade-off is typical with most vertical restraints, if to differing degrees and usually depending on the circumstances.

behaviour of one or both trading parties in some way. For example, this could be the seller obliging the buyer not to trade with any rival supplier (i.e. exclusive dealing), the seller agreeing to exclude sales to some or all other buyers (i.e. respectively, selective or exclusive distribution), or the supplier dictating the buyer's resale price (resale price maintenance - RPM). The purpose of such restraints is to tackle distribution and/or supply problems that in some way damage the joint profits of the parties (even though they may favour one party over another) – e.g. problems arising from sub-optimal investment, effort or sales, excessive transaction costs, or excessive competition. Moreover, given the multiplicity of distribution/supply problems that can arise, vertical restraints can occur on their own or in combination with others, apply to one trading relationship, several relationships, or be generally applicable in a market (i.e. where they are operated in parallel by different parties).

- 3.10 The view traditionally held in the economic analysis of vertical restraints is that they are motivated by the desire for vertical control within a principal-agent relationship, where the principal (e.g. a manufacturer) imposes contractual obligations on its agent (e.g. a retailer) when delegating responsibility for selling its good. In this framework, vertical restraints are viewed as responses to supply and distribution problems facing the principal. The problems stem from a divergence of the parties' interests, typically over the level and type of retail service. The notion is then that the principal uses vertical restraints in order to bring the agent's interests into line with its own interests.
- 3.11 The key problems for which a supplier (e.g. a manufacturer or wholesaler supplying a retailer) as a "principal" may wish to control are summarised in Table 3.1 (shown below). These fall into two groups. Firstly, problems may arise for a supplier, independently of concerns about competition with other suppliers, from retailers taking actions designed to maximise their own profits, but which act against the supplier's interest, i.e. concerns about "intra-brand" competition. These are represented by the first four problems in the table. Secondly, problems may stem from the actions of rival suppliers that have an adverse impact on the supplier's profits, i.e. concerns about "inter-brand" competition. In this case a supplier may wish to use particular vertical arrangements to deal with the other two problems listed in the table, i.e. concerning competition at the same level as the supplier.

Table 3.1 - Vertical Restraints as Responses to Supply and Distribution Problems

{P RI V A T E } Problems in supply and distribution	Contractual solutions
1. Successive (supplier then retailer) mark ups which result in prices being set higher than the optimal level (attained by setting a single mark up)	Two-part tariffs Quantity requirements Retail price ceilings
2. Damaging price competition between retailers which may dissuade retailers from stocking the supplier’s products	Resale price maintenance Exclusive distribution
3. Free riding by retail price discounters on the pre-sales services and/or reputation of full price dealers leading to under-investment by retailers	Service requirements Resale price maintenance Exclusive distribution Selective distribution
4. Providing the optimal number and density of dealers and capturing economies of scale in distribution	Resale price maintenance Selective distribution
5. Free riding by rival suppliers on product's image, advertising, and customer drawing power or on investment in dealers leading to under-investment by manufacturers	Exclusive dealing Fidelity rebates/discounts
6. Profit damaging price competition between rival suppliers offering similar (i.e. substitutable) products	Exclusive dealing Tie-in sales Exclusive distribution

Source: Adapted from Paul Dobson and Michael Waterson, “Vertical Restraints and Competition Policy”, Research Paper 12, Office of Fair Trading: London, 1996.

3.12 As shown by Table 3.1, it is apparent that different restraints may serve the same basic purpose. Though, in practice they may vary in their effectiveness, which along with legal and practical considerations is likely to determine the supplier’ choice. For instance, with a form-based policy, where a particular restraint is prohibited, e.g. minimum resale price maintenance (“RPM”), then a problem, say dealer free-riding³⁷, could in principle be tackled

³⁷ For instance, a dealer free-riding problem might occur when sales are maximised when dealers invest in demonstration services but they individually or collectively would not be prepared to undertake such action, instead choosing not to provide such services. In this situation a “market failure” problem arises because each dealer would under-invest in this services leading to sub-optimal sales. In order to overcome the problem, all dealers would have to be sure that (a) all other dealers would undertake similar investments and (b) they themselves were obliged to undertake such investment. This might be resolved by one of several different vertical restraints: (i) a service-level requirement (but which might be difficult for the supplier to monitor), (ii) a selective or exclusive distribution system which only allowed “full service” dealers to act as distributors (thus deliberately excluding low-service “discounters”), or (iii) (minimum) resale price maintenance (as this would mean that dealers would have to compete for customers through their service offer rather than through their

by implementing an alternative restraint. Accordingly, with this policy framework, firms may be tempted to adopt “form shopping”, i.e. use permissible restraints which have the same economic effects as prohibited restraints. On the other hand, it might be argued that such a policy approach may be preferable where the prohibited restraint has potentially multiple anti-competitive effects.

- 3.13 From the perspective of tackling distribution and supply problems, vertical restraints are imposed in order to increase profits. However, the problem for the policymaker is that the net economic effect of a restraint on society (i.e. taking account of the interests of the consumers and the firms operating in the market or sector) is not immediately obvious. For while vertical restraints may benefit society when they increase efficiency, say by allowing for improved investment decisions, reduced costs, and improved product/service quality, they may equally have a detrimental effect by restricting and distorting competition.
- 3.14 More specifically, an anti-competitive effect can arise through a restraint serving one or more of the following:
- (i) raising barriers to entry or expansion (i.e. a so-called “foreclosure effect”),
 - (ii) reducing the intensity of competition between existing firms (either for one particular brand with reduced intra-brand competition or between different brands with reduced inter-brand competition), or
 - (iii) facilitating collusion (including tacit collusion through conscious parallel behaviour).
- 3.15 Accordingly, each case needs to be examined on its merits and the market circumstances and other features will be particularly important in determining which effect (pro- or anti-competitive) is likely to dominate.

3.C Current vertical restraints policy

- 3.16 The message from economics is very clear: all vertical restraints need to be assessed on a case-by-case basis in their market context. Any vertical restraint can potentially have pro- or anti-competitive effects. However, if market power is absent it can be presumed that (in the absence of cumulative or parallel effects) there will be no significant impact on competition arising from vertical restraints and so they should be permitted so that the parties can benefit

retail prices). Clearly, each of these is different in respect of its directness – the first being the most direct, the third being the least direct.

from the efficiency benefits offered by the arrangement. Only when market power operates by one or both parties can there be a significant risk that the overall effect will be anti-competitive (and even here this far from certain when there are significant efficiency benefits offered).

3.17 In recognition of the limitations and inappropriateness of previous treatment, with its emphasis on “legal form” of vertical restraints, policy in the European Union and individual member states has shifted towards a more “economic effects” based approach. Thus, following extensive consultation,³⁸ the European Commission issued a new general block exemption regulation,³⁹ which came into force in 1999 (and effectively replaced the old sector specific block exemptions), and issued *Guidelines on Vertical Restraints* (hereafter referred to as “Vertical Guidelines”) in 2000⁴⁰.

3.18 Nevertheless, the EC Block Exemption Regulation retains a strong element of a “legal form” approach to vertical restraints policy by outright prohibiting particular restraints and limiting the use of others, and more generally using market share thresholds as surrogates for determining whether market power is likely not to be a concern (for levels below the threshold). In particular a set of five “hardcore restrictions” are not exempted:

1. resale price maintenance (except maximum or recommended resale prices provided that these do not amount to fixed or minimum resale prices)
2. restrictions concerning the territory into which, or the customers to whom, the buyer may sell (other than for certain trade used in exclusive or selective distribution)
3. restrictions on active or passive selling to end-users by authorised retail distributors in a selective distribution system (as long as the distributor sells only from a given location)

³⁸ Summarised in the European Commission’s “Green Paper on Vertical Restraints in EC Competition Policy” (published in January 1997) and the subsequently issued *Communication*, which set out the European Commission’s preferred course of action to remedy the identified shortcomings of then existing policy. See, respectively, European Commission, *Green Paper on Vertical Restraints in EC Competition Policy*, Com (96) 721, 4 C.M.L.R. 519, 1997 (available at http://europa.eu.int/comm/competition/antitrust/96721en_en.pdf) and European Commission, *Follow-up to the Green Paper on Vertical Restraints: Communication on the Application of the Community Competition Rules to Vertical Restraints*, 1997 (at http://europa.eu.int/comm/competition/antitrust/com1998544_en.pdf).

³⁹ Commission Regulation (EC) No 2790/1999 of 22 December 1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements and concerted practices (OJ L 336, 29.12.99, p.21), the so-called EC Block Exemption Regulation.

⁴⁰ See European Commission, *Commission notice - Guidelines on Vertical Restraints*, Official Journal C 291, 13/10/2000, pages 1-44 (available at http://europa.eu.int/eur-lex/pri/en/oj/dat/2000/c_291/c_29120001013en00010044.pdf).

4. restrictions on authorised distributors in a selective distribution system selling or purchasing from other members of the network (i.e. relating to cross-supplies amongst distributors)
5. restrictions on the sale of components as spare parts by the manufacturer of the component to end-users, independent repairers and service providers (i.e. relating to after-market sales)

3.19 For each of these cases it is argued that the anti-competitive effects are likely to be high and the efficiency benefits relatively weak (or at least not significantly greater than could be attained from using other arrangements). In regard to possible anti-competitive effects it is important to distinguish between those arising at the upstream level and those arising at the downstream level. If we take the upstream level to be suppliers of brands selling to distributors/retailers at the downstream level, then an important distinction is between what is termed “*inter-brand competition*” (i.e. rivalry between different supplier brands) and “*intra-brand competition*” (i.e. rivalry between distributors/retailers selling the same brand). In this context, a vertical restraint would necessarily be directed at influencing one or other of these two types of competition, but through knock-on consequences both might be affected.

3.20 Now in respect of the five hardcore restrictions, we can note that the first of these relates to vertical price fixing, something that is *per se* prohibited in most developed countries on the basis that it completely bars intra-brand price competition and can facilitate supplier collusion (i.e. weaken inter-brand competition by making it more straightforward to identify and move towards “focal prices” and assist in monitoring collusion through increased price transparency). Thus resale price maintenance has the effect of potentially preventing both intra-brand and inter-brand competition. Nevertheless, the practice may offer efficiency benefits, as noted in the previous sub-section, and it is not certain that the net effect will be anti-competitive. Indeed, the prejudice against RPM owes more to do with its history of being used by powerful producers seeking to control the retail prices of their goods in order to dampen inter-brand competition across all retail establishments.

3.21 This last observation is important since, as discussed later in the report in section 5, in the context of independent retailer groups, RPM would only apply to members and not the whole retail sector – i.e. would restrict *intra*-group competition but not *inter*-group competition. Moreover, in this specific context, the effect is exactly the same as an integrated retail chain being freely allowed to centralise its pricing decisions to dictate prices at all its stores (rather than, say, have local managers determine local prices). This begs the obvious question: why

can integrated chains be allowed to do this but independent retailer groups be prevented from doing this when the effect is exactly the same?

- 3.22 The other four restrictions, though, relate to various aspects of selective and exclusive distribution, but again where there are restrictions on intra-brand competition. However, rather than a concern about diminished inter-brand competition (which could only be expected to arise indirectly, say from the deliberate separation of downstream markets), the prime concern with these four restraints appears to be that they can lead to segmented markets (particularly for consumers) and increased scope for price discrimination – something very much at odds with the European Commission’s policy desire for integrated markets (preferably Community-wide) and an absence of barriers to trade across territories within the EU. In other words, while there may be competition concerns, there appears also to be a strong political motive behind the special treatment afforded these four restrictions – certainly compared to the much more benign view taken towards other non-price vertical restraints.
- 3.23 In addition to the prohibited hardcore restrictions, there are rules governing the use of certain other restraints. Most importantly in the present context of independent retailer groups, exemption does not apply to any non-compete obligation (like exclusive dealing, purchasing obligations or tying), where buyers are obliged to use the supplier (e.g. wholesaler) for more than 80% of their supply needs, if its duration is indefinite or exceeds five years.⁴¹ The primary concern here is about foreclosure effects on other suppliers, where they might not gain access to a market when all distributors are tied up.
- 3.24 Again, as with the prejudicial treatment towards RPM, this harsh treatment towards non-compete obligations appears to be very much applicable to concerns about the behaviour of powerful producers seeking to limit inter-brand competition and prevent new entry at their level, and thus potentially prevent new products coming into the market. The same does not apply with independent retailer groups where the issue is about a central office or wholesale operation providing purchasing and marketing activities on behalf of members. In these circumstances, there is no concern relating to product or service foreclosure as this central service works on behalf of all members (and the efficiency benefits increase with the greater the level of member participation as the central function benefits from increased scale economies). In this context, the only issue is one of possible replacement for this function and not about the need for choice from multiple service providers (which would be excluded

⁴¹ This position facing independent retailer groups as buying groups, wholesaler-led voluntary associations, symbol groups, and retailer co-operatives is in notable contrast to the position faced by retail franchises which are not generally subject to the limit of five years. See point 200 (2) of *Guidelines on Vertical Restraints* (OJ C 291, p. 1, 123/10/2000).

under non-compete obligations). Moreover, there are no concerns about a lack of in-store competition that might arise with producer-led non-compete obligations, resulting in retailers selling only one brand. In the present context, retailers will be catered for by the central function and be offered as wide a range of products as befits the marketing image and position of the group as a whole (normally a wide range of brands from multiple producers). These fundamental points, about the distinct position that applies to independent retailer groups, will be discussed in more detail later in the report in sections 4 and 5.

3.25 In regard to all other vertical restraints, the main criteria for exemption rests on the market share of the parties involved. Specifically, in the absence of possible parallel network or coordinated effects, if the parties each have less than a 30% share of their relevant market then practices will generally be covered by the block exemption regulation. Above this market share threshold there is no presumption of illegality. Instead, the threshold is intended to serve as a means of distinguishing the agreements that are presumed to be legal from those which may require individual examination.

3.26 With regard to self-assessment, the Vertical Guidelines propose the following four-step procedure for assessing the impact of a vertical restraint:

1. Define the relevant markets for the supplier and buyer and calculate their respective market shares.
2. check to see that neither market share exceeds 30%, in which case the vertical agreement is covered by the Block Exemption Regulation, subject to the hardcore restrictions and conditions set out in the regulation.
3. When a relevant market share exceeds 30%, assess whether the vertical agreement falls within Article 81(1).
4. If the vertical agreement falls within Article 81(1), examine whether it fulfils the conditions for exemption under Article 81(3).

3.27 For a restraint where the 30% market share threshold is met, the procedure effectively calls for a full competition analysis to assess whether the vertical restraint fulfils the conditions for exemption (as dictated by Article 81(3) of the EU Treaty). In this case, the assessment would be with regard to four economic tests:⁴²

⁴² These four tests are derived directly from Article 81(3) which states that a prohibition (in respect of Article 81(1)) does not apply to any agreement, decision or concerted practice “which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not: (a) impose on the undertakings concerted restrictions which are not indispensable to the attainment of these objectives;

- i. *Economic efficiencies*: Does the vertical agreement contribute to improving production or distribution or promoting technical or economic progress (i.e. offer efficiency benefits)?
- ii. *Consumer benefits*: Does it allow consumers a fair share of these benefits (e.g. by increasing choice, quality or accessibility and/or lowering prices)?
- iii. *Absence of any unnecessary restrictions*: Does the arrangement constitute the minimum necessary restriction to yield these benefits?
- iv. *Continuing effective competition*: Does it operate in a manner that does not eliminate competition in respect of a substantial part of the market?

3.28 Only with all four tests satisfied would the restraint meet the conditions for exemption.⁴³

3.29 In regard to the positive effects of vertical restraints, the EC's Vertical Guidelines note these, similar to Table 3.1 above, as arising from a number of sources that can solve a variety of distribution/supply problems giving rise to sub-optimal investment and sales.⁴⁴ For example, vertical restraints may (in the absence of strong anti-competitive effects) be justified on the grounds of (i) solving a free-rider problem (causing under-investment), (ii) encouraging new investment, (iii) facilitating new entry into markets, (iv) allowing for a different promotional strategy in different markets, (v) achieving economies of scale in distribution, (vi) alleviating capital market imperfections, or (vii) allowing for uniformity and quality standardisation.

3.30 In evaluating the overall effects of restraints, i.e. weighing the negative and positive effects, the Vertical Guidelines propose some general rules. Firstly, competition effects can only arise if market power is present, i.e. where there is insufficient inter-brand competition. Secondly, it suggests that vertical restraints that reduce inter-brand competition are generally more harmful than restraints that only reduce intra-brand competition.⁴⁵ For example,

(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question”.

⁴³ It should be emphasised that a competition authority is not obliged to grant a formal exemption even if these tests are passed. While an exemption might offer the parties a high degree of legal certainty, and thus be much desired by them, the authority may decide to offer only informal guidance or at most a written opinion, which might at least be expected to carry some weight if the restraint is legally challenged, e.g. by potential competitors or customers.

⁴⁴ In other words, efficiency benefits are possible which correct for or help avoid situations of “market failure” in which sub-optimal outcomes would otherwise arise. These should also be seen as pro-competitive benefits since with increased efficiency firms will be better placed to compete more effectively and thereby pass on a portion of these benefits in the form of increased choice, improved quality and/or lower prices.

⁴⁵ However, there is little basis for this distinction from economic theory. The EC's position really relies on the view that the variety and range of goods offered are significantly more economically important than the variety and range of distribution services offered to consumers, when in fact both are likely to take on importance to consumers. Indeed, in one sense they are equally important in that

producer-led non-compete obligations, by foreclosing other brands, may prevent these brands from reaching the market, but exclusive distribution, which instead forecloses certain buyers, does not in general prevent the good from reaching the final consumer. A further general rule claimed is that exclusive agreements are generally worse for competition than non-exclusive agreements as the degree of foreclosure is likely to be higher. Also, negative effects are likely to be compounded when the practice is common within a sector (with cumulative effects arising from parallel networks operating). Moreover, the view taken is that vertical restraints at the intermediate level are likely to be less harmful than restraints affecting the distribution of final, especially branded, goods and services.⁴⁶

- 3.31 In regard to distinguishing between different types of restraints in terms of possible detrimental effects, the Vertical Guidelines identify four groups: a single branding group, a limited distribution group, a retail price maintenance group and a market partitioning group. It is argued that the division is appropriate since the “vertical restraints within each group have largely similar negative effects on competition” (point 104).
- 3.32 The single branding group comprises non-compete obligations and quantity forcing on the buyer as well as tying. The common element is that the buyer is induced to concentrate his orders for a particular type of good with one supplier. The chief competition effect is through reduced *inter-brand* competition as a consequence of foreclosure of certain suppliers and no in-store competition when retailers sell only one brand.
- 3.33 The limited distribution group covers exclusive distribution, exclusive customer allocation, exclusive supply, quantity forcing on the supplier, qualitative and quantitative selective distribution, and after-market sales restrictions. The common element is that the producer is selling only to one or a limited number of buyers.⁴⁷ The chief effect on competition is that it leads to foreclosure of certain buyers, which consequently may directly reduce *intra-brand*

goods and distribution services are perfect complements – i.e. consumers need both to make purchases. However, it is not necessarily the case that the decision over what to purchase and where to purchase it from are made simultaneously or in a particular sequence, or that one is prioritised over another. For instance, consumers may be encouraged to make purchases by the knowledge that a good is available in advance of their decision to use a specific retail service (e.g. through an advertisement) or only upon using a distribution service (and as such the purchase may be “impulse” in nature rather than “planned”). Furthermore, it is just as possible for retailers to “brand” their distribution services as it is for suppliers to “brand” their products to build up consumer loyalty and have a differentiation advantage over rivals.

⁴⁶ Again, there is little economic theory or evidence to support this distinction being made. Indeed, it could be that vertical restraints occurring earlier in the supply chain may have more far reaching effects as they can have knock-on effects right down the supply chain.

⁴⁷ Note, the term buyer here relates to an “intermediate” buyer such as a producer who uses the product or a wholesaler, distributor or retailer who sells on the product – i.e. not a “final” buyer like a consumer.

competition, which in turn may have the effect of reducing in-store *inter-brand* competition, particularly if the restraint is widely practised.⁴⁸

- 3.34 The resale price maintenance group covers minimum, fixed, maximum and recommended resale prices. Concern about maximum and recommended resale prices is that they may work as fixed RPM. The competition effects of (fixed) RPM are that *intra-brand* price competition is totally eliminated and the increased transparency on price and responsibility for price changes make horizontal collusion between manufacturers easier, at least in concentrated markets. The absence of *intra-brand* competition may also have the indirect effect of reducing *inter-brand* competition.⁴⁹
- 3.35 The market partitioning group is made up of exclusive purchasing, territorial resale restrictions, customer resale restrictions, and prohibitions of resale. The common element is that the buyer is restricted in where it either sources or resells a particular good, leading to a reduction in *intra-brand* competition that may aid the supplier or buyer to partition the market and thus hinder market integration and facilitate price discrimination.⁵⁰
- 3.36 Concerning differentiation of vertical restraints between groups, the view taken in the Vertical Guidelines is that RPM and market partitioning are likely to be more restrictive and offer fewer efficiency benefits than the other two groups.⁵¹ In addition, single branding (non-compete obligations) is generally considered to be more restrictive than limited distribution, reflecting the European Commission's view that *inter-brand* competition is more critical than *intra-brand* competition.

⁴⁸ The direct effect will be to reduce *intra-brand* competition when there are fewer distributors handling a particular good. If, though, the practice is widespread so that other producers use the same restraint and they tend to appoint separate exclusive distributors, say, and not rely totally on common distributors (which handle all producers' goods), then in-store choice for consumers will tend to be more limited compared to unrestricted distributor supply. This would then result in a reduced in-store *inter-brand* competition, serving to affect detrimentally overall *inter-brand* competition if consumers were reluctant to shop around. In contrast, though, where common distributors are used on an exclusive basis then this can enhance *inter-brand* competition, since the common distributor can act as an efficient sharable platform for producers.

⁴⁹ This may be because it facilitates collusion in the market as it may allow for "focal prices" to emerge, making it easier for rival suppliers to match each others' prices, while making monitoring prices more straightforward (given that all retailers set the same price for the same product).

⁵⁰ In themselves, these effects may not necessarily be detrimental to competition – and clearly there is a political aspect here about the perceived social desirability of having a common market with no price discrimination. Even so, there would be an adverse effect where these restraints lead to market segmentation which allows firms to avoid or reduce competition in sub-markets and as a consequence soften competition in the overall market (leading to reduced consumer choice, convenience or accessibility and/or higher prices).

⁵¹ The latter choice appears more politically motivated than any particular competition concern, reflecting the EU competition law aim at preventing "the creation of obstacles to market integration, including, above all, limitations on the freedom of consumers to purchase goods or services in any Member State they may choose" (Vertical Guidelines, point 103).

3.37 There may be some merit in these broad generalisations between different types of arrangements when it comes to assessing negative effects of producer-led restraints. However, this prejudiced perspective has an unfortunate bearing on independent retailer groups. The restraints that are of most value to such groups are non-compete obligations (because they improve the scale efficiency of the wholesale operation and its negotiating position in dealing with producers) and the restraints relating to the resale price maintenance group (because they assist in developing a consistent marketing image and appeal to consumers for the benefit of inter-group competition). Unfortunately, independent retailer groups are “tarred by the same brush”, so that even though there is considerably less cause for concern about any negative effect arising from such restraints when applied within independent retailer groups, they nevertheless receive a considerably more sceptical and even prohibitive response from competition authorities than do other restraints. This is apparent with both maximum resale prices and exclusive purchasing obligations, which are typically subject to restrictions in their use or application. It is even more apparent with fixed resale prices, which are outright prohibited (even if they might be required for optimising the effectiveness of short-term, limited-line promotions).

3.D Critical assessment of current vertical restraints policy

- 3.38 It should be apparent from this brief review of EU vertical restraints policy that while it might have the intention to be geared towards being economic effects based, it remains heavily form-based and mechanistic in nature. There are certain prohibited restraints (notably RPM and various market partitioning agreements), additional restrictions on specific restraints (like the duration limits on purchasing obligations), and a general market share threshold rule (that appears arbitrary and might or might not have any real bearing on whether market power is present in the specific market context in which the restraint operates).
- 3.39 In principle, Article 81 provides an appropriate legal framework for a balanced assessment of vertical restraints, recognising the distinction between welfare-reducing and welfare-enhancing effects. Specifically, Article 81(1) restricts the scope of Article 81 to agreements that appreciably restrict or distort competition, while Article 81(3) allows agreements caught by Article 81(1) to be exempted (from the consequences of 81(2)⁵²) if they provide sufficient

⁵² Specifically, Article 81(2) states that “any agreements or decisions prohibited pursuant to this article shall be automatically void”.

efficiency benefits. However, there are economic issues that suggest possible weaknesses and limitations of the new block exemption approach and the guidelines offered.

3.40 First, an important message from economic theory is that the effects of vertical restraints are entirely dependent upon market conditions and market behaviour. The new policy approach adopts a structural rule, based on market share alone - as a proxy for market power. This may be regarded as a crude way of capturing or releasing vertical agreements from regulation and, notwithstanding the comments in the EC's *Communication* and subsequent Vertical Guidelines, economics has yet to provide clear guidance on what might be appropriate levels of market share for thresholds, or even whether a sufficiently strong relationship exists between market share and the likelihood of anti-competitive effects outweighing efficiency effects to allow for thresholds to be used with any degree of confidence. Thus the 30% market share rule appears to be somewhat of an arbitrary level. Even with high market shares in evidence, it is of course entirely possible that the market may be acting in a competitive manner, particularly if market shares are highly unstable (i.e. volatility of market shares needs to be taken into account as well as the absolute levels). Equally, it is conceivable that firms with low market shares may be able to exert market power⁵³, where perhaps the vertical restraints may be market-wide and act to strengthen market segmentation and allow firms to avoid intense (e.g. head-to-head) competition (i.e. the extent of coverage of the restraint in the market may be crucial). More importantly from a business planning perspective, the EC's Vertical Guidelines singularly fail to provide suitable advice on the treatment of vertical restraints around the market share threshold limit, leaving the difficult problem of self-assessment to be made when there is the risk that competition authorities may subsequently take a negative view towards the restraints.⁵⁴

3.41 Second, and this has a particular bearing on the treatment of vertical restraints used within independent retailer groups, most of the anti-competitive concerns expressed in the Vertical Guidelines, and indeed going back to the Green Paper, are, at least by inference, to do with producers placing restraints on distributors. Indeed, this is reflected in the analysis and discussion set out in the Vertical Guidelines. As a result, the underlying arguments for not exempting certain restraints and imposing limits on others (notably the 5-year duration limit

⁵³ For instance, this might arise where customers lack information about prices, choice and/or availability and are reluctant to "shop around" because search costs are high relative to the perceived value of the product.

⁵⁴ An important example for independent retailer groups is the treatment of maximum resale prices which might be required to ensure that all retail members price goods at a low level (e.g. on special promotional items), but that if the group's collective market share exceeds 30% then it will not be certain that such a practice will be endorsed by the relevant competition authority – giving rise to business uncertainty and possible consumer detriment if such restraints are not used.

on non-compete obligations) relate to producer-led restraints. Unfortunately, the same rules and prejudices apply to independent retailer groups even though the economic effects are likely to be very different for the same type of restraints. Thus while producers might use RPM to dampen inter-brand competition and possibly aid collusion across markets where they compete head-to-head, the same does not apply with independent retailer groups where RPM only affects members, offers obvious efficiency and pro-consumer benefits, and is anyway exactly the same practice as that freely allowed by integrated retail chains (where a central administrative function determines all store prices in the chain).

3.42 Third, and related to the previous point, the emphasis in the Vertical Guidelines is on the primary importance of protecting inter-brand competition (e.g., point 119). This perspective is somewhat at variance to the categorisation of hardcore practices that are directly concerned with intra-brand competition. In particular, vertical restraints that directly affect inter-brand competition (e.g. from the non-compete group) are given a relatively more lenient treatment than the hardcore restraints that directly affect intra-brand competition (i.e. those from within the resale price maintenance and market partitioning group). Indeed, this perspective is markedly different from the policy approach in the US where tying (as from the non-compete group) has traditionally received harsher treatment than most other restraints, with the notable exception of RPM. Yet, the apparent contradiction within the European Commission approach is evident in the Vertical Guidelines where it is stated that: “Vertical restraints which reduce inter-brand competition are generally more harmful than vertical restraints that reduce intra-brand competition. For instance, non-compete obligations are likely to have more negative effects than exclusive distribution” (point 119 (2)).⁵⁵

3.43 In fact, economic theory does not lend support to this stance by the European Commission. Specifically, protecting intra-brand competition can be just as important as protecting inter-brand competition and the negative effects of restraints that impede inter-brand competition can be just as damaging as those that impede intra-brand competition, and vice versa. This observation serves to reinforce the view that the hardcore treatment of aspects of exclusive and selective distribution, in particular, is really more about the political motivation to see markets integrated within the European Union rather than about the competition and economic welfare effects of these restraints. Indeed, this view is further reinforced by the somewhat arbitrary pigeon-holing of vertical restraints into four different groups when most

⁵⁵ This is particularly the case given the absence of a limitation on post-term non-compete obligations imposed on suppliers (unlike those imposed on buyers).

economists would probably just think of there being two groups: those restraints that directly affect intra-brand competition and those that directly affect inter-brand competition.⁵⁶

- 3.44 Finally, apart from the form of restraint and whether it affects inter- or intra-brand competition, another contentious issue is contract duration. Specifically, how long is it appropriate for a restraint to last, both in the sense of present commitments (and their possible renewal) and also their absolute duration? As noted above, in the case of non-compete obligations on a buyer a five-year duration limit is applicable (Vertical Guidelines, point 58), and such a duration limit is not imposed on any other restraint (i.e. non-compete obligations are singled out for harsher treatment). However, like market share thresholds, this level seems somewhat arbitrary and does not cater to all circumstances. In practice, each case may be expected to differ as different trade-offs and market conditions may be involved. Specifically, firms should be able to recoup investments made in developing highly specific trading relationships that offer efficiency benefits, but equally they should not be allowed to foreclose a significant part of a market for a considerable amount of time and thereby protect themselves from the rigours of competition. There will be concerns about non-compete obligations when used by producers that can serve to tie up distributors and prevent other (new) producers having a route to market. But the same arguments do not apply with independent retailer groups, where the foreclosure concern is absent. In view of this, it would have been appropriate to make a specific exception for these groups, rather than cause business uncertainty and complicate their contractual renewal arrangements.

⁵⁶ Moreover, the EC's classification of restraints is not always clear-cut. For example, a series of resale restrictions that amount to territorial exclusivity (in the market portioning group) is really just an example of exclusive distribution (in the limited distribution group). Similarly, exclusive purchasing (in the market portioning group) is really just a non-compete obligation (in the single branding group).

4. Current Policy Towards Groups of Independent Retailers

Building on the previous section, this part of the report examines more specifically current policy towards groups of independent retailers. It considers the current policy and legal frameworks operated within the European Union, the treatment of mixed structures involving horizontal and vertical agreements (as typically characterising independent retailer groups), and relevant market definition and critical market shares (in both procurement and retail markets). The section also considers in detail the fundamental aspects relating to the economic purpose of most independent retailer groups, namely joint purchasing and the role of purchase obligations, and joint commercialisation and the role of retail pricing requirements.

4.A Current policy and legal frameworks

- 4.1 This section of the report examines in more detail the specific aspects of competition policy that impinge directly on the operation, behaviour and performance of independent retailer groups.
- 4.2 Building on the analysis in the previous section relating to vertical agreements, the section begins by considering the impact of the joint presence of horizontal and vertical agreements that characterise many groups of independent retailers. With groups using arrangements that could be interpreted as having horizontal (retailer to retailer) and vertical (central office to retail member) elements, then different applications of EU competition law may follow since separate and sequential assessments will be required of agreements – with horizontal agreements being assessed prior to vertical agreements. This separate and sequential assessment gives rise to the possibility of inconsistent treatment since the rules and guidelines for clearing or exempting agreements differ between the two types of agreements. This is most evident with the different market share thresholds that may apply in respect of each type; with 15% the usual limit regarding horizontal agreements and 30% the usual limit for vertical agreements. However, there may also be inconsistencies in respect of practices that may be outright prohibited or subject to additional restrictions. Accordingly, determining the appropriate interpretation and consequent treatment of agreements may be crucial in determining whether groups of independent retailers can achieve appropriate efficiency benefits that serve to protect or enhance competition in the relevant markets to the ultimate benefit of consumers.
- 4.3 Given the importance of market share thresholds in the economic assessment of horizontal and vertical agreements, market definition of the relevant procurement and retail markets in

which groups of independent retailers operate takes on considerable significance. Here, both the product/service and geographic scope of these markets needs careful consideration. In general procurement markets tend to be product-category based and national in scope. However, with international sourcing on the rise and extensive cross-border trade occurring within Europe, procurement markets are becoming increasingly international. In regard to retail markets these are national or local in nature depending on the extent of mode of retail operations (essentially whether practices are intentionally uniform across the country or subject to local variation) and the patterns of consumer behaviour (specifically whether consumers shop very locally or more widely so that local markets considerably overlap). More controversially, there has been a recent tendency by competition authorities to view the product/service dimension in retail markets quite narrowly, seeking to distinguish between retail markets by the size of the retail format and/or whether retailers offer a full assortment or are specialised in respect of the products they handle (even when they may be targeting the same consumers with the same products). We consider the legitimacy and consequences of such distinctions and more generally the problems involved in applying generalisations to defining procurement and retail markets.

- 4.4 Following on from this, we consider two particular aspects of existing policy that directly impinge on the efficient operation and the ability of independent retailers to compete effectively in retail markets; namely joint purchasing (and the associated use of purchasing obligations) and joint marketing/commercialisation (and the need for control over retail prices). Both aspects can be fundamental to the efficient operation of independent retailer groups. However, both aspects may receive different and inconsistent treatments under horizontal and vertical agreement regulations, and there is a clear need for assessment to be fully on the economic effects of these arrangements and not simply on an interpretation of their legal form (as unfortunately tends to happen at the moment). In both cases, there are strong arguments for considering a more lenient treatment towards agreements that support and promote the benefits of joint purchasing and joint marketing/commercialisation in circumstances where this is likely to act in a pro-competitive manner and benefit consumers.

4.B Mixed structures involving horizontal and vertical agreements

- 4.5 Groups of independent retailers by the very nature of their collaboration usually represent a horizontal agreement as defined by the European Commission (i.e. where a horizontal

agreement is “any agreement entered into by enterprises at the same market level”⁵⁷. Thus, when retailers formed groups initially to pool their purchasing, they were bound by horizontal agreements.

4.6 Thereafter, following profound changes in distribution, and notably in order to respond to competition from new forms of distribution and especially the growth of wholly integrated chain store groups, some independent retailer groups adopted structures and their central organisations then:

- ◆ make purchases at their own risk;
- ◆ develop and offer to their members concepts of common brand names involving the organization of a genuine network of sales outlets;
- ◆ develop and offer products under their own brands, marketing concepts, training programmes, communication policies, etc.

4.7 These activities are formalised by a whole range of vertical agreements entered into between members and central organisations, which are separate entities from their members.⁵⁸

4.8 In practice, however, we observe that the activities of some groups have remained totally horizontal, being solely related to joint purchasing. Often, through, these activities have become (or are tending to become) governed only by vertical agreements. Nevertheless, for a good many cases, independent retailer groups are governed by and characterised by a co-existence of vertical and horizontal activities and agreements. Such groups of independent retailers thus have a so-called “mixed structure”.

4.9 When faced with mixed situations, the European Commission’s Guidelines on horizontal agreements (and the European Commission’s Guidelines on vertical restraints) advocate assessing the horizontal agreements first. If this assessment leads to the conclusion that these agreements are acceptable, a complementary evaluation must then be carried out to assess the group’s vertical agreements.

4.10 This sequence in performing this dual examination based on different legal texts derives from the fact that the Commission considers that vertical agreements are less harmful to competition than horizontal agreements (as evidenced by the different market share thresholds

⁵⁷ See Commission Notice: *Guidelines on the applicability of Article 81 of the EC Treaty to horizontal co-operation agreements*, O.J. C3/02, 2001.

⁵⁸ According to the EC’s Vertical Agreements Block Exemption Regulation, a vertical agreement is “any agreement entered into between two or more enterprises, each of which operates, for the purposes of the agreement, at a different level of the production or distribution chain”.

used in exempting agreements – typically 15% in the case of horizontal agreements and 30% in the case of vertical agreements).

- 4.11 However, this approach can lead to problems in misinterpreting the true nature of an agreement and its effects on participants and subsequent market behaviour and outcomes.
- 4.12 As a good case for illustration, consider the issue of retail prices. If retailers were to reach agreements among themselves to sell a particular product at the particular price, this practice could be considered as illegal because it results from a horizontal agreement.⁵⁹ In contrast, if the central organisation of the same group, in the context of the group's brand policy, for example, requests that its members charge a maximum selling price for certain products, it could be considered that such prices are legal under certain conditions because they come under a vertical structure between the central organization and its members. In the practice the outcome of such arrangements may be exactly the same – i.e. the same price level used under both arrangements by all retailer members – yet the legal treatment may be clearly very different.⁶⁰
- 4.13 The question of determination of the appropriate interpretation and application of the relevant law is clearly important. The practice may or may not be considered as illegal, depending on whether the authority considers that it is based on horizontal or vertical activities or agreements. This point has become even more important because, since 1st May 2004, national jurisdictions can apply EU competition law.
- 4.14 Therefore, there is a certain risk that the same practice by a group may be treated as coming under a different law, and therefore subject to sanctions or not, depending on the country before whose courts the dispute is brought.
- 4.15 Moreover, this may not just be a theoretical possibility. National competition authorities or courts could, despite the European Commission definition of and guidelines on vertical and

⁵⁹ While this is generally the case in Europe, there may be exceptions at the national level. For example, in France where Article L. 124-1 Code de Commerce provides an exception in particular circumstances to horizontal agreements to Article L. 420-1 Code de Commerce.

⁶⁰ The point here is that while there might be a view that independent retailers may wish to collude amongst themselves in order to agree on a high price and avoid intra-group competition, this might not necessarily be the case. Just as with the justification for a vertical agreement involving maximum resale prices as being a means to support a common and consistent brand image (to reassure consumers about the value-for-money proposition offered by the group's members), a horizontal agreement could have exactly the same intention and purpose (i.e. it does not necessarily have to serve against consumers' interests). Indeed, this aspect lies behind the concept of "joint commercialisation", whereby common marketing and promotion practices used within an independent retailer group may be interpreted as horizontal agreements, which may be justifiable under Article 81(3).

horizontal agreements, consider a central organisation of a group which has wholesale activities as not having vertical agreements with its retailer members if these members were at the same time customers and owners of the central organisation.

- 4.16 The problem may be exacerbated when EU laws and regulations run alongside existing and separate national laws and regulations. As an example, under French law, if there are many vertical agreements, even authorized ones, within the same group, then the authorities may consider these agreements from the viewpoint of the law on concentrations.⁶¹
- 4.17 Clearly, from the perspective of allowing independent retailer groups to operate efficiently and not be handicapped unduly discriminated against, it is fundamentally important that those uncertainties in legal interpretations are removed. Specifically, it is necessary to ensure that
- ◆ First, it is possible to differentiate the economic effects in each analysis, and that any suspicion of an illegal agreement of the horizontal type should be ruled out when a vertical agreement would serve exactly the same pro-efficiency, pro-competitive purpose (not least as this prejudices the examination of the vertical aspects from the outset);
 - ◆ Second, an examination of the horizontal aspects does not lead to a ban on behaviour that is allowed in the context of vertical agreements;
 - ◆ Third, exchanges of information, for example, between members to improve the responsiveness of retailers to competition should not necessarily be considered as an anti-competitive horizontal behaviour when the primary aim of such exchanges is to enhance the overall efficiency and competitive ability of the group through improved co-ordination between the central office and individual members (in respect of competing with other retail groups and networks and not least as this typically entails improving supply responsiveness and improved stocking and product selection for the direct benefit of consumers).

4.C Relevant market definition and critical market shares

- 4.18 With market shares taking such a prominent role in the assessment of vertical restraints and horizontal agreements, in line with the EC's new rules and guidelines, it is not surprising that market definition has been given special emphasis by market participants and regulators.

⁶¹ For example, this may be seen to be relevant to the “lignes directrices” written by the DGCCRF (French competition authority) to interpret new legislation regarding concentration (introduced in May 2001) – available at <http://alize.finances.gouv.fr/concentration/lignesdirectrices.pdf> (in particular point 10 and annex 2).

This is an especially contentious area in retailing since market definition must cover procurement markets and retail markets, of which both types can relate to the retail service (as a means of distribution to end consumers) and the products purchased and then resold, and yet both may be different in nature in respect of their product/service dimension and their geographic dimension (so they may not coincide fully or do so only perhaps tangentially).

- 4.19 In the “economics effects” approach used in assessing horizontal and vertical agreements under Article 81, market share is used as a proxy measure of market power – such that below certain critical market share levels, the presumption is that (in the absence of parallel effects) parties will possess insufficient market power for their agreements to have a material detrimental effect on market outcomes. The definition of the relevant product and geographic markets affected by an agreement therefore becomes of primary importance for the assessment of the activities of any retailer grouping. However, the market definition will also determine whether the retailers are (actual or potential) competitors on the relevant product and geographic markets, which is another important factor for the assessment under Article 81 (particularly in relation to horizontal agreements for joint purchasing and joint marketing).
- 4.20 Following a good number of retail sector merger cases and market inquiries in the past few years, some clear patterns have emerged as to how competition authorities view procurement and retail markets.⁶²

Procurement market definition

- 4.21 At the procurement level, where retailers or groups of retailers purchase products, either directly or through a wholesale operation, competition authorities generally consider that each different kind of product or group of products constitutes a separate product market. For example, the European Commission has found a separate product market at purchasing level for butchery products, for fish, for fruits and vegetables, for bread and fresh bakery, for dry

⁶² Some of the notable European Commission merger decisions are as follows: *ICA Ahold/Dansk supermarked* (Case No COMP/M.2604, 13-11-2001), *Ahold/Superdiplo* (Case No COMP/M.2161, 23-10-2000), *Carrefour/GB* (Case No COMP/M.2115, 28-9-2000), *Carrefour/Promodes* (Case No COMP/M.1684, 25-1-2000), and *Kesko/Tuko* (Case No IV/M.784, 20-11-1996). In addition, there has been extensive analysis undertaken in market and merger investigations at the national level. In this regard, the reports by the UK’s Competition Commission on supermarkets in 2000 and on the contemplated mergers involving Safeway in 2003 are particularly noteworthy: see Competition Commission, *Supermarkets: A Report on the Supply of Groceries from Multiple Stores in the United Kingdom*, Cm 4842 (Oct. 2000), available at http://www.competition-commission.org.uk/rep_pub/reports/2000/446super.htm#full; and Competition Commission, *Safeway plc and Asda Group Limited (owned by Wal-Mart Stores Inc); Wm Morrison Supermarkets PLC; J Sainsbury plc; and Tesco plc: A Report on the Mergers in Contemplation*, Cm 5950 (Sept. 2003), available at http://www.competition-commission.org.uk/rep_pub/reports/2003/481safeway.htm#full.

grocery, for toys and leisure products, for clothes and shoes, for small electrical appliances and for big electrical appliances.

- 4.22 Furthermore, due to the similar market coverage and reach of producers and distribution channels, as well as price negotiations with suppliers generally taking place at the national level, the geographic scope of these markets is mostly national within the EU (although regional variations may exist within individual member states). However, the European Commission has observed that where purchase conditions are centrally negotiated with suppliers across national borders, the relevant geographic market may be wider (e.g. covering a number of adjacent member states). Indeed, geographic expansion of the relevant market, even up to the level of the entire EU or European continent, is something that may well develop over time, as retailing further internationalises and cross-border procurement becomes normal business practice.⁶³
- 4.23 In summary, the market share of a purchaser group at the procurement level is the share that the combined purchases of the relevant product represent out of the total purchases of the relevant product in the relevant geographic market (i.e. whether national or multi-national depending on the extent of cross-border sourcing and distribution activity).

Retail market definition

- 4.24 At the selling level, the European Commission and national authorities have generally distinguished between an overall retail market for “daily consumer goods” (or “groceries”) and narrower product markets where specialised retailers are concerned.
- 4.25 The retail market for daily consumer goods in respect of the product dimension comprises the entire range of food and non-food products for daily consumer household needs that is normally offered at retail level (e.g. food, drink, pet food, household goods, cleaning products, etc.) and sold through grocery stores. The European Commission has considered breaking down this market definition by retailer segment, e.g. into “superettes”, supermarkets, hypermarkets and discount chains, but thus far has not taken a final decision in this respect. This contrasts with the view taken in the UK where “one-stop shopping” (generally conducted in stores with sales areas of at least 1,400 square metres) is seen as a separate economic

⁶³ For example, this scope may already apply to those distribution organisations already operating with a pan-European presence, such as Metro/Makro. A further factor may be the widespread presence of international buying alliances, which may undertake pan-European purchasing, e.g. Euronic.

market from “secondary shopping”, which includes convenience and top-up shopping and which may be undertaken in the full range of grocery store sizes.⁶⁴

- 4.26 Nevertheless, there are problems with defining the product/service dimension of retail markets too narrowly where there is inevitable overlap. A prime example being the distinction in the UK between “one-stop shopping” and “secondary-shopping” when in fact it can be the same stores (i.e. superstores and hypermarkets) serving both of these markets but other stores (i.e. small supermarkets and convenience stores) serving only one of these markets (i.e. the secondary shopping market but not the one-stop shopping market).
- 4.27 This example relates to a broader problem that in practice retail outlets may have different emphases or character but they may serve the same consumer needs in respect of individual products and therefore that the range of possible outlets that consumers might use to satisfy these needs can be very wide, and equally supplies to these outlets can be from a wide supply base. Take, for instance, the case of the Swedish Competition Authority defining a product market including “full-assortment daily consumer stores” and “wholesalers” supplying such stores. It can be argued that this narrow approach does not reflect the competitive environment of the daily consumer goods market in Sweden. For example, stores in the ICA group of retailers purchase on average 30-35% of their total purchases from other sources not included in this market definition. Thus, a large part of the suppliers to the retail market are excluded from the market share calculation. This suggests the needs to include products supplied by niche or local suppliers as well as direct supplies from manufacturers.
- 4.28 Yet, there is also the nature of products sold which might be available from a very wide range of outlets suggesting that the market should be broader than simply by the look or main focus of a retail outlet. For instance, in food retailing, supermarkets selling ready-to-eat items (like salads and sandwiches) may be categorised as simply representing a “full-assortment daily consumer goods store” but in reality they are competing directly with other types of outlets for selling these products such as convenience stores (like 7-eleven), petrol forecourt shops (such as Shell Select), fast food restaurants (like Subway), or even local restaurants offering take-away services. More generally, it should be apparent that there is a wide range of overlap between stores of different appearance and general character selling the same goods (e.g. apart from ready-to-eat items this applies to other goods sold widely like confectionery and alcoholic/non-alcoholic beverages as well as range of goods where there are specialist retailers for selling items like bread, cakes, meat, poultry, fish, newspapers/magazines, health

⁶⁴ For further details, see the 2000 and 2003 reports by the UK Competition Commission; *supra* note 36.

and beauty products, household goods and pet food). The point being that supermarkets and the like compete very widely with other types and formats of retailers. Taking too narrow a definition misses this point and fails to appreciate the extent of this competitive interaction for many product categories. Only in situations where there are very clear differences in market behaviour (e.g. prevailing prices) and consumer shopping patterns (e.g. bulk vs. small purchases, commercial vs. private purchases, etc.) should a narrow definition be used.⁶⁵

4.29 As regards the relevant geographic market, the European Commission has considered the catchment area of a retail outlet as the critical factor, using a radius of between 10 and 30 minutes driving time to and from the outlet (depending on the context, e.g. less in densely populated urban areas, and more in less densely populated rural areas). This suggests that the relevant geographic market is a regional or local one. In this case, it may be possible that only one retailer belonging to a given independent retailer group may be established in a relevant geographic market, so that there would be no competition between the independent retailers of the same group in respect of retail markets.

4.30 However, there are two caveats. First, the European Commission and other authorities have also found that where retailers negotiate and purchase goods in a centralised way at national level and decide on consumer prices, product promotion and advertising campaigns at national level, the relevant geographic market is likely to have a national, rather than local, dimension. In practice, this may mean that an authority might make separate assessments in respect of behaviour which is local in nature as opposed to that which is national in nature.⁶⁶ Second, there might be sufficient overlap in local markets, especially in densely populated countries, that a chain of substitution connects local markets right across the country (i.e. with no breaks from one area to another). In this case (as, for example, Netherland's NMa has considered in grocery merger cases), the geographic extent of the market may be viewed as national.

4.31 In the case of specialised retailers, the European Commission has established narrower product market definitions according to the products or group of products concerned. For example, the Commission has separately defined a market for retail consumer book sales, for

⁶⁵ A good example is the very detailed investigation undertaken by the US Federal Trade Commission to determine that office stationery superstores operated in separate local markets from other outlets selling office stationery. See, *Federal Trade Commission v. Staples, Inc. and Office Depot, Inc.*, Civ. no.97-701 (TFH), 1997, where the FTC used evidence on local pricing to argue that a merger between Staples and Office Depot would raise prices by reducing local market competition.

⁶⁶ For a good illustration of what this might entail, see the 2003 report by the UK Competition Commission on the contemplated mergers involving Safeway determining the possible unilateral and coordinated effects of a merger between two major national grocery chains; *supra* note 36.

retail IT products, for retail music cassettes, CDs and other multimedia products, for retail toys, etc. From a geographic point of view, these product markets are generally considered to be national in scope. However, the geographic scope may be taken as local if there is evidence of local-based policies (e.g. in respect of pricing, product ranges determined according to local tastes, and extensive independent retailers).

4.32 *Issues arising for groups of independent retailers*

4.33 For independent retailers, the relevant retail market is likely to be local in nature (in relation to the relevant catchment area of retail outlets). This follows since, even though there might be a central office setting out marketing policy, decisions are still made in respect of the key marketing and store operation variables at the local level (i.e. over price, product range, category depth, staffing, etc.). This applies to both retailers of daily consumer goods (supermarkets) and for specialised consumer goods retailers.

4.34 In these circumstances, retail outlets located outside a given geographic area do not constitute effective alternative sources of supply for retail customers because these customers would and could not, “in the short term and at a negligible cost”,⁶⁷ switch to outlets located elsewhere “in response to a hypothetical small (in the range 5% to 10%) but permanent relative price increase”⁶⁸ occurring in the retail outlets within the relevant catchment area. In practice, for the purchase of consumer goods (especially of daily household goods), consumers will not drive beyond a certain distance from their home even in the case of a small but permanent increase in prices at their local retail store (as economic search costs begin to outweigh any shopping-around benefit of finding lower prices). In such instances, the consumer would most likely rather switch to another type of retail store in the same geographic area (such as a local discounter). Accordingly, for the purpose of the relevant product market definition, a breakdown between different types of retailers may not generally be justified, unless there is a very clear difference in respect of consumer behaviour as to where and on what basis shopping trips are undertaken.⁶⁹

⁶⁷ European Commission Notice on the definition of the relevant market, OJ (1997) C 372/5, at point 29.

⁶⁸ *Id.*, at point 17.

⁶⁹ For example, the UK authorities are currently reviewing their decision to split the retail grocery market between “one-stop shopping” and “secondary shopping” on the basis that these (a) do not separate out retailers (e.g. a large store would likely be operating in both markets if both types of shoppers visited the store), and (b) critical size differences may appear arbitrary when there is a spectrum of shopping habits rather than a dichotomous type of behaviour (i.e. either one-stop or secondary shopping on a specific shopping trip).

- 4.35 If retail markets can be taken to be local in nature, then the important implication which follows is that the retailers belonging to a given group may not be direct competitors on the relevant selling markets (especially if separate territories are allocated to independent retailers, i.e. akin to many retail franchises), and accordingly they should receive a favourable assessment in respect of their joint purchasing, joint commercialisation and other co-operative activities relevant to their association or group.
- 4.36 Apart from these contentious issues surrounding market definition, it has to be borne in mind why the exercise needs to be conducted in the first place. This is really about the market share rules that have been introduced in the context of Article 81 on horizontal and vertical agreements and Article 82 on dominance. Here, there are various blanket rules on market share thresholds. However, it is questionable how reasonable this approach is when market sizes differ very much across different Member States. This is particularly apparent in regard to Member States that have small populations. Take, for example, the daily consumer goods industry where it is important to be able to purchase large volumes in order to obtain good prices. Here, ICA and Kesko, the respective market leaders in Sweden and Finland, have relatively high market shares in their respective country and thus face a double disadvantage: the vertical block exemption has market share thresholds that could more easily be exceeded on a small market while still not being able to benefit from the full advantages of being sufficiently large to obtain the most advantageous purchasing conditions in the negotiations with the suppliers.
- 4.37 Here, it should be borne in mind that the 30% market share threshold in the assessment of vertical agreements block exemption regime was notably introduced to signify that a company has market power. Below this threshold, the presumption is that the company has no such market power. Yet, for sectors like the daily consumer goods industry it is likely to be the case that a high market share on a small national market is not equal to market power in a comparison to the European market – especially as many supplies are obtained from multinational suppliers operating generally across different, and perhaps all, Member States, and not simply from local, national suppliers.
- 4.38 Accordingly, there is a general question about the appropriateness of blanket rules that are intended to apply equally to all situations. In particular, it would make sense to consider allowing consideration of national characteristics in the EU legislation regarding competitive analysis for the future application of the vertical block exemption regulation. In particular, there might be an argument for raising the market share threshold for distinctly smaller

Member States if cross-border sourcing and dealing with internationally operating suppliers is a common feature.

4.D Joint purchasing and non-compete obligations

Joint purchasing arrangements as horizontal agreements

- 4.39 Joint purchasing in the context of independent retailer groups is a horizontal agreement between retail members, even though a (vertically) separate central office or wholesale arm may actually conduct negotiations and handle logistical arrangements with producers.⁷⁰ The economic benefits of such an arrangement for retail members in securing more favourable terms from suppliers (compared to them negotiating separately) are recognised under EU law.
- 4.40 In general, as long as buyer power is not created in a way that might distort competition in procurement markets and subsequently in retail markets, and that consumer benefits (e.g. lower prices) can be expected to flow from the arrangement, then such arrangements may be looked upon favourably by competition authorities. In particular, it is recognised and understood that joint purchasing by small and medium size companies may be vital in allowing them to compete with larger companies on an effective basis.⁷¹
- 4.41 When the combined market share of the group is low then such arrangements will normally be permitted under the *de-minimis* notice (in the absence of any hardcore restrictions, like retail price fixing). More directly, the EC's Horizontal Guidelines on joint purchasing make it clear that Article 81(1) is unlikely to apply where the retailers have a combined market share of below 15% on each the relevant procurement markets and the relevant retail markets. In any event, if these market share thresholds are not exceeded, the conditions of Article 81(3) are likely to be fulfilled and the practice allowed.⁷²
- 4.42 In situations where the market share threshold of 15% is not significantly exceeded, then as long as larger competitors are active on the relevant markets and there are strong suppliers

⁷⁰ Even though joint buying may be viewed as first and foremost a horizontal agreement, the precise relationship may have a strong vertical element when it involves purchasing obligations – which are normally treated in the framework of vertical agreements, e.g. the treatment of non-compete obligations in the EC's regulations and guidance on vertical restraints.

⁷¹ For instance, the European Commission's Horizontal Guidelines (point 116) acknowledges that these agreements allow quantities to be purchased with similar discounts to those available for their larger competitors, therefore "*these agreements between small and medium-sized enterprises are normally pro-competitive*".

⁷² Horizontal Guidelines, point 130.

with countervailing power, the joint purchasing cooperation may still escape application of Article 81(1) or at least qualify for an exemption under Article 81(3).⁷³

4.43 Indeed, higher market shares may still justify an exemption. This is particularly so if the agreement does not confer significant buying power for the group, as then joint purchasing is unlikely to restrict competition in retail markets. However, where the parties have buying power (i.e. a significant share of the relevant purchasing market), they may be in a position to drive down purchase prices below a competitive level so that competing buyers may be foreclosed or will be charged higher purchase prices to compensate the low prices negotiated by the strong buyers. This may hamper these competitors' cost positions on the selling market and therefore restrict competition on the selling market.⁷⁴ The condition for a restriction of competition on the selling market through a purchasing cooperation is thus the creation of buying power. Therefore, where joint purchasing does not create buying power, it will not restrict competition neither on the purchasing nor retail market, and thus may fall outside Article 81(1).

4.44 This view is supported by the examples of cases provided in the Horizontal Guidelines.⁷⁵ In each of these cases which are deemed to fall under Article 81(1), the joint purchasers have considerable buying power on the purchasing market, their buying market share ranging from at least 20% (Example 3) to 40% (Example 4). From these examples it may be surmised that, independently of the selling market share, Article 81(1) may be unlikely to apply where the buying market share is below 20%. However, much may depend on the position of other retail groups and how well placed suppliers are in respect of the countervailing power they may hold. If there are other stronger and larger (integrated) retail groups and strong suppliers, then the joint purchasing arrangement may not create or exacerbate buyer power in a way that can, by itself, distort competition in procurement and retail markets.⁷⁶

4.45 In respect of justifying joint purchasing, assessment under Article 81(3) involves consideration of the four criteria listed above in section 3.4. In this regard, the primary justification for joint purchasing by groupings of independent retailers under Article 81(3) would normally be that the efficiencies achieved by joint purchasing (economies of scale in

⁷³ Horizontal Guidelines, point 131.

⁷⁴ Horizontal Guidelines, point 126.

⁷⁵ Horizontal Guidelines, points 135-138.

⁷⁶ Nevertheless, some caution must be exercised here since even with more modest market share levels then they may be concerns about buyer power distorting procurement and retail markets. For instance, in UK grocery retailing, the view taken has been that retail groups with shares as low as 8% hold significant buyer power. See Competition Commission, *Supermarkets: A Report on the Supply of Groceries from Multiple Stores in the United Kingdom*, Cm 4842 (Oct. 2000).

ordering and transportation and a better negotiating position through bundled purchases) are necessary in order to enable the parties to compete with the large (integrated) retail groups and thus to maintain competition on the selling market, which is clearly to the benefit of consumers.⁷⁷

- 4.46 In a similar vein, it may be argued that additional obligations are indispensable. Most notably, an obligation to buy exclusively through the cooperation can in certain cases be indispensable to achieve the necessary volume for the realisation of economies of scale.⁷⁸ This might, for example, apply in cases where larger (integrated) retail groups are active on the relevant markets. In these circumstances, since these groups have significantly larger purchasing shares in the relevant purchasing market than the independent retailers, a total purchasing obligation on the retailers may be viewed as indispensable in order to bundle the necessary volume and to enable the independent retailers to compete in the purchase of products. The presence of larger, more powerful retail groups on the selling market can be expected to play an important role here since they will also ensure that the retailer group pass on the economies to the consumers in order to compete with the large retailers.⁷⁹

Non-compete obligations as vertical agreements

- 4.47 Viewed in the vertical context of a central office serving retail members, purchasing obligations may clearly play a crucial role in the effectiveness of the joint purchasing function of an independent retailer group. Such obligations ensure that retail members will take the goods that the central office (or wholesale arm) manages to source from producers, which in turn provides bargaining leverage (through guaranteed access to outlets and large sales volumes) that enables favourable terms to be negotiated with producers to the collective benefit of retail members, and in turn consumers when these benefits are passed on in the form of lower retail prices and/or better products.
- 4.48 In this vertical context, purchasing obligations are treated as non-compete clauses in the vertical block exemption regulation. The obligation to purchase all or more than 80% of the

⁷⁷ In the Examples 3 and 5 on joint purchasing in the Horizontal Guidelines, the existence of larger competitors against which the smaller retailers must compete appears to be decisive for the exemption under Article 81(3). In Example 3, the two large competitors have shares of 25% and 35% on each the relevant purchasing and selling market, whereas the smaller retailers have a combined share of 20% on these markets. In Example 5, the combined share of the smaller retailers was even as high as 25%, with two larger retailers having a share of 20-25% each. The joint purchasing of the smaller retailers was considered necessary to enable them to compete with the two larger retailers.

⁷⁸ Horizontal Guidelines, point 133.

⁷⁹ Indeed, the Horizontal Guidelines (Example 5 at point 138), suggest that the presence of two competitors with market shares similar to the share of a joint buying organisation is likely to result in the efficiencies of the joint purchasing being passed on to consumers, so that the agreement could be exempted.

buyer's requirements from the central office, are covered by the block exemption⁸⁰ for a duration of 5 years if no individual retailer who is member of the retailer group has a total annual turnover exceeding €50 million and the market share of the supplier (central office) does not exceed 30% of the relevant selling market.

4.49 There are two qualifications to this general rule that may be specifically applicable to independent retailer groups:

- ◆ First, if the premises from which the retailer sells the products are owned by the supplier or leased by the supplier from third parties, the non-compete obligation can exist for as long as the buyer occupies these premises.
- ◆ Second, the EC's Vertical Guidelines⁸¹ states that restrictions (such as a non-compete obligation) imposed by an association of retailers in which only a limited number of the members have a total annual turnover not significantly exceeding €50 million will in principle also be exempted under Article 81(3).

4.50 Where the above-mentioned turnover or market share threshold is exceeded, the block exemption does not apply and the non-compete obligation has to be assessed under Article 81 in accordance with the Vertical Guidelines.

4.51 In general, a non-compete obligation is unlikely to have restrictive effects falling within the scope of Article 81(1) (or at least would be exempt under Article 81(3)) where the supplier (the central office) has an insignificant market share and where there are numerous and strong competitors. It is only likely that competing suppliers will be foreclosed if they are significantly smaller than the supplier applying the non-compete obligation.⁸² Accordingly, and in the context of independent retailer groups, if competing integrated retail groups hold strong market positions then it is unlikely that a non-compete obligation imposed by a central office on its members will foreclose these competitors' access to the distribution market.

4.52 In any individual assessment, it also needs to be borne in mind the role and purpose of a non-compete obligation and the efficiencies that can be generated. In the horizontal context (as discussed above), this may be about improving the bargaining position of the group in negotiations with suppliers. However, in the vertical context, a non-compete obligation may also serve another important purpose in assisting in developing a common identity and brand reputation for the group. Specifically, a non-compete obligation may be necessary to

⁸⁰ Commission Regulation No 2790/1999.

⁸¹ European Commission *Guidelines on Vertical Restraints*, OJ (2000) C 291/1, at point 28.

⁸² Vertical Guidelines, point 142.

establish and maintain the common identity and reputation of the common distribution brand used by the independent retailer group.⁸³ As we discuss below in the next sub-section on joint commercialisation, developing a common identity and building brand reputation for the group can offer important consumer benefits when it provides greater assurance over the quality and consistency of the value-for-money proposition offered by its retail members. This in turn allows consumers to make more informed choices and also ensures that they receive a consistent treatment (and thus builds trust in the brand and potentially increases total consumer demand).

4.53 Furthermore, competitive forces should ensure that the general efficiencies arising from a non-compete obligation are likely to be passed on to consumers. Specifically, quantity-forcing and non-compete obligations can produce efficiencies such as economies of scale in distribution in accordance with Article 81(3) where they enable a supplier to concentrate the resale of his products on a limited number of distributors so that he can plan his sales better and save transport costs.⁸⁴ The existence of competition on the market, which effectively constrains the parties to a quantity-forcing or non-compete obligation, will ensure that efficiencies ultimately benefit consumers as well, by way of lower prices.⁸⁵ Thus where competing integrated retail groups hold strong market positions, and exert competitive pressure through their own economies of scale and perhaps superior cost positions, then a non-compete obligation applied by the central office of an independent retailer group is likely to be exempted under Article 81(3).

4.54 The other critical issue relates to the duration of non-compete obligations. The five-year rule is in place because of concerns about foreclosure to new suppliers (as non-compete obligations may in principle tie up all existing distributors making new entry or expansion difficult). However, this issue really relates to the context of producer-led restraints where there is a serious risk that inter-brand competition may be stifled. In the context of independent retailer groups it is difficult to see how such a concern could manifest itself when there is either other retailers available through which a supplier could gain access to consumers or the supplier itself could undertake its own retail distribution.

⁸³ This point seems to be accepted for franchising but the logic is not applied to independent retailer groups more generally – given rise, again, to a source of discriminatory treatment. For example, Vertical Guidelines, point 200. Specifically, point 200 (2) states that: “A non-compete obligation on the goods or services purchased by the franchisee falls outside Article 81(1) when the obligation is necessary to maintain the common identity and reputation of the franchised network. In such cases, the duration of the non-compete obligation is also irrelevant under Article 81(1), as long as it does not exceed the duration of the franchise agreement itself”.

⁸⁴ Vertical Guidelines, points 116 (6) and 160.

⁸⁵ Vertical Guidelines, point 136.

- 4.55 Yet, while there may be little risk of anti-competitive harm arising from foreclosure effects from such obligations in the context of independent retailer groups, there is a real concern that a fixed duration on such obligations would harm the competitive ability of the group. The reason is that the central office's (or wholesale arm's) ability to negotiate with suppliers will be restricted if long-term trading undertakings cannot be guaranteed. It will also undermine willingness to commit to necessary investments on both sides of the group if there is the prospect that the relationship may break down or be periodically revised in a manner that might not suit all parties. Furthermore, there will be the efficiency loss associated with periodic re-contracting when by its very nature an independent retailer group is set up to operate on a permanent (or at least indefinite time) basis. All of these factors may work together to feed through to higher prices for consumers. Accordingly, there must be a serious question over whether a five-year or any other fixed duration is an appropriate requirement to make on independent retailer groups to ensure that their use of non-compete obligations are exempted.⁸⁶
- 4.56 Finally, there is issue of the appropriateness of non-compete obligations if the market share of the independent retailer group exceeds 30% in the relevant markets in which it operates. Here there is a greater risk of anti-competitive harm arising through foreclosure effects. To allay such concerns, it may be required that the extent and coverage of non-compete obligations (e.g. the level of purchases required) are reduced. For example, it may be reasonable to allow purchasing obligations to groups that exceed the 30% market share threshold so long as the total purchase requirements only reflect a foreclosure of an equivalent share of the total market at a specific level. Thus, for example, a possible objective might be to ensure that the purchasing obligations do not result in an economic foreclosure effect on the market which is no different than for a company that has a 30% share. This, though, would call for careful analysis of the economic effects on the market (which may not be easy to undertake when it involves hypothetical comparisons). Nevertheless, purchasing obligations should not be ruled out simply because the 30% share threshold is exceeded, given the very important efficiency benefits that typically flow from such arrangements. In other words, a reasonable compromise on the extent of allowable purchasing obligations (balancing foreclosure concerns against efficiency benefits) may be in the best interests of consumers.

⁸⁶ Again, with respect to note 83 above, observe the sharp contrast in the treatment and guidance towards retail franchises and independent retailer groups.

4.E Joint commercialisation and retail pricing requirements

- 4.57 The pressures of increased competition and a recognition of the need to cater better for consumers needs have meant that many independent retailer group have moved on from simply providing their members with better purchasing conditions. Today, the objective pursued by such groups is often considerably broader. They are typically designed to bring the associated retailers (and, where appropriate, craftsmen as well) the technical and material resources in the field of marketing and the know-how to contend with competition and develop efficient retail and distribution businesses. By doing so, they facilitate retail members being better able to respond effectively to the expectations of consumers by providing for a more consistent retail image and a more assured value-for-money proposition.
- 4.58 In order to support such activity, and ensure that consumers benefit from such developments, independent retailer groups will look to using two particular practices relating to requirements on retail pricing. The first of these is the obligation on retail members not to price specified goods above a certain price level – what is known as a maximum resale price obligation – for the purpose of ensuring that retail prices are sufficiently low to drive sales volumes for the benefit of the group (by increasing total revenues) and consumers (by ensuring that they receive low prices). The second of these is the obligation for retail members to stick to a fixed common retail price on certain promotional goods that are intrinsic to the joint marketing and overall retail image being developed by the group and which provide assurance for all consumers that they will enjoy the same value-for-money offer irrespective of their location and place of purchase (i.e. providing clarity about the offer and assisting in consumers making more informed purchasing decisions when contrasting the group’s offer with that offered by other retail groups active in the same market).
- 4.59 Both of these types of obligations can be seen as being pro-efficiency and pro-competitive in nature. They may also offer significant consumer protection benefits (e.g. by ensuring that advertised promotions do not mislead or falsely inform consumers as to the prices that will find on visiting stores). However, under present policy regulations both may restricted or even prohibited in their use depending on how they are interpreted by competition authorities – depending on whether they are viewed as horizontal or vertical agreements. Also, the market context may have a significant bearing on their treatment, not least since different market share thresholds apply in respect of horizontal and vertical agreements, and that more generally there is considerable legal uncertainty over whether agreements will be allowed if market share thresholds are exceeded.

4.60 The importance of this matter cannot be underestimated for independent retailer groups to function well and be an effective pro-competitive force. Pricing strategy is perhaps the single most important element in the means by which retailers compete against each other for the custom of consumers. This is particularly so if they are selling generally the same goods and offering comparable retail services. In these circumstances it is crucial for a group of retailers to be competitive on prices that are indicative of the overall value-for-money offer being presented to consumers. This is most apparent in respect of the prices used in advertising campaigns (which reflect the overall group image), prices on products in the stores' basic assortment (which often drive stores' footfall by influencing which stores shoppers will choose to visit), and the price for private labels (as these directly relate to the group's image, brand positioning and point of distinction from the products offered by rival groups). In such areas, it may be imperative that groups be able to exercise suitable control over retail pricing if they are to be truly effective retail operators and provide consumers with the maximum level of benefits that can be achieved.

Maximum resale price obligations

4.61 As was observed above, in section 3 of the report, a number of economic problems can arise in relation to supply and distribution arrangements amongst formally separate parties, resulting in sub-optimal outcomes for the parties concerned. These arise from individual behaviour that, while being individually rational and profitable, is not in the joint (i.e. collective) interests of the parties. In this case, choices taken with only consideration of the impact on the individual concerned, and not only other parties, can lead to "externality effects" which are detrimental to remaining parties. Just such an instance is with the application of separate decisions over pricing which result in retail prices being set "too" high from a joint perspective (i.e. the problem of successive mark ups listed in Table 3.1 above). Such an outcome arises within a group of independent retailers when an individual retail member chooses to set prices higher than the group as a whole would like because this allows that retailer to capture additional profits (say, by exploiting some local market power) but as a consequence this reduces the volume of sales, which impacts detrimentally on the wholesale arm (which by implication loses income for a set wholesale price). In these circumstances, in order to prevent this individual retailers, and others like it, from acting in this way, some exercise of vertical control is required (otherwise the group will perform sub-optimally).

4.62 This, in a nutshell, explains why groups of independent retailers will seek to use maximum resale price obligations. Imposed retail price ceilings will ensure that individual members do not undermine the collective efficiency position of the group by raising their own prices but in

the process leading to underselling and reduced group revenue as a consequence. Of course, this is not only in the interests of the group (seeking to prevent loss of income). It is also in the interests of consumers as it ensures that they prices are kept low and that they are not exploited in areas where individual retailers may be able to exploit some element of local market power.

- 4.63 In recognition of this need for vertical control, EU policy allows this practice to benefit from the Block Exemption Regulation on Vertical Agreements when it is applied to retailers (or equivalently their vertically-linked wholesale operation) whose collective market share does not exceed 30% of the relevant market being supplied, so long as this does not directly or indirectly lead to fixed or minimum resale prices.
- 4.64 However, it is unclear as to the extent to which a (vertical) central unit, whose market share exceeds the 30% threshold, may use maximum pricing in its chain controlling system, since in these circumstances the issue is not directly covered by the Block Exemption Regulation nor dealt with in the required detail of the EC's Vertical Guidelines.
- 4.65 Nevertheless, it would seem reasonable in economics terms to allow this practice, even if the market share of the vertical central unit exceeded the 30% threshold, so long as the purpose is designed to prevent increases in the group's retail prices.⁸⁷ Then, by setting maximum prices, the central unit of the group can help ensure a reasonable price level and thus benefits are transferred to consumers in the form of lower prices.
- 4.66 To see whether this is in fact the purpose of maximum resale prices, it may be useful to consider the type of products that it applies to (e.g. advertised items, basis assortment goods, and private label goods, where one would expect restrictions on raising prices to have most beneficial effect for the group) and/or whether the prices relate to having a competitive position with rival retail groups (e.g. on goods which are purchased frequently and/or where consumers are likely to be well informed about prices – i.e. what are called “known value items” or “KVIs”).
- 4.67 If it is clear that the purpose of price ceilings is to limit prices, and not as a means to coordinate high prices by the notified levels acting as focal prices, then it seems reasonable to allow maximum resale price obligations even in situations where the market share is

⁸⁷ This has been recognised previously at the national level, most notably in Finland where it was a possibility to apply for individual exemptions (but this has been abolished since 1st May 2004 with the move to relying solely on EC regulations and guidelines).

significantly in excess of 30%. Indeed, in cases where there are very high market share levels in retail markets, the practice may be a very useful way of preventing individual retailer members from exploiting local market power, i.e. when local competition is absent or weak (e.g. in remote rural areas or socially deprived urban areas, especially as low-income consumers in these areas may be particularly harmed by high prices).

Common retail prices for promotional purposes

- 4.68 While retail price ceilings may prove to be an important and useful element in vertical control to ensure that efficiency benefits (arising from high sales volumes and combined revenues) are realised by the group and that these are shared with consumers (when these leads to lower retail prices), setting fixed prices may be more to do with horizontal control.
- 4.69 Fixed resale price maintenance is per se prohibited under EU law and does not benefit from an exemption at any market share level. The reason for this strict treatment is that while the practice can offer benefits (like curbing retail prices or tackling free-rider problems resulting in diminished retail service levels – as illustrated in Table 3.1 above), it is generally not viewed as being “indispensable”. In other words, competition authorities take the view that there will be other vertical restraints available than can serve the same benefits but be less restrictive on competition. Thus, for example, competition authorities might prefer to see price ceilings used rather than fixed prices to prevent the problem of successive mark ups arising. Similarly, competition authorities may prefer to see the use of retail service obligations being used as a direct way to control free-rider problems in retail service provision rather than the more indirect way of controlling the problem with fixed resale prices.
- 4.70 However, when seen in the light of common prices being required in a horizontal context, then there may well be indispensable for realising the benefits on offer. In particular, fixed prices may be necessary in the case of a campaign for launching a product on the market or for promoting a product or a specific assortment with price positioning. This can involve imposition of prices at the “commercialisation” level – possibly jointly with manufacturers – to allow the marketing of an assortment of branded articles in a reasonable price framework. The benefits of such an arrangement are most apparent when the promotional campaign is carried out with the products offered at a single price – as this enhances retail brand image and provides assurance and clarity for consumers of the value-for-money proposition being offered to them.

- 4.71 To see why such an arrangement may be indispensable, consider what would happen if a group of retailers were not allowed to have fixed prices. In this case, it might be impossible to match the performance of its wholly-integrated competitors (which are freely allowed to use such practices and thus can guarantee manufacturers promotions at fixed prices in their stores, e.g. for a new product launch requiring clear, consistent pricing to go with the product's intended image). Then, groups of independent retailers would become less attractive to manufacturers (seeking to promote new or improved products), are likely to lose market share, in danger of losing efficiency, and perhaps even eventually disappearing (when market positions cannot be sustained), which is harmful for competition and against customers' benefits in the market.
- 4.72 EU competition policy recognises the possibility that there may be benefits from such arrangements. According to the Horizontal Guidelines (point 149), commercialisation agreements between competitors that do not involve price fixing are exempted under Article 81(3), when the combined market share is below 15%. Furthermore, "Example 1" of the Commission's Horizontal Guidelines on joint commercialisation shows that price fixing can be exempted under Article 81(3), when it is indispensable for the integration of other marketing functions and the attainment of economic benefits, which at the end constitute significant efficiencies that are of benefit to consumers.⁸⁸
- 4.73 Nevertheless, the possibility to exempt price fixing as part of joint purchasing as well as joint marketing and promotion is limited to the threshold of 15% of a combined market share of the parties, above which an assessment must take place. However, it may be argued that agreements to pool purchases or commercialisation agreements that include common selling prices, do not automatically give the parties any particular market power.
- 4.74 Here, competition policy needs to make a sensible judgement over situations where fixed prices are just a promotional tool as opposed to an anti-competitive collusive arrangement. The former is much more likely to take precedence over worries about the latter when (i) the products with fixed prices are limited in number, (ii) the duration of the agreement is short term (e.g. a two-week promotion), (iii) the promotion is at the request of (and perhaps partly sponsored) by a manufacturer, (iv) the promotion helps develop retail image of the group and build consumer demand, and (v) the group faces effective competition from rival retail groups.

⁸⁸ At the national level, there appears to be recognition of the relevance of these points to allowing fixed prices in certain circumstances. For example, in France, fixed prices may be allowed when there is no intrabrand competition present (because the zone of coverage by each retailer are geographically separate meaning that they do not compete in the same local markets).

- 4.75 Recognition of such benefits outweighing any potential detrimental effects has already occurred to a degree at the national level. For example, in France, allowance has been made for the use of fixed prices in circumstances where independent retailers do not directly compete with each other in local markets. In Finland, an exemption has existed which allows for common prices (subject to allowing freedom to discount) and joint purchasing co-operation relating to joint short-term marketing campaigns of the independent retailers who belong to the same chain and whose market share does not exceed the 30% threshold. This is perhaps a good example for other countries to consider as it takes into account the fact that through joint purchasing and joint marketing the costs through the group's activities can be lower than the costs of the individual retailers when they buy or market their products each by themselves. It also recognises that a larger promotional sales volume can be obtained by concentrating the marketing of the members of the chain on particular items within a unified and consistent approach.
- 4.76 Finally, it should be borne in mind that circumstances may exist where fixed prices are required to sustain new modes of retailing and service provision that have clear consumer benefits. For example, "bricks-and-clicks" (i.e. internet-cum-store) retailing has attractions for consumers, who can search for products on-line (through a "centralised site" managed by the central office) then pay for them and pick up them up from a contracted store of their choice (typically the one closest to where they live or work). In such a setting, for the system to work effectively, contracted stores may have to give undertakings to provide consumers with the goods at their advertised prices (otherwise there would be scope for opportunistic behaviour on the part of retailers that would undermine the reputation and efficiency of the whole operation, with a resulting loss of trade).

5. Conclusions and Policy Recommendations

This section concludes the report and offers a number of policy recommendations in order for independent retailer groups to receive a more appropriate legal treatment. These cover the joint treatment of horizontal and vertical agreements; guidelines for groups whose market share exceed the relevant market share thresholds for particular arrangements (specifically, exceeding 15% for horizontal agreements and 30% for vertical agreements); the possibility of removing the percentage and time limit on purchasing obligations; and the use of common or maximum retail prices for promotional purposes.

5.A Need for a level playing field

- 5.1 Should consumers be left to regulate retail markets? This might be a claim made by large, powerful vertically integrated retail chains. It is a stance that may suit them well. On the one hand, this would leave them unfettered to consolidate markets by mergers and free to use sharp practices against smaller players and suppliers. On the other hand, they can rely on many of their competitors being hampered in other ways, and this may not be just due to a lack of comparable scale economies but rather down to the legal and institutional impediments that affect other organizational forms (i.e. non-integrated chains) and restrict their ability to compete on effective terms.
- 5.2 Leaving consumers to regulate markets only works well when there is a good basis for effective competition between a sufficient number of equally able and competent players without entrenched positions to ensure that market outcomes (prices, quality, variety, efficiency, etc) are at their best. This requires a broadly level playing field. Unfortunately, the playing field in many retail markets has become so tilted that effective competition is being undermined. This is not simply to do with the level of concentration (since even two players can generate perfectly competitive outcomes), nor one player holding a significant market share advantage over others (since the competitive threat may still be sufficient to ensure that any efficiency benefits associated with size are passed on to consumers). In many cases, the competitive playing field has become tilted because of the way that competition policy and competition law discriminates against certain players simply by virtue of the way they are organized.
- 5.3 This policy discrimination is particularly apparent with the treatment given to associations of independent retailers. By their very nature, these associations are intended to be pro-efficiency and pro-competitive forces. They involve independent retailers using their collective resources and market presence to build scale economies (e.g. in marketing,

procurement, and central services such as training, store planning and visual merchandising) that allow them to operate more efficiently on an individual level. By being more efficient on an individual level, then the independent retailers are better able to compete with larger players in their respective local markets. This helps ensure that all retailers (whether independents or integrated chains) are forced to pass on their efficiency benefits to consumers in the form of lower prices and better service levels, and that consumers continue to enjoy choice and diversity from a range of outlet types and the different retail propositions that they have to offer.

- 5.4 Agreements and arrangements between formally separate businesses need to be judged on their economic merit, not on their legal form. Unfortunately, while the intention of EU competition policy is that it should be economic effects based, actual practice (both in respect of current regulations and their associated guidelines) is still to an extent contractual form based. This means that certain practices are per se prohibited (so-called “hardcore restrictions”) or significantly constrained (e.g. in respect of low market share thresholds applying or extra conditions, say relating to contract duration and extent of coverage) simply because of the form they take. While this may be reasonable with agreements that are blatantly against the interests of consumers (e.g. collusive arrangements with the intension of raising prices, denying choice, and/or reducing product/service quality for final consumers), the same is not true of most other agreements. In general, agreements can have both anti-competitive and pro-competitive effects and, accordingly, the net effect is *a priori* ambiguous. Clearly, the risk of anti-competitive effects will be diminished if the parties do not possess any market power, but even if they do have market power then it may still be possible for the efficiencies generated to outweigh any potential anti-competitive effects to have a net pro-competitive effect and benefit consumers.
- 5.5 Competition authorities might like to conceive of agreements as falling neatly into one of two camps – either horizontal or vertical in nature – and then treat them differently. However, this is yet again a form-based interpretation rather than an effects-based interpretation of agreements. While this might be reasonable if the nature of all agreements were cut-and-dried, and fell neatly into one of the two camps, the reality is that many agreements can be interpreted in either a horizontal or vertical light. This is particularly apparent in relation to the types of agreements that groups of independent retailers may wish to use in order to

obtain the same, or at least similar, economic benefits that integrated chains are free to enjoy.⁸⁹

- 5.6 Groups of independent retailers require agreements that make their joint purchasing and joint marketing/commercialisation effective, otherwise their own existence becomes largely superfluous (since they will add little to that which could be obtained by an individual retail member acting on its own). However, when one considers the actual arrangements that are often sought – like purchasing obligations and maximum or common retail prices – then these can be seen as being horizontal (agreements between retailer members) or vertical (agreements between a central office and individual retailer members) in nature.
- 5.7 Whether the legal form of an agreement specifies parties as being at one or another level is not especially relevant in an economic effects interpretation, since one needs to look at the effects on all parties, both within the arrangement and outside the arrangement (i.e. the central office, retail members, competitors, suppliers, and consumers). In the same light, just because the signatories to a contract may be trading parties does not mean that the agreement cannot be essentially horizontal in nature (with the central office, say, merely acting as a facilitator between the different retail members). Equally, while joint purchasing may come about by an agreement amongst horizontal competitors to establish and empower a central office to act on their behalf to organise trading (e.g. sourcing, distribution, and marketing) activities, it could be seen the other way around, with the central office signing up individual retail members, and therefore being a vertical agreement.
- 5.8 Unfortunately, this possible dual-interpretation of agreements (as being either horizontal or vertical) is likely to affect how competition authorities respond to such agreements, and may make obtaining clearance or exemption for their use more difficult to secure. This is because, for groups of independent retailers at least, the separate and sequential assessment and treatment of horizontal and vertical agreements under the present EU competition policy regime amounts to a “double-hurdle” test for their arrangements. Groups seeking exemption or clearance can fall at the first hurdle (with horizontal agreements being deemed anti-competitive) and then the second hurdle becomes redundant (when associated vertical agreements are invalidated, so the parties may have to fall back on stand-alone vertical agreements). Yet, if they get over the first hurdle (and the horizontal agreements are allowed) then they can still fall at the second hurdle (with vertical agreements being prohibited, restricted or watered down).

⁸⁹ More pointedly there is the possibility for confusion as to what is a horizontal agreement and what is a vertical agreement when both types may be relevant or indeed when just one type appears relevant.

- 5.9 The problem with this double-hurdle test is that exactly the same arrangement may receive different treatments under these separate, sequential assessments. So, for example, agreeing common retail prices might be acceptable as a horizontal agreement but strictly prohibited as a vertical agreement even if the collective market shares of the parties were very low. While, agreeing maximum retail prices might be acceptable as a vertical restraint (even if the 30% market share threshold were exceeded) but prohibited as a horizontal agreement when it is viewed as a potentially collusive or competition-distorting arrangement (if say the collective market share were only just above 15%).
- 5.10 The legal risk for a group of independent retailers is that its agreements may get caught one way or the other. Still, prohibiting or restricting these agreements would not matter in economics terms if consumers were unaffected. Unfortunately, though, it is likely that the inherent inconsistencies in this dual-hurdle policy approach may prevent groups of independent retailers from using certain practices or limit their size and growth in a way that does restrict the amount of efficiencies that can be generated, and thus have a potentially detrimental effect on consumer welfare (when these efficiency benefits would otherwise in part be passed on to consumers, say by lower prices, increasing quality, or providing additional choice). Consequently, this is not only an issue for groups of independent retailers, but it is also an issue for consumers when they are denied benefits that would otherwise be available.
- 5.11 All of this needs to be put into comparison with the practices that wholly-integrated chains are freely allowed to enjoy. In their case, the central administrative function of an integrated chain can dictate precisely all the amounts, all the goods, and all the prices that each and every individual store in the chain must adhere to, without any duration limits whatsoever. In other words, wholly-integrated chains can freely practice the equivalent of total non-compete obligations and full resale price maintenance on their stores (and, if necessary, deny local store managers any freedom to act on their own regarding stocking and pricing decisions) simply because there is common ownership of the central function and each of the stores.
- 5.12 In contrast, groups of independent retailers are prevented from having this freedom under EU competition policy simply because they have separate legal ownership of these aspects of the business. The economic effects may be exactly the same, but because the legal form is different between the two situations, different competition policy rules apply. Whereas the integrated group is allowed complete freedom, the independent retailer group is subject to considerable restrictions on the very practices where it is most likely to derive efficiency

benefits (i.e. in relation to joint purchasing and joint marketing/commercialisation) that can be expected to benefit consumers.

- 5.13 The generosity to which competition authorities afford integrated chain groups compared to independent retailer groups is perhaps nowhere more apparent in respect of mergers and the market shares they are allowed to command. For integrated chains, there is the distinct possibility that with favourable market conditions (like the presence of suppliers holding significant bargaining power and reasonably low barriers to entry in retailing) then a merger between two integrated chains in the same national market may be allowed even up to the level normally associated with dominance (i.e. around 40%), or possibly higher.⁹⁰ In contrast, two independent retailer groups may be prevented from merging (or at least not find it worthwhile merging if their joint purchasing arrangements would be prohibited) if their combined market share exceeded 15%.
- 5.14 Such discrimination, though, runs counter to the likely economic effects of a market concentrating merger involving integrated chains compared to independent retailer groups. Take the very extreme case, where there is a merger to monopoly. With a single integrated chain controlling the entire market there is no competition whatsoever and so consumers are likely to suffer the full consequences of being supplied by a monopolist. In contrast, with a single independent retailer group covering the entire market, while there will be no *inter*-group competition there will usually at least be a certain degree of *intra*-group competition (as retail members compete against each other for the custom of shoppers even when there are certain joint commercialisation arrangements in place). In other words, there is still the chance that a share of efficiency benefits may be passed on to consumers.
- 5.15 More generally (i.e. with less extreme concentrations), with retail markets dominated just by integrated chains there is by definition no *intra*-group competition. In this case, everything relies on *inter*-group competition to ensure that benefits flow to consumers; and clearly the more concentrated the market then the less chance there is of this happening. In contrast, with retail markets dominated by groups of independent retailers, then not only is there the prospect of *inter*-group competition but there is also the possibility of a certain degree of *intra*-group competition. Thus consumers might be expected to have a better chance of sharing in the economic efficiencies that might flow from consolidation when it involves groups of independent retailers than from the control and power exercised by integrated chains when competition is limited.

⁹⁰ For extensive discussion on this point regarding EC merger policy, see Simon Bishop and Mike Walker, *The Economics of EC Competition Law*, 2nd edition, Sweet & Maxwell: London, 2002.

- 5.16 On the basis of this logic, competition authorities should be encouraging the development of groups of independent retailers compared to integrated chains, especially in view of the current tendency for retail markets to be consolidating rapidly across Europe. However, a policy shift does not need to go this far. All that is required is to ensure that there is an even playing field by which groups of independent retailers gain efficiencies from joint purchasing and joint marketing that allows them to be competitive and be efficient. In this way, they can help ensure that consumers continue to benefit from rigorous retail competition and that procurement markets remain sufficiently competitive so that, in the absence of producer competition being distorted, new and improved products continue to flow to final consumers.
- 5.17 Crucially, there is no inherent economic reason why independent retailers should decline if they are allowed the same legal freedom that integrated chains enjoy in controlling their retail functions involved in procuring, distributing and then retailing goods to consumers. Groups of independent retailers do not require special treatment and unduly favourable policies (that serve to protect competitors rather than protecting competition). They just need a level playing field, with requisite legal certainty over their arrangements, to allow them to achieve sufficient efficiency benefits and consistency in their marketing image to enable them to compete on effective terms with integrated chains. If they can obtain this, then there is a much greater prospect that procurement and retail markets across Europe will remain competitive to the definite and continuing advantage of consumers.

5.B Specific policy measures

- 5.18 From the preceding analysis in the report, four particular areas appear to warrant special policy consideration in respect of the treatment of the arrangements and agreements used by groups of independent retailers:

1. The treatment of mixed agreement structures

- 5.19 Many groups of independent retailers operate with what can be called a “mixed structure” of agreements, involving elements which are both horizontal (retailer to retailer) and vertical (central office to retail member) in nature. In this situation there is the strong possibility that competition authorities might adopt different interpretations into the nature of these agreements without taking full consideration of their purpose and economic effects. Thus, it is entirely possible that pro-competitive vertical arrangements might be misinterpreted as anti-competitive horizontal agreements, and equally pro-competitive horizontal agreements might

be misinterpreted as anti-competitive vertical agreements. This creates the distinct possibility that pro-competitive agreements could be prohibited or that, with legal uncertainty hanging around the arrangements, groups could be deterred from using them.

5.20 Consequently, it is important that such uncertainties in legal interpretations, which may seriously handicap groups of independent retailers, are eliminated or least curbed. More specifically, it is necessary to ensure that:

- ◆ The purpose and economic role of agreements takes precedence over their legal form in respect of how they are viewed and treated;
- ◆ The “double-hurdle” sequential analysis, of first horizontal and then second vertical agreements, should not be used as means to lessen the possibility of groups being allowed to use pro-competitive agreements when these are directed primarily at controlling co-ordination problem undermining group efficiency or competitive positioning;
- ◆ An examination of the horizontal aspects of agreements should not automatically lead to a ban on behaviour that is allowed in the context of vertical agreements (e.g. where market share thresholds are exceeded in a horizontal assessment but not in a vertical assessment);
- ◆ Behaviour that is consistent with the improved functioning and efficiency of a group should be assessed on its merits rather than on an assumption that because of its form it is necessarily anti-competitive (e.g. exchanges of information between members to improve the responsiveness of retailers in response to inter-group competition may not amount to anti-competitive horizontal behaviour when inter-group competition takes on greater significance than intra-group competition in ensuring that consumers benefit from effective competition⁹¹);
- ◆ Authorities should, where possible, assess mixed agreement structures on a full effects basis (rather than the present sequential dual-effects basis) to examine whether the associated cooperative agreements offer efficiency benefits to group members while not distorting, restricting, or preventing supplier and retailer competition to the detriment of consumers – taking the view that if there is no net detrimental effect on either side of the market then all horizontal and vertical control agreements should be allowable (i.e. using

⁹¹ In fully integrated, single-owned retail chains this kind of use of information is totally permitted. Exchange of information can be viewed as necessary efficiency-enhancing requirement in a vertical chain or other independent retailer system. For example, information, which the central office function may be justified in receiving from retailers and in turn disseminating information back to retailers to ensure their effective and informed competitive positioning might reasonably include weekly data and key figures regarding sales, profit, profitability, customers, personnel, and price levels.

as a benchmark the practices that would be used by a single-owned vertical-integrated business undertaking in the same market circumstances).

2. Market definition and guidelines when market shares exceed 30%

- 5.21 With market shares playing a very prominent role in the assessment of horizontal and vertical agreements, market definition takes on special importance. This requires determining the relevant procurement markets and retail markets in which the independent retailer group operates. Procurement markets are typically defined at the product-category level and usually viewed as national in scope. However, with the move towards internationalisation and increased cross-border trade within Europe, procurement markets are tending to become more international in nature. In regard to retailing markets, these tend to be either local or regional/national in nature depending on retailer behaviour (e.g. whether local or national pricing and promotion are used) and consumer behaviour (e.g. whether consumers buy very locally or more widely so that local markets overlap to a large extent). More contentiously, though, competition authorities have recently tended to view retail markets narrowly in respect of the retail service (e.g. distinguishing between markets based on store format and store size or whether retailers are full-assortment or specialised).
- 5.22 The upshot is that procurement markets may be taken as being significantly less concentrated than retail markets, which may have a bearing on how authorities assess agreements. This may, for example, benefit groups in respect of how joint purchasing arrangements and vertical control to enhance the bargaining position of the group are viewed (as these primarily have a bearing on procurement markets). However, it may work against groups in respect of how joint marketing/commercialisation arrangements and vertical control to enhance the market position of retail members are viewed (as these primarily have a bearing on retail markets). Nevertheless, as long as practices are pro-efficiency and pro-competitive in nature then they should be allowed.
- 5.23 The problem, though, for groups of independent retailers is that where markets are viewed narrowly then there is a greater chance that market thresholds will be exceeded in terms of assessing agreements, generating legal uncertainty as to whether arrangements will be allowed by the relevant authorities. Here, much clearer guidance is required for groups on which practices will be allowed even if they possess high market shares, e.g. greater than 30%, as there may be very good pro-competitive and pro-consumer reasons for allowing certain practices. For instance, maximum resale prices can serve to prevent retailers exploiting local market power when retail markets are concentrated. Also, consideration should be given to

limiting the coverage of agreements rather than outright prohibiting them when anti-competitive concerns can be allayed while significant efficiency benefits can be still achieved.

5.24 These observations would suggest the following policy considerations:

- ◆ In regard to defining procurement markets, consideration should be given to the extent to which procurements are becoming international rather than simply national in nature, by virtue of the amount of cross-border trade and international sourcing activity taking place;
- ◆ In regards to defining retail markets, only where there are very clear differences in market behaviour between different retailer types (e.g. in prices and product ranges) and consumer shopping patterns (e.g. bulk vs. small purchases, commercial vs. private purchases, etc.) should a narrow product/service definition be used;
- ◆ Even when critical market share thresholds are exceeded, agreements should be allowed where the benefits for consumers are clearly evident and potentially measurable (e.g. allowing maximum resale prices on advertised, staple and private label items when it is clear that this practice is being undertaken to lower retail prices and enhance the competitive position and retail image of a grouping);
- ◆ When critical market share thresholds are exceeded then rather than outright prohibiting an agreement where there may be some anti-competitive concerns, authorities should consider allowing modified agreements (with less extensive coverage or less onerous requirements) that allay anti-competitive concerns (e.g. by reducing the chance of foreclosure effects), but which still allow for significant efficiency benefits to be achieved (for example, allowing purchasing obligations to groups that exceed the 30% market share threshold so long as the total purchase requirements only reflect a foreclosure of an equivalent share of the total market at a specific level, say a maximum of 30% of the market).

3. Joint purchasing and non-compete obligations

5.25 The general context in which independent retailer groups find themselves is very important in understanding why joint purchasing and non-compete obligations are necessary for the survival and competitive development of independent retailer groups and the efficiency and pro-competitive benefits that these bring forth to the ultimate benefit of consumers.

5.26 Independent retailer groups are generally facing increasingly fierce competition from large integrated chain groups. The latter operate on a national and increasingly international level, usually with standardized marketing systems, very often associated with or supplemented by Internet-supported commerce with full European, if not global, reach. In this setting, the

members of independent retailer groups are in competition with these integrated chain stores in their regional markets. In order to maintain their position, they are dependent on the work of the groups with respect to pooled purchasing and development of standardized marketing strategies and sales systems. This process is assisted if groups can use purchase obligations on members as it greatly enhances the ability to conduct favourable negotiations with suppliers (by ensuring high sales volumes and widespread distribution for the suppliers' products), which in turn are likely to benefit consumers when lower wholesale prices translate into lower retail prices.

- 5.27 With joint purchasing activity and associated purchasing obligations on members set up on an indefinite basis to the mutual benefit of all participants (and consumers), policy consideration should be given to the need for a finite duration on allowable non-compete obligations in this specific context.
- 5.28 Also, it appears relevant to consider the effects of the total freedom that integrated chains enjoy from having complete control in respect of a central administrative function dictating exactly the quantities and range of goods to be stocked at each and every store. This is, after all, directly equivalent to an indefinite non-compete obligation with 100% purchase requirement – i.e. something that would not be exempted under EU rules. If it were acceptable for integrated chains to have no percentage limit, then it would be reasonable for equivalently sized groups of independent retailers to be allowed to operate with no percentage limit as well.
- 5.29 Similarly, we can observe that franchises are given much more lenient treatment than independent retailer groups under EC rules regarding non-compete obligations and duration of agreements when there appear little economic justification for such different treatments. Most pertinently, in the Commission's guidelines on the application of Article 81(3) it is stated that if, for example, the main object of a franchise agreement does not restrict competition, then restrictions, which are necessary for the proper functioning of the agreement such as obligations aimed at protecting the uniformity and reputation of the franchise system also fall outside Article 81(1).⁹² Independent retailer groups which use a vertical chain control system (and could even be labelled as a wholesaler-retailer franchise arrangement) have certain similarities with the (business format) franchise system in the sense that the main object of the vertical chain agreement is not to restrict competition and the use

⁹² For details, see note 83 above.

of restrictions and obligations on retailers may be viewed as necessary for the proper and efficient functioning of the arrangement.

5.30 These observations suggest the following four policy considerations:

- ◆ Independent retailer groups should be able to operate joint purchasing arrangements (in the form of horizontal agreements) when their combined market share exceeds 15% so long as this is required in order to be competitive with other, larger groups of retailers operating in the same markets, and so long as competition in the relevant procurement and retail markets is not thereby distorted or restricted to the ultimate detriment of consumers;
- ◆ Purchasing obligations (as vertical agreements) should be seen as acceptable ancillary restraints, when they are linked to the principal objective of the commercialisation under a common brand name and/or are essential for ensuring that benefits from joint purchasing can be fully realised and when this result in consumers receiving tangible benefits (e.g. lower prices);
- ◆ The percentage and time limit on purchasing obligations (as non-compete obligations) should be removed when used in the specific context of independent retailer groups so long as this does not distort or restrict supplier competition or reduce effective competition in procurement markets to the ultimate detriment of consumers;
- ◆ For common marketing activities by the group, it should be possible to oblige the retailers (a) to order and keep in stock certain core product ranges in quantities appropriate to their regional market and (b) to participate in advertising campaigns organised centrally by the groups that may be national or even international (e.g. within the “Euro zone”), with an obligation to charge a fixed common price so long as the promotions are short term (e.g. a two-week duration) and designed to provide clear consumer benefits (e.g. introducing a new or improved product or offering a low price).

4. Joint marketing and retail pricing requirements

5.31 Integrated retail chains are free to enjoy complete control over the setting of retail prices of every product sold at every one of their stores. By stark comparison, an independent retailer group is likely to be prevented from having its central office set the retail price on a single product at a single store. On the face of it, there is no sensible economic reason for such a marked difference in policy treatments, especially when the two retailer groups are serving the same set of consumers, perhaps with the same set of products, and even when the independent retailer group has a tiny market share so there is no prospect of it possessing any market power. The reason for this prejudicial position is simply down to the fact that under

EU competition law, fixed resale price maintenance is per se prohibited. In other words, there is a form-based prohibition that takes no account of any economic effects arising whatsoever.

- 5.32 The lesson from the economics of vertical restraints is that every vertical restraint can have both potentially pro-competitive and anti-competitive effects. The reason usually cited for the complete ban on fixed resale prices is that it is not “indispensable”, i.e. an alternative and less restrictive restraint could serve the same pro-competitive purpose with the same anti-competitive concerns. This is a moot point. Service requirements (which are usually viewed as the obvious alternative to RPM) may prevent “free-rider” behaviour associated with under provision of pre-selling services (e.g. discount operations cutting back on demonstration facilities) and using other retailers’ “quality certification” (e.g. their reputation for stocking high quality products). However, service requirements can only control the retail service elements provided by the retail group, they cannot directly control the pricing image and consumers’ conception of the group’s value-for-money proposition. Resale price maintenance can tackle this aspect when full elimination of intra-group pricing differences is required in order for the group retail image to be enhanced in consumers’ minds (e.g. by being perceived as operating a “fair”, “non-discriminatory” pricing policy) and thereby providing assurances to consumers (and so potentially encouraging demand). Thus there can be obvious efficiency and consumer benefits. At the same time, if the practice only applies to a very limited number of products promoted on a short-term basis then there can be no anti-competitive effects arising. In other words, it is conceivable that RPM can satisfy all four exemption criteria, if competition authorities were prepared to have an open mind on the practice.⁹³
- 5.33 In contrast to the per se prohibition status of fixed RPM, fixed retail prices may be a justifiable arrangement when it is viewed as a horizontal rather than a vertical agreement. In this case, there is explicit recognition given to the fact that fixed retail prices may be necessary as part of a joint commercialisation and marketing process, promoting a consistent brand image across retail members that facilitates trust and assurance in the mind of consumers in support of value-for-money propositions, facilitating more informed decisions for consumers and generally encouraging demand (and therefore offering significant consumer benefits).
- 5.34 These observations suggest the following policy considerations:

⁹³ One should also consider the essential character of the desired behaviour in relation to market situation and the type of products being sold. A good example relates to household electrical appliances. Here, communication about the same low price in the framework of a promotion campaign is the essential weapon of competition between brands.

- ◆ Competition authorities should consider allowing commonly set prices (i.e. fixed retail prices that apply across all or some retail members) within *vertical* agreements of groups of independent retailers for a limited number of short-term marketing campaigns and for certain products/ranges (e.g. on private label goods, key brands, and known value items) when they are indispensable in developing and promoting a consistent group image, providing consumers with reassurance and clarity about the value-for-money proposition being offered, advancing inter-group competition while providing efficiencies (e.g. removing duplicated effort in otherwise running separate advertising/marketing campaigns for price promotions).
- ◆ Fixed prices should be allowed as indispensable in *horizontal* agreements when they promote efficiencies in respect of joint purchasing (by improving the bargaining position of the group when producers are desiring retail promotions that expose their products widely to consumers) and joint commercialisation (by providing a consistent retail brand image), which cannot be achieved by maximum price obligations or other restraints alone, and when they relate to a limited number of short-term marketing campaigns where there is no prospect of this engendering collusion to raise prices amongst retail members or in retail markets more generally.

APPENDICES

APPENDIX A

UGAL ECONOMIC STUDY QUESTIONNAIRE

Background to this questionnaire

UGAL has commissioned Professor Paul Dobson to conduct an economic study in relation to Groups of Independent Retailers in Europe and co-operation agreements in the light of national and European competition law. Professor Paul Dobson is one of Europe's leading experts in retailing and competition economics. He holds the Chair of Competition Economics at Loughborough University Business School in the UK. Professor Dobson is being assisted in the analysis of this information by CRA International, an economics, business and finance consultancy with particular expertise in the field of competition economics and presenting cases to both national and European competition authorities.

Information from this questionnaire will feed into a report for UGAL examining empirical and analytical aspects of these groups, the economic context in which they operate and the need for them to survive and be competitive.

Confidentiality

Professor Dobson and CRA International have a great deal of experience in handling private and commercially sensitive data. The data you provide will be kept and treated in confidence and used only for the purposes of this project. No information of a commercial nature will be disclosed in a way that could be attributed to your company. Instead information will be used to have an aggregate picture of the role of groups of independent retailers in Europe.

Minimising the effort of responding to this questionnaire

We understand that responding to this questionnaire will require time and effort. We have thought carefully about the information required and consulted with UGAL in order to ensure that the questions are well defined and that the information requested will feed into the analysis. However, if you do not understand any of the questions, please feel free to contact Professor Paul Dobson at the details provided at the end of the questionnaire. In order to further minimise the effort of responding, we have made this survey available electronically. Please type your answers into the area below the question using as much space as is necessary to give a full answer.

Definition of terms

Since different UGAL members are organised and structured in different ways, it is necessary for us to define some terms in order to ensure that we have consistency across responses to this questionnaire.

Organisational definitions

- Central office – this is the company, association or group to whom this questionnaire has been sent. The central office is a member of UGAL. This will be referred to as either “your organisation” or “the central office”.
- Association member – this represents those members of your association who are not independent retailers themselves, but rather are organisations that represent the individual retailers. For example, the association members could be regional or sector specific associations or buyer groups.
- Independent retailer member – this represents those members who are independent retailers. They may be independent retailers who have direct membership of the central office, or they may be independent retailers who are members of associations who have direct membership of the central office. Please include information about both these two groups in responses to questions about independent retail members.
- End customers – this represents the final customer or consumer who purchases the resulting products.

Market definitions

In some places we ask for market share information. Please assume that the *geographical* market is national. However, if there are significant regional or local differences that may mean that a more narrow market definition is appropriate, then please provide additional details on these aspects in your

response. In regard, to the *product* market, please assume this relates to the relevant retail sector (e.g. grocery, toys, sports goods, etc.). However, please provide additional details if there are such significant differences in retail formats (e.g. store size and/or product range) that mean a more narrow market definition is appropriate (e.g. the UK authorities have distinguished between “one-stop” shops and “top-up” shops as operating in separate retail grocery markets).

Contact details

Your contact details

Please provide details of the person we should contact in the event of queries or in order to gain additional information.

Name

Address:

Email:

Telephone number:

1 Background information about your organisation

- 1.1 In what year was your organisation formed?
- 1.2 What are the broad aims, objectives and goals of your organisation?
- 1.3 Have there been any changes in these aims, objectives and goals since the organisation was formed? (If so, please specify)
- 1.4 What are the primary roles that your organisation undertakes? Please list your five most important functions e.g. buyer agreements, distribution arrangements, supply chain management, training, provision of information, advertising, engagement with national or international public policy, other (please specify).
- 1.5 How wide is the geographical coverage of your organisation? For example, regional, national, cross-border within Europe, or international. If cross-border within Europe, please specify the countries in which you operate.

Regional – please specify

European – please tick all that apply – have a list of EU countries

Global – please tick continents that apply? Include “other non-EU Europe”

- 1.6 Are there any other organisations at your level that offer similar services to you, i.e. other buying groups or alternative organisations that could provide similar services to your members as those you provide?
 - 1.6.1 If so, in total, how many independent retailer members do your competitors currently represent? If possible, please specify by each main alternative organisation.
 - 1.6.2 What is the total retail turnover in € of all your competitors’ independent retailer members? If possible, please specify by each main alternative organisation.

2 Background information about your association members

- 2.1 How many association members do you currently have? If zero, please go to section 3.
- 2.2 Are these association members organised on a *geographic* basis (e.g. regional association members) or on a *retail-type* basis (e.g. association members separately representing convenience stores, supermarkets, etc.)?
- 2.3 How have the numbers of association members changed over the last ten years? If possible, please specify the numbers joining and leaving, for example, to go independent, join a rival group, consolidate groups, be acquired, or go out of business etc.
- 2.4 How many independent retailer members are currently represented through these association members?
- 2.5 How have these numbers changed over the last ten years? If possible, please specify the numbers joining and leaving, e.g. to go independent, join another group, be acquired, or go out of business.

- 2.6 As well as association members, do you have independent retailer members who are direct members of your organisation in addition to those independent retailer members who are members through the association members? Please give details.

3 Background information about your independent retailer members

Please include in this section information relating both to those independent retailer members who are direct members of your organisation as well as those independent retailer members who are members of associations who have direct membership of your organisation.

- 3.1 In total, how many independent retailer members do you currently represent?
- 3.1.1 Do these represent all retailer members?
- 3.1.2 If not, what other form of retail members does your organisation represent?
- 3.2 How does your organisation define “independent retailer”?
- 3.3 How have the numbers of independent retailer members changed over the last ten years? If possible, please specify the numbers joining and leaving, e.g. to go independent, join another group, be acquired, or go out of business.
- 3.4 Of your independent retailer members,
- 3.4.1 How many do you have that only have single outlets as opposed to multiple outlets?
- 3.4.2 How many do you have that have multiple outlets?
- 3.5 What is the total annual retail turnover in € of all your independent retailer members? Please give details over the last ten years if available.
- 3.6 What is the current range of annual retail turnover in € for all your independent retailer members, from smallest to largest?
- 3.7 What is the total annual retail turnover in € of all your independent retailer members with only single outlets (i.e. one retail shop) as opposed to multiple outlets (i.e. many retail shops)?
- 3.8 What is the total annual turnover in € of all your independent retailer members relating to wholesale purchases? Please give details over the last ten years if available.
- 3.9 What is the current range of annual turnover in € for all your independent retailer members relating to wholesale purchases, from smallest to largest?
- 3.10 What is the total annual turnover relating to wholesale purchases in € of all your independent retailer members with only single outlets as opposed to multiple outlets?
- 3.11 What is the total retail surface area in square metres covered by all of your independent retailer members?
- 3.12 What is the current range of total retail surface area in square metres for all your independent retailer members, from smallest to largest?
- 3.13 What sectors are your independent retail members involved in? (Please give top five by order of importance e.g. grocery, clothes, toys, sport, shoes jewellery, clocks, nursery equipment, domestic equipment, stationery, books, records, optical, photo, tourism, other). Please also specify the proportion of the total membership turnover that these activities represent.

4 Background information about the competitors to your independent retailer members and the market context

Identification of competitors and market share information

- 4.1 Who would your independent retailer members see as their main competitors? Why?
- 4.2 Please provide annual market share data over the past ten years (or as far back as you are able to up to if less than this) for retail sales. In this case the market should be seen as the relevant national retailing market. If your independent retailer members are in more than one product market, please provide details on each of them:

- 4.2.1 What is the combined annual market share of all your independent retail members?
- 4.2.2 What is the combined annual market share from your largest 5 independent retailer members (by ownership)?
- 4.2.3 What is the combined annual market share from your largest 5 independent retailer members (by franchise name)?
- 4.2.4 What is the combined annual market share from the largest 5 retail competitors who are not members? (This could include both independent retailers who are not members as well as vertically integrated retailers.)
- 4.2.5 What is the combined annual market share from all vertically integrated retailers?
- 4.2.6 What is the reason for any trends in market shares that are shown in the data?
- 4.2.7 What is the reason for any significant changes in market shares? (For example, large members leaving or joining your organisation.)
- 4.3 Please provide annual market share data over the past ten years (or as far back as you are able to up to if less than this) for wholesale purchases as a share of the whole relevant national purchasing market. Again, please assume that the market is national and if your independent retailer members are in more than one product market, please provide details on each of them:
 - 4.3.1 What is the combined annual market share for wholesale purchases of all your independent retail members?
 - 4.3.2 What is the combined annual market share for wholesale purchases from your largest 5 independent retailer members?
 - 4.3.3 What is the combined annual market share for wholesale purchases from the largest 5 competitors who are not members? This could include both independent retailers who are not members as well as vertically integrated retailers?
 - 4.3.4 What is the combined annual market share for wholesale purchases from all vertically integrated retailers?
 - 4.3.5 What is the reason for any trends in market shares for wholesale purchases that are shown in the data?
 - 4.3.6 What is the reason for any significant changes in market shares for wholesale purchases? (For example, large members leaving or joining your organisation.)

Nature of competition

- 4.4 How do your independent retailer members compete with others in the retailing sector? For example, what type of retailer do they compete with, how intensive is price competition compared with other forms of competition relating to service. Please give details
- 4.5 Are there particular aspects in which your independent retailer members find it difficult to compete on price or other bases of competition (such as product range and service quality) in the markets in which they operate? For example, access to common products, private label, marketing ability, logistics, stock replenishment, information technology, other
- 4.6 To what, if any, extent are your independent retailer members less cost efficient than other retailers? Why? Is it size disadvantage, legal impediments or other reasons?
- 4.7 In what ways would customers be detrimentally affected if your independent retailer members were forced to exit the market because of the market power of competitors?

5 Organisational and ownership structure

- 5.1 Please give a brief overview of the relationships that exist between your organisation, association members and individual retailer members
- 5.2 Please explain the set of relationships that govern your organisation and its links to association members through to individual retailer members?

- 5.3 Who owns your organisation e.g. a co-operative, holding agency, owned by individual retailer members etc?
- 5.4 How is the central office managed? Is there a permanent secretariat? How are decisions taken by your organisation?

6 Contractual agreements and arrangements

Background on agreements

- 6.1 What contractual agreements does your organisation use in respect of association members? E.g. exclusive purchasing, exclusive territory requirements, obligation to purchase, retail price maintenance (both horizontal and vertical), advertising or promotion, use of logistics, other.
- 6.2 What contractual agreements does your organisation use in respect of independent retailer members? E.g. exclusive purchasing, obligation to purchase, retail price maintenance (both horizontal and vertical), advertising or promotion, use of logistics, other.
- 6.3 What contractual agreements do your association members use in respect of independent retailer members? E.g. exclusive purchasing, obligation to purchase, retail price maintenance (both horizontal and vertical), advertising or promotion, use of logistics, other.
- 6.4 Are there any price agreements in place at any stage of the organisational structure? Please give details, particularly explaining, who the agreements are between and whether the agreements are fixed, minimum, maximum or suggested prices.
- 6.5 Is it a condition of membership of your organisation that all independent retailer members have to agree to all of these agreements? Please give details.
- 6.6 For each of the agreements specified, what efficiency benefits do these bring to your organisation? Please quantify this as far as possible.
- 6.7 For each of the agreements specified, what efficiency benefits do these bring to association members? Please quantify this as far as possible.
- 6.8 For each of the agreements specified, what efficiency benefits do these bring to independent retailer members? Please quantify this as far as possible.
- 6.9 For each of the agreements specified, what efficiency benefits do these bring to end customers? Please quantify this as far as possible.
- 6.10 Do any of the suppliers you would want to use have, or could have, exclusive purchasing agreements with other buyers?
- 6.11 Do you have written or oral agreements with suppliers? Please provide an estimate of the proportion if there is a mix

Timescale of agreements

- 6.12 For each of the agreements specified, what is the practical minimum length of time that these agreements need to last?
- 6.13 How long do these agreements typically last?
- 6.14 How long would you like these agreements to last and what additional benefits would this bring? Please include benefits to your organisation, association members, independent retailer members and end customers.
- 6.15 How easy would it be for association members to exit these agreements? How long would this take? Would any penalties be due?
- 6.16 How easy would it be for independent retailer members to exit these agreements? How long would this take? Would any penalties be due?

Necessity of agreements

- 6.17 Please give examples of where these agreements have been necessary for trades to occur i.e. where trades would not have been possible in the absence of these agreements. Please specify why these agreements were necessary.

- 6.18 What services are you unable to provide because of (a) the organisation's present structure and remit, and (b) legal impediments or regulations?
- 6.19 Are there agreements with producers that you are unable to negotiate because you do not have sufficient control over your members? Please give examples where trades have not been possible because you do not have these or other restraints in place.

Benefits from the agreements

- 6.20 What additional costs would be incurred by independent retailer members if they were not members of your organisation? For example, fixed costs of negotiation; higher purchase prices; lower economies of scale. Please provide quantitative information on these costs as far as possible. For example, please provide a percentage increase in costs that independent retailer members would typically face if they stopped being members of your organisation
- 6.21 What benefits would be lost to independent retailer members if your organisation did not exist or if its operation was greatly restricted? Would there be any reduction in the diversity of products? What are the indispensable benefits for being organised as you are? E.g. independent retailer members can change prices quickly, local decisions, other. Are there products which independent retailer members would be unable to purchase if they were not in your organisation? Please give details.
- 6.22 In what ways would customers be detrimentally affected if your organisation was forced to exit the market or if its operation was greatly restricted?
- 6.23 What, if any, alternative ways might there be to achieve these same benefits?
- 6.24 Why do your independent retailer members wish to remain as independent?
- 6.25 What advantages do integrated firms have that your members do not have?

7 Policy issues

National policy

- 7.1 In what ways does national or federal/regional competition policy impact your organisation and practice?
- 7.2 Have there been any national decisions (directly or indirectly) relevant to the retailing sector served by your members in respect of market definition, permitted/prohibited practices, and/or mergers that have been seen to be of concern? Have these been investigated and have any exemptions been achieved? Please provide details.
- 7.3 How does current national competition authority policy affect your organisation? (For example, through market definition, restrictive practices, horizontal agreements, and vertical agreements. Please give details).
- 7.4 Are there any specific restrictions set out by your national competition authority regarding co-operative agreements / buying organisations / associations of independent companies? E.g. market share limits, legislative restrictions or regulations. Please give details.
- 7.5 What elements of national policy impede your organisation and members with respect to their ability to compete on effective terms?
- 7.6 Have there been any recent investigations (e.g. on mergers) or reviews by the national competition authority into sectors of relevance to you organisation or its members? If so, please provide details.
- 7.7 What, if any, horizontal and vertical relationships in your organisation have been reviewed, investigated or commented on by the national competition authority or a court of law?
- 7.8 What, if any, policy/regulation benefits are available in other EU Member States to equivalent organisations and members that your own organisation and members are unable to enjoy because of present national policy/regulations?
- 7.9 Are you aware of any imminent policy changes, industry reviews, or company/merger investigations? If so please provide details.

European policy

- 7.10 In what ways does current European (EU) competition policy impact your organisation and practice?
- 7.11 What would you like changed and why? How would these changes benefit or hinder your organisation, independent retailer members, and end-customers?
- 7.12 What alternative options would you wish to put forward for change?
- 7.13 Are there dissenting views amongst your independent retailer members on the most urgently required policy changes? If so, please provide details.
- 7.14 What aspects of your organisation do you consider may face possible challenges by competition authorities in the future? What would happen if you were no longer able to use these arrangements? How would these changes benefit or hinder your organisation, independent retailer members, and end-customers?

Our contact details

If at any point while completing the questionnaire you have any queries or require clarification on any questions, then please contact Professor Paul Dobson either via e-mail (p.w.dobson@Lboro.ac.uk) or by telephone (+44 1509 223297).

If using the web-based questionnaire is not convenient, please send your completed response by e-mail to Professor Dobson (p.w.dobson@Lboro.ac.uk). Alternatively, please post your response to: Professor Paul Dobson, CRA International, 1 Undershaft, London EC3A 8EE, United Kingdom.

APPENDIX B

RESULTS AND FINDINGS FROM THE QUESTIONNAIRE STUDY

1 Background and Summary

1.1 General information on the questionnaire

To gather primary-sourced information and data, a questionnaire study was undertaken with the aim of identifying empirical information and evidence on aspects of groups of independent retailers, the economic context in which they operate and the political, legal and economic factors that influence their ability to be efficient and be competitive. The prime objective of this questionnaire study was to elicit information from a perspective as wide as possible in relation to geographic coverage (with responses sought from organisations in as many EC member states as possible), product coverage (with responses sought from organisations representing members in the food and a range of non-food sectors), organisational coverage (representing the different of organisational structures that independent retailer associations might take), and representative coverage (with responses sought from different sized organisations, in different market and competitive positions).

Given that responding to the questionnaire requires time and effort on behalf of respondents, considerable care was taken over the design of the questionnaire. In particular, careful consideration was given to the information required and consultations were held with UGAL (as the key pan-European body representing most associations and groups of independent retailers operating in the European Union) in order to ensure that the questions were well defined and that the information requested would feed into the relevant economic and policy analysis. Furthermore, a pilot study was conducted and some questions then reconsidered, added or deleted in the light of the feedback on the pilot study. In order to further minimise the effort of responding, the survey was made available electronically over the internet, and in addition respondents were provided with the option to instead e-mail their responses. The questionnaire was made available in the three working languages used by UGAL (and therefore by member associations/groups of independent retailers that we would target with our questionnaire), namely English, French and German.

Due to the confidential nature of some of the responses, information cannot be revealed on an individual basis but rather information is used to present an aggregate picture of the role of groups of independent retailers in Europe.

1.2 Questionnaire design and structure

The full questionnaire (English version) used in the study is reproduced in Appendix A. The questionnaire is divided into seven main sections. In total, the questionnaire asks for information in respect of ninety-six main questions, with the intention of soliciting from respondents a broad mix of quantitative and qualitative information.

The first section covers general background information relating to the representative organisation. For example, it covers the organisation's age, general aims, objectives and goals, geographic coverage, whether there are any competitor organisations (i.e. offering the same or similar services), number of retailers represented, and size by turnover.

The second section seeks background information on association members. The questions relate to the number of association members, their basis of organisation (e.g. geographic or retail-type), their size and membership composition, and changes to them over the last decade or so.

The third section requests background information on independent retailer members. This includes the number of retailers represented, definition applied to the term "independent retailer", changes in membership levels over the last decade, balance of single outlet v. multiple outlet members, total

annual retail turnover and wholesale purchases of retail members, size range (by retail turnover and wholesale purchases) of members, sales area range of members, and retail sectors covered.

The fourth section seeks background information about competitors to independent retail members and the general market context in which the latter operate. This includes details of market shares by retail type (e.g. independent retailers v. integrated chains), by retail turnover and wholesale purchases, concentration levels, explanations for patterns over time in market share and concentration levels, intensity and nature of retail competition, bases of competition, and relative competitiveness of independent retailers (compared to other retailer types).

The fifth section addresses organisational and ownership issues, looking at the links across association and retail members with the central organisation, ownership form (e.g. cooperative, holding agency, joint ownership by independent retailers), and central office management and decision making responsibilities.

The sixth section requests information on contractual agreements and arrangements, such as vertical and horizontal agreements with association and/or retail members, conditions of membership, benefits of such agreements, length of agreements, exit arrangements, economic necessity of arrangements, costs of alternative arrangements, and advantages of integrated firms over independent retailers.

The seventh (and final) section looks at public policy issues at national and European levels, including impacts arising from relevant competition policy decisions or imminent/possible changes (e.g. regarding market definition, mergers, and vertical and horizontal agreements), and consideration of desirable alternative policies.

The material in this Appendix is structured in a manner that presents and discusses the questionnaire survey findings on each of these aspects separately in successive sections (sections 2-7 below).

1.3 Questionnaire responses and sample size

The questionnaire was originally sent out to around 150 different organisations identified to us by UGAL as representing independent retailers (and in some cases covering other providers and artisans directly supplying consumers). The exact breakdown of the sample can be seen below in Table B1.

Table B1: Sample and responses⁹⁴

Organisation	Questionnaire sample	Number of responses	Response rate
Direct UGAL Members	28	16	57%
Indirect UGAL Members	n.a.	22	n.a.
of which ZGV	99	16	16%
of which FCA	18	3	17%
of which SOCR	n.a.	3	n.a.
Total	n.a.	38	n.a.

Source: CRA International

Direct UGAL member associations are a mix of apex organisations acting as (national) associations representing the interests of a number of different independent retailer groups (e.g. ZGV, FCA, SOCR and ACS), and (nationally or internationally operating) individual organisations (e.g. Kesko and ICA). Some of the individual groups may be members directly of UGAL as well as indirectly through a broad association (e.g. EDEKA as a direct UGAL member, as well as indirect representation through ZGV).

In order to obtain information and views at different organisational and association levels, all direct UGAL members were contacted and asked to complete the questionnaire. The response rate from these direct UGAL members, as shown in Table B1, was 57%. In addition, the individual groups of independent retailers represented by three UGAL member associations (namely, ZGV, FCA, and SOCR) were also asked to complete the questionnaire. The number of responses from these indirect

⁹⁴ Note that the questionnaire was originally sent to SOCR who then forwarded it on to some of their members. Hence there is no sample size given for SOCR members.

UGAL members was higher than for the direct members, but the response rate was somewhat lower at around 16-17%.

In total, 38 organisations responded to the questionnaire. However, the degree to which respondents provided full answers to all questions varied widely. Most respondents did not provide answers to all of the questions. Furthermore, different interpretations to required data in some instances also restricted the comparability of responses to some questions across the organisations. Accordingly, the sample of organisations considered in the analysis varies for each question. The descriptions and discussion of the results given in this Appendix are based on only those answers that could be clearly interpreted. Thus, answers suspected of significant misunderstandings or inconsistencies were left out of the analysis of the answers.⁹⁵

1.3.1 Summary statistics

Table B2 provides some summary statistics relating to the general quantitative information given by respondents. Similar tables to summarise remaining answers are shown in the relevant sections. The information shown below is split for direct UGAL and indirect UGAL members and shown in the sections describing the results in more detail.

Table B2: Summary statistics

	Minimum	Maximum	Average	Standard deviation	Sample size	Total
Number of independent retailers represented by the respondent	28	40,000	3,863	8,111	35	135,201
Number of independent retailers represented by other organisations in the country	146	20,000	4,838	5,619	17	82,253
Retail turnover of independent retailers represented by the respondent (€ billion)	0.05	99.00	8.86	19.34	28	248
Retail turnover of independent retailers represented by other competitor organisations (€ billion)	1.1	380.5	34.1	95.4	16	546
Total retail surface in square metres (million)	0.2	6.2	2.4	4.2	25	60.8

Source: Various questions.

1.4 Key findings

As a summary, and to provide some direction to the more detailed analysis of the responses discussed below, the key findings of the questionnaire study were found to be as follows:

Characteristics of associations and groups of independent retailers

The information provided by respondents to the questionnaire shows that the structure, functioning and organisation differ widely among associations of retailers. For example, some associations simply represent groups of independent retailers, other organisations represent retailers directly, and yet other organisations represent both groups and individual retailer members. With regard to the functioning of the association or group, some respondents indicated that the central office is organised by an executive board or management aided by an advisory council. Other respondents have a permanent secretary whereas yet other respondents noted that their organisation is managed by working groups. The heterogeneity in the organisation of respondents implies that it is difficult to draw any generalisations regarding the structural/organisational characteristics of retailer associations, each differing according to the market, legal and historical context in which they operate.

⁹⁵ For example, the number of retailers represented through association members was indicated to be larger than the total number of independent retailers represented by the association (direct members and indirect members through association members). As an example of an apparent misunderstanding, respondents sometimes confused questions relating to the number of indirect members with the number of independent retailer members. We report the percentage of respondents which gave a meaningful answer for each question and which were considered in our analysis.

Nature of competition

Respondents indicated that independent retailer members compete in several areas including the level of service and choice as well as on prices. Competitors are viewed as other retailers in general, but most significantly integrated retailers, with the most significant challenge posed to small-format independent retailers being hypermarkets and discounters. Respondents indicated that their independent retailer members find it increasingly difficult to compete with the aggressive pricing policies of integrated chains (including the perception that these competitors use below cost selling to undermine their positions). Nevertheless, compared to unaffiliated independent retailers, who are not members of any group or association, the consistent view expressed was that independent retailers as members of a group were in a significantly better position (albeit with some limitations) to compete with integrated retailers.

Regarding cost efficiency, compared to integrated chains, respondents indicated that independent retailers are generally less cost efficient because they do not benefit from the same extent of economies of scale that benefit large integrated chains, especially in purchasing. Another factor contributing to the relative cost inefficiency of retailers compared to integrated chains was considered to be retailers' higher personnel costs due to their higher level of service and fewer possibilities to balance staff requirements.

Types of agreements between organisations and independent retailers

Coordination between the groups or individual retailer members represented takes place in various ways besides explicit contractual agreements. These include voluntary service offers, gentlemen's agreements, and regulation of the relationship in the organisation's statute. Voluntary service offers include the transfer of know-how, information services, lobbying and/or training.

For those groups that use contractual arrangements between themselves and their independent retailer members, the nature and content of the contracts appear to be very diverse, ranging from mandatory price negotiations to various marketing agreements. One of the most common arrangements related to inducing retailers to concentrate a certain percentage of their purchases (usually around 80%) from one supplier (in order to ensure central purchasing efficiencies). Other contractual arrangements allow the group (specifically, the central office) to retain the right to a store's location (so to allow for control over future store planning and growth of the store network). Some respondents have brand licensing agreements in place. Other groups set up framework agreements, which serve as a basis for individual agreements between retailers and suppliers. In these cases, the central office of the group provides essentially a facilitating service, rather than engaging in joint purchasing (which is more typical).

Many respondents also have price recommendations in place. Nearly all price recommendations relate to maximum resale prices. A few respondents stated that these price agreements or recommendations apply only to certain brands or promotion goods (where some control is needed to ensure a consistent retail image across the group and ensure that consumers obtain the advantages of low prices for key products).

The majority of contracts are mainly vertical in nature, between a central office function and independent retailer members, and not between individual retailer members (as a horizontal arrangement). Furthermore, for the majority of respondents it is not a condition of membership that all independent retailers have to adhere to all agreements.

Benefits of agreements

The consistent view reported in the questionnaire responses was that the chief benefit of the agreements relate to the cost savings they create for members. Cost savings result from economics of scale in purchasing, logistics and marketing. These cost savings are passed on to the consumer in the form of lower prices and a larger choice of products. These agreements, and the cost savings they create, are considered to be necessary for independent retailers to compete against the usually much larger integrated chains. They allow retailers to survive, thereby reducing concentration and contributing to the level of competition in the market. Besides cost savings, commonly listed benefits of the agreements used include joint marketing as a means of achieving a well-recognised retail brand and unified store image. Respondents further mentioned that maximum pricing leads to lower prices for customers because retailers are free to set lower prices but are prevented from setting higher ones.

In general, the answers given indicate that it is indispensable for independent retailers to cooperate and pool their resources and bargaining power in order to be able to compete effectively against integrated chains and to provide a counterweight to the power of producers.

Problems relating to national and European policy

Respondents reported that there are practices which are currently prohibited but which should, in their view, be allowed; for example, common pricing for promotion goods (and thereby permit some equity with integrated chains) and allowing international agreements between groups of independent retailers (so that they procure more effectively on an international basis). Furthermore, some respondents stated that certain pricing and purchasing practices, which are allowed for integrated retailers, and extensively used by multinational operators, should be allowed for groups of independent retailers (e.g. control over retail prices and exclusive purchasing obligations).

Other areas of expressed concern relate to the manner in which agreements are assessed. Some respondents noted that (under the EC treatment of vertical agreements) a market share threshold of 30% is too low to ensure that the efficiency benefits of agreements can be fully obtained. One respondent further stated that market definitions should also consider the purchasing market and not just the relevant retail market in the general treatment of retail groups. A further issue raised was the evaluation of horizontal aspects in an agreement, with concern that these should not influence the evaluation of vertical agreements (as typically these are prejudged if horizontal agreements are in place). Another concern expressed relates to problems posed by a lack of legal certainty; for example, regarding the extent to which a vertical central unit with a market share exceeding 30% may use maximum pricing.

More generally, respondents took the view that present regulations and policy guidance do not give sufficient weight to the economic reality facing independent retailers, appearing to hamper rather than assist their ability to compete on effective terms with integrated retailers. Independent retailers and their groups appear to be discriminated against because of their organisational and ownership form, and not because of their competitive behaviour and their impact on the markets that they serve.

2. Background information on the association/group and members

2.1.1 Respondents' organisation

In the first part of the survey, respondents were asked to give background information about their organisation. First, respondents were asked to indicate the year in which their group/association was formed. Some 97% of respondents answered this question. The average year of formation across the full sample was 1962. For the associations and groups as direct members of UGAL, the average year of formation was 1957. From the responses given by the indirect UGAL members, the average for FCA was 1942, the average for ZGV was 1963 and the average for SOCR was 1995.⁹⁶

Respondents were further asked to list the overall goal of their organisation. In the majority of cases, the general aim was the strengthening of their members' position in the marketplace. Respondents were further asked about the primary roles undertaken by their organisation – e.g. buyer agreements, distribution arrangements, supply chain management, training, information provision, advertising, and engagement with national or international public policy (taken to include communication with the media). The answers show that most organisations fulfil several of the mentioned roles. The most frequently mentioned roles include buyer agreements, joint purchasing and marketing, lobbying and training. Information provision was also often mentioned as a significant purpose of the group/association.

Respondents were also asked if there had been any changes in the aims of their organisation since it was formed. Some 66% of respondents stated that there had been no changes in the goals or objectives of the organisation since it was formed. Of the remaining 34% who had changed their goals, some

⁹⁶ It should be noted that the sample for SOCR and FCA members is very limited when interpreting answers for differences between memberships of the respondents. We received three answered questionnaires from members of FCA, representing 8% of all respondents, three questionnaires from SOCR, who forwarded it to their organisations, 42% of organisations which responded are members of ZGV and 42% are members of UGAL. Hence, in further analysis we restrict ourselves to describing differences in the outcome of the survey between direct UGAL (19 answers) and indirect UGAL members (21 answers).

respondents gave examples such as moving from a position where the organisation was aimed at negotiating with public services in order to agree prices towards a position where they are discussing with public services how to improve the law.

Respondents were further asked to describe the geographical coverage of their organisation – for example regional within a country, national, cross-border within Europe or international. The majority of the respondents operate on a national basis (around 51% of the respondents stated that they operate nationally, compared to 14% which operate regionally, 32% on a European basis and 3% on an international basis). For associations and groups belonging directly to UGAL, the majority of these are organised on a national basis (60%), compared to 27% who are organised on a European basis and 7% who are organised respectively on a regional basis. The proportion of indirect UGAL members organised on a national basis is slightly lower (at 45%) compared to the proportion of direct UGAL members, while 36% were organised on a European basis and 18% on a regional basis.⁹⁷

2.1.2 Competitor organisations

To determine whether the respondents represent organisations that offer unique services, they were asked whether organisations (i.e. groups or associations) exist which offer similar services. The majority of respondents (75%) indicated that there were competitor organisations. Splitting this proportion up between direct/indirect UGAL members, 86% of direct UGAL members indicated that competitor organisation existed compared to 57% for indirect UGAL members. Some respondents, however, noted that although there were organisations offering similar services, they did not offer identical services (e.g. groups differing in the extent to which they offer integrated services that span procurement, marketing and store/staff development).

In order to estimate the significance of competitor groups of independent retailers, respondents were asked to indicate the number of independent retailer members represented by competitors. Around 68% of respondents gave a meaningful answer. However, some respondents appeared to misunderstand the question and indicated the number of retailer members they themselves represent. These responses have therefore been excluded from the analysis of this question. Respondents were also asked to indicate the total turnover of all the retail members of competitor organisations. Around 53% of respondents gave a meaningful answer to this question.⁹⁸ The turnover of competitor organisations ranged from €1.1 billion to €380 billion, with €380 billion a clear outlier. On average, the total turnover indicated was €34 billion (€11 billion without considering the outlier of €380 billion).

Table B3 shows the average number of independent retailers and turnover for direct and indirect UGAL respondents and those of their competitors. The table shows that the share of the average number of retailers represented by direct UGAL associations/groups is larger than the share for indirect UGAL groups. However, the share of average retail turnover is larger for indirect UGAL member retailers.

⁹⁷ Note that if the respondent listed the main countries in which the organisation was present instead of stating national, regional or international, the geographic coverage was defined as national if a large majority of the organisations' sites were in one country even if it had a few of sites abroad, for example through participation in another organisation. The geographic coverage was defined to be European if the organisation had sites in more than three European countries.

⁹⁸ If the respondent indicated total retail turnover for each main alternative organisation, the turnovers indicated were summed.

Table B3: Number and turnover of independent retailer members and their competitors

	Direct UGAL members	ZGV, FCA and SOCR respondents
Average number of independent retailers represented by the respondent	6,787 (range from 30 to 40,000) STDEV: 11,649 Sample: 15	1,267 (range from 28 to 6,000) STDEV: 1,408 Sample: 20
Average number of independent retailers represented by other organisations viewed as competitors	8,123 (range from 193 to 20,000) STDEV: 8,075 Sample: 6	3,047 (range from 146 to 7,500) STDEV: 2,813 Sample: 11
Share of number of independent retailers represented by respondent (% of sum of respondent and respondent competitor organisation)	46%	29%
Average retail turnover of independent retailers represented by the respondent (€ billion)	17.6 (range from 0.13 to 99.0) STDEV: 26.2 Sample: 13	1.3 (range from 0.05 to 3.5) STDEV: 1.1 Sample: 15
Average retail turnover of independent retailers represented by organisations viewed as competitors (€ billion)	85.5 (range from 3.8 to 380.5) STDEV: 149.1 Sample: 6	3.4 (range from 1.1 to 3.4) STDEV: 2.2 Sample: 10
Share of retail turnover independent retailers represented by respondent (% sum of respondent and respondent competitor organisation)	17%	27%

Source: various questions.

2.2 Background information on association members

Given the complex structure of some groups of retailers, it was necessary in designing the questionnaire to define “association members”. This represents those members of an association who are not independent retailers themselves, but rather are groups or organisations that represent the individual retailers. For example, the association members could be regional or sector specific associations, buyer groups, or central office operators providing procurement and marketing services.

2.2.1 Number of association members and independent retailer members represented by association members

Table B4 shows the number of association members represented by each of the respondent organisations and the number of independent retailer members represented each group/association member. Around 32% of the respondents indicated that they had no (“0”) association members (without considering respondents which did not answer this question by leaving a blank) – in other words, they represented a single group of independent retailers. Some 76% of respondents gave a meaningful answer to this question.

Table B4: Number of groups of independent retailers represented

	Direct UGAL members	ZGV, FCA and SOCR respondents
Average number of groups represented	14 (range from 0 to 65) STDEV: 18 Sample: 14	135 (range from 0 to 1,650) STDEV: 438 Sample: 14
Average number of independent retailers represented by each group	10,005 (range from 531 to 40,000) STDEV: 13,554 Sample: 10	2,330 (range from 28 to 7,000) STDEV: 2,330 Sample: 8

2.2.2. Number of independent retailer members represented through association members

Respondents were also asked if they have independent retailer members who were direct members of their organisation in addition to those independent retailers who are members through the association

members. Some 46% of respondents gave a meaningful answer to this question. The majority (70%) indicated that they do not have independent retailer members who are direct members of the respondent’s organisation, implying that are predominantly as apex organisations representing different groups rather than individual retailers. Around 30% of respondents indicated that they have members that are both direct members of their organisation as well as indirectly through their association members.

2.2.3 Organisation of association members

Respondents were asked if their association members are organised on a geographic or on a retail-type basis. 46% of respondents gave a meaningful answer to this question. The responses given indicate that the majority of the association members are organised on a geographic (mainly country) basis (76%).

2.2.4 Changes in the number of association members

We were also interested in whether the number of association members increased or decreased over the last ten years. As answers were given in several forms including absolute numbers, percentage changes or descriptive answers, we divided these answers three categories, namely whether the number of members increased, decreased or remained constant for descriptive purposes. The majority of respondents (around 53%) reported an increase in members, 20% a decrease and 27% answered that their membership had stayed constant.

2.3 Background information about independent retailer members

In Section 3 of the questionnaire, respondents were asked to give background information on their independent retailer members (members which are both direct members and indirectly via association members).

2.3.1 Number of independent retailer members

First, we were interested in the total number of independent retailer members represented through the respondents’ organisation. Around 94% of the respondents provided us with meaningful information for this question.

Table B5: Number of independent retailer members represented

	Average	Total	Range	Standard Deviation	Number
All respondents	3,863	135,201	28 to 40,000	8,111	35
Direct UGAL members	6,787	108,585	30 to 40,000	11,649	15
ZGV, FCA and SOCR respondents	1,267	26,616	28 to 6,000	1,408	20

Source: Answer 3.1.1.1, based on adjusted numbers as explained below.

Given that not all respondents answered this question, it is notable that the survey results are based on respondents who between them represent over 130,000 independent retailer members. Hence the answers provided by the respondents should capture the main aspects of the economic context in which independent retailers operate.

81% of the respondents stated that the number of independent retailer members represents all retailer members. Respondents that answered that they represent other forms of retail members, mentioned forms of retail members such as integrated companies, wholesalers, multiples and cooperatives. However, it is not straightforward that the mentioned forms fall under the definition of independent retailers and no indications were given to the number of extra retailer members involved. One respondent indicated that the total number of members should be 1,300 instead of 136, in which case the total number of retailers was adjusted. Other adjustments to the total number of independent retailer members included taking the number of independent retailer members represented through the association members as an indication for the total number of independent retailer members if this number was zero (this regards one respondent) and deleting from the sample respondents which did not indicate the number of independent retailer members (two respondents).

To examine whether the definition of independent retailers is consistent across respondents, respondents were asked to indicate how their organisation defines “independent” retailers. The definitions listed by the respondents usually included expressions relating to independence of business decision making or that the majority of the share capital of the company should be owned by a natural person.⁹⁹ Some respondents further mentioned the number of outlets (e.g. the maximum number of outlets should be 10) as a factor for distinguishing independent retailers.

2.3.2 Changes in the number of independent retailer members

Respondents were asked to indicate changes in the number of independent retail members in the past ten years. 67% of respondents gave a meaningful answer to this question. Due to the diversity of the answers given, the answers were divided into categories (increase, decrease, or constant). The proportion of respondents indicating an increase was equal to the proportion indicating that the number of independent retail members had decreased (42%). On average, it appears that the number of independent retailer members stayed constant compared to the number of association members, which increased over the past ten years.

2.3.3 Number of outlets of independent retailer members

Respondents were asked to indicate the number of independent retail members which have single outlets compared to multiple outlets. Answers were given in absolute numbers, percentages and descriptions such as “the majority”. In order to draw conclusions from the answers, all answers were transformed into the percentage of independent retail members with a single outlet. If the respondents stated “the majority”, we assumed that 75% of the respondents’ retail members had single outlets. For around 66% of respondents the proportion of independent retail members which had single outlets compared to multiple outlets was greater than 50%. This implies that most of the respondents represent independent retailers with single outlets.

2.3.4 Total annual retail turnover of independent retailers

The questionnaire also asked respondents to indicate the total annual retail turnover of all their independent retailer members, if possible for the last ten years. Very few respondents provided data going back before 2003. However, for those that did provide data, total turnover increased steadily over the ten-year period (at least in nominal terms).

Table B6 shows the descriptive summary statistics for the current total annual retail turnover in € of all the respondents’ independent retailer members – first for all respondents, then for direct UGAL members and then for ZGV, FCA and SOCR members.

Table B6: Total annual retail turnover for independent retailer members (€ billion)

	Average	Total	Range	Standard Deviation	Number
All respondents	8.86	248	0.05 to 99	19.34	28
Direct UGAL members	17.6	229	0.13 to 99	26.2	13
Other respondents	1.3	19	0.05 to 3.5	1.1	15

Source: Answer 3.1.1. Note that the respondents which were excluded from the analysis of the total number of retail members were also excluded in the analysis of the total annual retail turnover.

The table shows that the ranges indicated by the respondents are relatively wide, for example from €0.05 billion to €99 billion, considering both direct UGAL members and the other respondents. The average total retail turnover of all independent retail members is €8.8 billion. However, the average is greatly skewed by one respondent. The average total retail turnover of all independent retail members excluding the outlier value is €5.5 billion. The majority of the respondents indicated that the smallest annual turnover of their retail members is around €100,000.

⁹⁹ One respondent pointed out that when starting up the store, the retailer association/group may own the majority share capital of the company during the start-up of the business but that the independent retailer is the person that is in control of the company despite holding the minority share of the capital.

2.3.5 Differences in total annual retail turnover between retailers with single outlets compared to multiple outlets

Respondents were asked to indicate the total annual retail turnover of all their independent retailer members with only single outlets as opposed to multiple outlets. This question was answered by 39% of respondents, with answers given in absolute numbers, percentages or in qualitative form. To compare the answers, we calculated the percentage of total annual retail turnover of all independent retailer members belonging to the respondents' organisation attributable to independent retailers with single outlets. The average percentage of turnover attributable to retailers with a single outlet was 42% (range from 0% to 100% of turnover). For around 57% of respondents, less than 50% of the total annual turnover of their independent retailer members is attributable to retailer members with only single outlets. This implies that even though the associations/groups questioned represent on average more retailers with single outlets, retailers with single outlets account on average for a lower proportion of the total turnover of retailers.

2.3.6 Total annual turnover of all independent retailer members relating to wholesale purchases

We were interested in the retailers' turnover which is due to wholesale purchases which flow through the organisation, i.e. which are centrally regulated by the organisation. Respondents were asked to indicate the total annual turnover of all independent retailer members relating to wholesale purchases. Two respondents provided us with data going back to 1995. For these two respondents, total turnover relating to wholesale purchases increased steadily over the ten-year period. However, the majority of respondents indicated answers for 2004, and these in various forms such as absolute numbers, percentages or in qualitative form. Absolute numbers were changed to percentages by dividing the annual turnover relating to wholesale purchases by the total retail turnover indicated in previous questions. Table B7 shows the responses based on 2004 data.

Table B7: Total annual turnover of all independent retailer members relating to wholesale purchases as a percentage of total turnover (%)

	Average	Range	Standard Deviation	Number
All respondents	45%	5% to 80%	0.23	19
UGAL members	53%	20% to 80%	0.12	8
Other respondents	39%	5% to 80%	0.25	11

Source: Answer 3.1.1. Note that the respondents which were excluded from the analysis of the total number of retail members were also excluded in the analysis of the total annual retail turnover.

2.3.7 Total retail surface area

Respondents were asked to indicate the total retail surface in square metres of all their independent retailer members. The responses are shown in Table B8. The table shows the average retail surface of all independent retailer members is 2.4 million square metres.

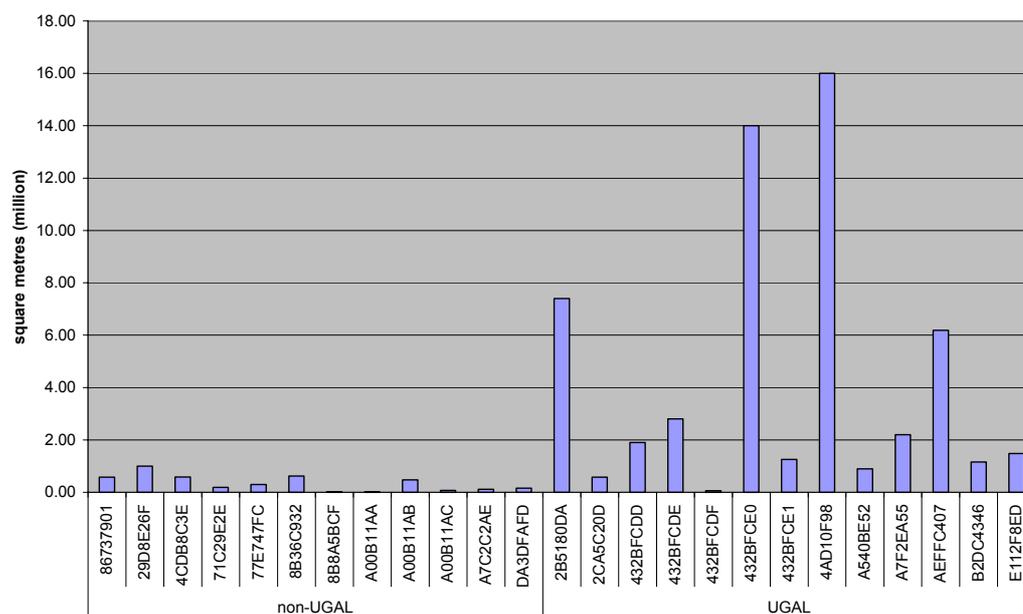
Figure B1 shows that the retail surface of respondents belonging to UGAL is significantly larger than the retail surface of "non-UGAL" members (i.e. respondent groups represented by ZGV, FCA and SOCR). (Note the assigned code numbers on the bottom axis are simply for our benefit in identifying the group/association).

Table B8: Total retail surface area covered by independent retailer members (sq m million)

	Average	Total	Range	Standard Deviation	Number
All respondents	2.4	60.08	0.02 to 16	4.21	25
Direct UGAL members	4.3	55.93	0.06 to 16	0.31	12
Other respondents	0.35	4.15	0.02 to 1	5.22	13

Source: Answer 3.11

Figure B1: Total retail surface area covered by independent retailer members? (sq m million)



Source: Answer 3.11

Respondents were asked to indicate in which sectors their independent retailer members were involved. The responses indicate that the organisations questioned represent members in a wide range of sectors. Groceries were among the most commonly mentioned answers. Other sectors mentioned at least once include non-consumables such as shoes, clothing, toys and electronics.

3. Background information about competitors and market context

3.1. Identification of competitors and market share information

3.1.1 Main competitors mentioned by independent retailer members

Supermarkets, hypermarkets and discounters controlled by integrated chain-store operators were among the most commonly mentioned competitors of independent retailers active in the grocery sector. Among the main reasons cited for viewing these particular organisations (and their particular store formats) as key competitors was their ability to lower prices and their size generating substantial economies of scale. Other reasons mentioned included that these competitors have a similar product offer (essentially selling the same or at least very similar food and daily goods items). Organisations active in other sectors such as the sports sector also mentioned vertically integrated chains as their key competitors, because of their aggressive pricing policy, large shop formats with a broad range of products, and because of their consistency in their operations and overall image with consumers. Multinational chain-store group were also seen as a growing competitive threat with their ability to source across different countries and use replicated logistics and store formats to operate very efficiently.

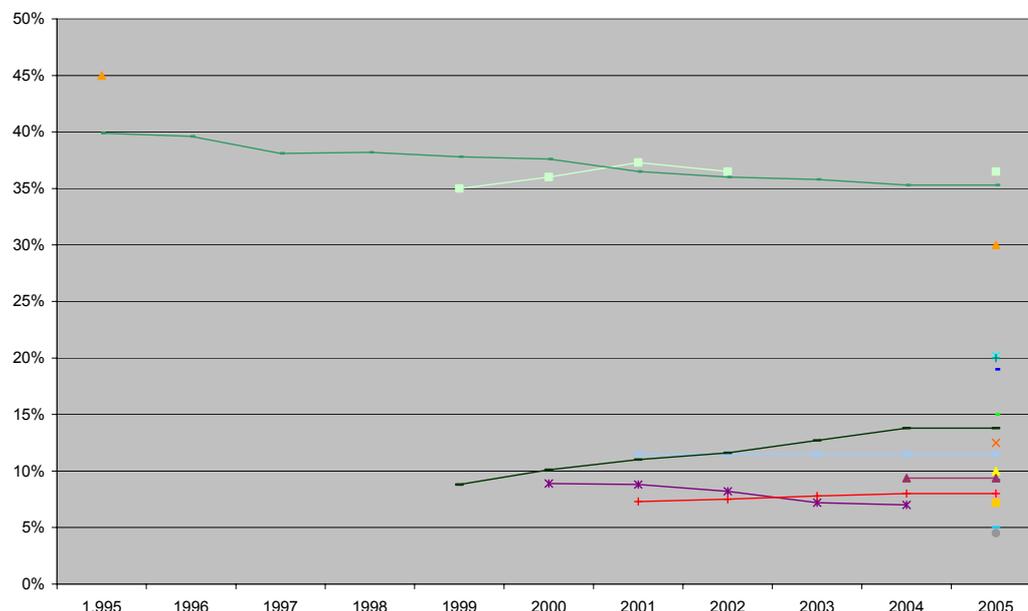
3.1.2 Market shares of independent retail members

Respondents were asked to provide annual market share data over the past ten years based on retail sales for all independent retailer members. One respondent provided data for the past ten years. Five other respondents provided market share data going back a couple of years.

Figure B2 shows the development of market shares for each respondent that provided us with this data. This figure excludes three respondents that indicated the current market share for separate product markets.

It is notable from Figure B2 that those respondents representing very large shares of retailers have typically seen their market share fall, with one falling from 45% to 30% over the ten-year period and another from 40% to 35% over a similar period. Organisations representing smaller shares of retailers have seen more mixed fortunes.

Figure B2: Market share of independent retailer members (in relevant national markets) over recent years



Source: Answer 4.2.1

Although many respondents did not provide information on the development of past market shares, around 51% of respondents indicated the current market share of all their independent retailer members.¹⁰⁰ Table B9 gives the summary statistics of the responses.

Table B9: Current market share of all independent retailer members (in relevant national markets) (%)

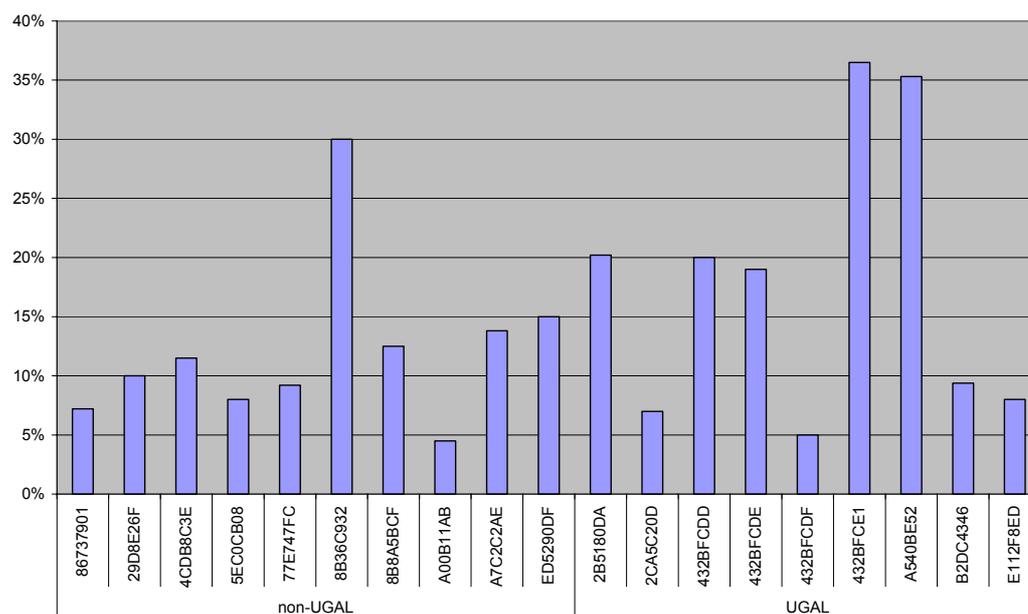
	Average	Range	Standard Deviation	Number
All respondents	14.8%	4.5% to 36.5%	0.1	19
UGAL members	17.8%	5% to 36.5 %	0.12	9
ZGV, FCA and SOCR respondents	12.2%	4.5% to 30%	0.07	10

Source: Answer 4.2.1

Figure B3 shows the current market share of the independent retailer members indicated by the respondents.

¹⁰⁰ If no current market share was indicated, the market share indicated for 2004 or 2003 was taken. Note that if an answer stated “slightly above”, “slightly below” followed by a certain percentage, the indicated percentage was used.

Figure B3: Current market share of all independent retailer members (%)



Source: Answer 4.2.1

Figure B3 shows that the market share of the independent retailer members is below 15% for the majority of organisation (without taking into account respondents which indicated market share for several products markets). As shown by the figure, in only three cases were market shares significantly in excess of 20%.

Respondents were further asked to indicate the combined market share of their five largest retailer members by ownership and by retail brand/franchise name. The average market share of the five largest retailer members by ownership was 4%. Additionally, around four respondents indicated that this market share was “unsubstantial” (these are not considered in the average of 4%), due to the small size of all individual members. In only one case (representing the maximum of the indicated range, 15%) does the market share of the largest five independent retailers reach double figures.

Table B10: Combined market share of the five largest retailer members by ownership

	Average	Range	Standard Deviation	Number
All respondents	4%	1% to 15%	0.04	10
Direct UGAL members	6%	2% to 15 %	0.02	4
Other respondents	3%	1% to 7%	0.01	6

Source: Answer 4.2.3

For the market share of the five largest retail members by retail brand/franchise name, the market shares provided by the respondents were of similar magnitude (with the average market share around 2%) as those provided for the five largest retail members by ownership. Respectively, 29% and 23% of respondents gave a meaningful answer to these two questions.

3.1.3 Market share of five largest retail competitors and of fully integrated retailers

Our survey further asked for the combined market share of the five largest retail competitors which are not members of the respondents (including fully integrated retailers). If the respondents indicated the market shares of the individual retail competitors, these market shares were summed to derive the combined market share of the retail competitors. As shown in Table B11, the average market share indicated was 38%.

A comparison of the average market shares in Table B11 to those in Tables B9 and B10 shows that the average market share of competitors is much larger.

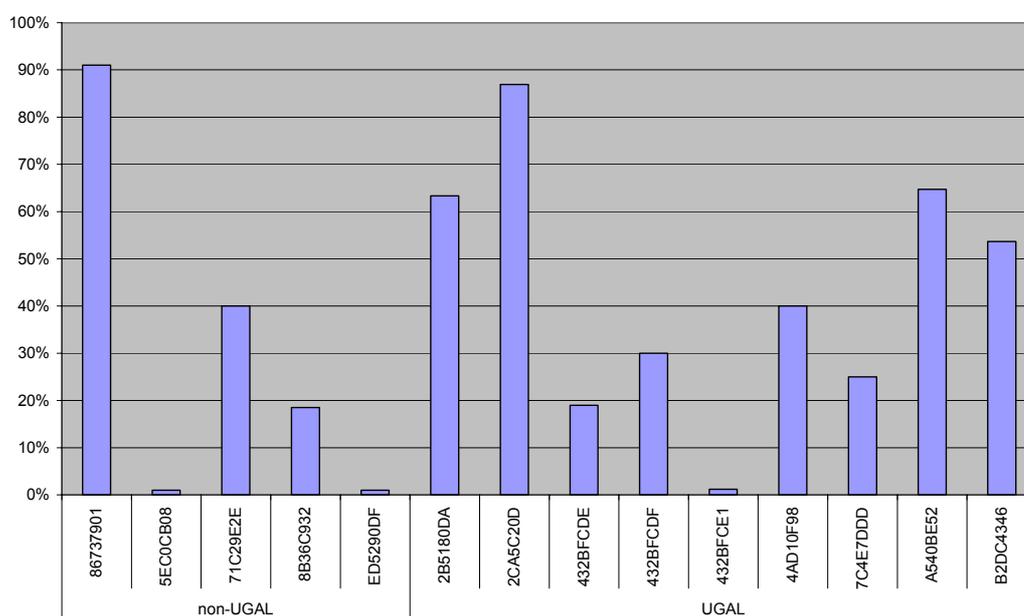
Table B11: Combined market share of the five largest retailer competitors

	Average	Range	Standard Deviation	Number
All respondents	38%	1% to 91%	0.30	14
Direct UGAL members	43%	1% to 87 %	0.27	9
Other respondents	30%	1% to 91%	0.38	5

Source: Answer 4.2.4

The answers indicated a range from as low as 1% to in excess of 90%. These are shown for individual responses in Figure B4.

Figure B4: Combined market share of largest 5 retail competitors



Source: Answer 4.2.4

Respondents were also asked to indicate the combined market share of all fully integrated retailers acting as their competitors. The average market share of all fully integrated retailers indicated is 48% (around 44% for direct UGAL members and 59% for the other respondents).

3.1.4 Trends in market shares

We were further interested in reasons for any trends in the market share shown in the data. Some respondents interpreted this question as referring to vertically integrated retailers. These respondents noted that vertically integrated chains (including discounters) have been able to secure market shares rapidly because of their profitability and their investments in business operations (including product sourcing, merchandising, logistical support, store operations, and marketing), as well as by mergers and acquisitions (serving to raise concentration levels significantly in some retail sectors). Other respondents interpreted this question as referring to trends in the market shares of their own organisation and independent retailer members. Changes in the collective market share of groups/associations were mainly due to changes in the number of members and the increase in competition from vertically integrated retailers (including discounters), leading to a fall in their own market shares.

3.1.5 Market shares of independent retailer members based on wholesale purchases

Respondents were also asked to indicate market shares over the past ten years for wholesale purchases. However, none of the respondents provided market share data for past years, although one respondent

indicated that this market share increased slightly from 10% to 12% between 1995 and 2004 (ID 7C4E7DD). Seven of the respondents provided market shares based on the whole relevant national purchasing market. The average current market share indicated by respondents, which answered was 23% of the sample, ranges from 5% to 90%.

Respondents were further asked to indicate the combined annual market share for wholesale purchases for their five largest independent retailer members.¹⁰¹ Only three respondents gave meaningful indications of the combined annual market share for wholesale purchases of their largest five retailer members (60% for ID 4AD10F98, 3% for ID 7C4E7DDD and 2% for ID ED5290DF), implying an average of 22%.

3.1.6 Market shares of independent retailer members based on wholesale purchases who are not members

Our survey further asked organisations to provide market shares of the five largest other groups of other (rival) independent retailers. Five respondents gave a meaningful answer to this question, namely 19% (ID 432BFCDE) 75% (ID 4AD10F98), 70% (ID 5EC0CB08), 25% (ID 7C4E7DDD) and 5% (ID ED5290DF), implying an average of 39%. This average is higher than the average market share indicated for the wholesale purchases of the independent retailer members.

Respondents were further asked to indicate the combined annual market shares for wholesale purchases from all fully integrated retailers. However, only four respondents gave meaningful answers to this question, with an average market share of 47%.

Organisations were also asked to indicate the reasons for any significant changes in market shares as well trends in market shares for wholesale purchases. Two organisations gave a reason for the trends in market shares, mentioning shareholders' equity arrangements and pricing structures of the suppliers (tending to favour integrated retailers). In a similar vein, respondents were asked to indicate reasons for significant changes in market shares. Four respondents answered, listing changes in the range of goods, shareholders' equity and members joining and leaving as reasons for fluctuations in the market shares.

3.1.7 Nature of competition

In order to obtain an impression of the nature of competition in the retailing sectors, respondents were asked to describe how their retailer members compete with others in the retailing sector (e.g. the kind of competitors they face and the intensity of the price competition). Respondents gave detailed and lengthy answers, which showed that competition focuses on several characteristics such as service and location of shops besides price. However, price competition was an issue for most respondents, which stated that there had been an increase in the pricing pressure from integrated chains (particularly integrated discounters). Competition between other retailers often takes place in the service dimension. One respondent mentioned that its retailer members are successful due to promotions and flyers and specialised catalogues besides the usual services they offer. Regarding the type of competitors, most respondents answered that other types of retailers, differing by their capital structure and market focus (e.g. integrated supermarket chains), represent their main competitors. In addition to integrated retailers providing similar retail services with similar products, one respondent also listed franchise stores and department stores as competitors (taking a wide view of the market in respect of competitors coming from a variety of backgrounds and market positions).

Respondents were further asked to indicate any particular aspects in which their independent retailer members find it difficult to compete on. The most common aspect mentioned was that independent retailer members find it difficult to compete on prices because integrated chains have more financial means and market power to support lower prices. Two respondents mentioned a suspicion that these competitors sell below costs (in a deliberately predatory manner). Nevertheless, two organisations also responded that their members are well positioned to compete on prices, especially compared to non-members, because the organisation manages to negotiate competitive prices with producers.

We were also interested in the extent to which respondents' independent retailer members are less cost-efficient than other retailers. The majority of respondents replied that their independent retailer

¹⁰¹ The answers 4.3.1 and 4.3.2 were combined to derive the combined annual market share for wholesale purchases from the largest five independent retailer members.

members are less cost-efficient than integrated chains, with the most frequently mentioned reason being smaller economies of scale (e.g. in purchasing volume). Other reasons for lower cost efficiency include higher personnel costs due to the higher service level offered and the higher administrative burden on small- and medium-sized enterprises (“SMEs”). A small number of organisations (around 10%) replied that their independent retailer members are more cost efficient compared to other retailers. (For example, according to one respondent, its independent retailer members are more cost efficient than fully integrated retailers because they are able to cope more flexibly with market needs than integrated retailers that have a rigid retail offer across their stores to reflect their retail brand image and slower responses to changing local needs).

Finally, our survey asked respondents how consumers would be detrimentally affected if their independent retailer members were forced to exit the market. The most important detrimental effect mentioned was the reduction of product and service choice. Other impacts cited include higher prices due to less competition, lower level of retail service, and supply shortfall in regional areas. Two respondents replied that there would be no effect on competition.

4. Organisational and ownership structure

Respondents were asked to give an overview of the relationships that exist between their organisation, association members (if the association represents a number of groups of independent retailers) and individual retailer members. The answers varied widely. For example, some organisations have retailers as direct members and no association members. These organisations are often organised as cooperatives, with independent retailer members controlling the supervisory board of the organisation. Other organisations have only association members, which in turn have retailers as members. Some respondents noted that these association members are shareholders in the organisation. Some organisations stated that the relation between their independent retailer members is regulated via contracts. In other cases, internal statutes regulate the relation between independent retailer members and the organisation.

Organisations were also asked to explain the set of relationships that govern their organisation and its links to association members through to individual retailer members. Again, answers for this question were very diverse, ranging from detailed descriptions of the decision-making structures within the organisation to answers such as “corporate identity” or “buyer loyalty” (reflecting the need for coordinating a broadly homogeneous retail brand image across members or group cohesion in respect of maximising the effectiveness of collective purchasing in dealing with suppliers). One factor mentioned by several respondents was that the organisation sets the framework for the relation between the wholesalers and the individual retailers. Some organisations stated that they have a steering board that determines the strategy to be implemented towards the association members and individual retailers. In other cases, the relationship between independent retailers and the organisation is laid down in internal documents and statutes.

We were also interested in who owns the respondent’s organisation. According to the responses given, some organisations are owned by their members or by associates. Four respondents answered clearly that independent retailer members own their central organisation (i.e. the central office function) and another four respondents clearly stated that cooperatives own their central organisation.

To give a flavour of the very diverse nature of the surveyed associations and groups of independent retailers, Table B12 shows the nature of the relationships that exist between the respondents’ organisation and the members it represents (i.e. groups of retailers or individual retailer members). The table shows that members usually own the organisation. For example, independent retailers are often direct shareholders and members of the organisation. Nevertheless, as evident from the table, many different forms of organisations exist, such as stock corporations, trade associations with no commercial links between members, or vertical chain operating systems.

Table B12: Relationships between associations, groups and individual retailer members

Category	Number of respondents
Retailers are members of the organisation (usually cooperatives), retailers are also shareholders of the organisation	7
Retailers are limited partners	1
Cooperatives own the organisation	2
Retailers are members of the cooperatives, which are in turn members of the national organisation. These cooperatives own the national organisations.	5
Central office is a stock corporation, shares are owned by the retailers	1
Public limited corporation	1
Organisation operates as a fully fledged operating company for wholesale, support, distribution, logistics	1
Organisation is partly owned by retailers	2
Private limited liability company owned by associated companies	1
Wholesalers own company	1
Cooperative limited liability company	3
Trading companies own the organisation	1
Vertical chain operating system	1
Trade association with no commercial links between members (service centre)	1

Source: Answers 5.1 to 5.4.

Finally, participants were asked how their central office is managed. Table B13 summarises the responses, again demonstrating the diverse nature of associations and groups of independent retailers. The majority of respondents stated that their central organisation is managed by an executive board or management aided by an advisory council. Seven respondents reported that they have a permanent secretary, while others reported that decisions are taken in working groups. Some respondents mentioned that they have other permanent staff or management staff dealing with the day-to-day operation of the organisation. The fact that a relatively large number of respondents have permanent staff implies that the retailer associations often take on more roles than joint purchasing such as joint marketing activities or management of logistics.

Table B13: Key decision-making bodies and central office management

Key bodies and management structure	Number of respondents
Executive board	2
Executive board and advisory council and/or supervisory council	8
The central office is a stock cooperation and the management (CEO, CFO, COO) runs the company assisted by an advisory board consisting of independent retailers.	1
Service centre with permanent staff and working groups	1
Management boards aided by a supervisory board. Members take part in the decision-making process through annual shareholder meetings.	2
Permanent secretary	7
Buying groups managed by a director who follows the strategy decided by a board that consists of elected retailers. A permanent secretary and numerous specialists take care of the daily decisions.	1
Retailers are organised geographically in eight districts. Each district has a board. The members of the district board with the board members of the organisation exercise voting rights at the annual general meeting. The organisation has a management team consisting of a managing director, CFO and company lawyer managing day-to-day work, with the company functioning as a full-fledged operating company within the retail business.	1
Permanent staff	1
Operative central	1
Advisory board and management	1
Working groups with participants from wholesalers	1
Working groups	1

Administrative board, 1 managing director and 1 secretary.	1
Leading executive body is the conference of member consumer associations	1
Highest decision making power is exercised by the company's shareholders at the General Meetings. The Board of Directors handles all matters that are financially, commercially and fundamentally significant for the Groups' operations. The group also has a management board, the chairman is the CEO. In the chain management, the central unit makes the decisions regarding the chain management. Retailer representatives are members in the chain's planning teams. Retailers are responsible for operations in their own stores, for local marketing, purchasing local products.	1
Central office is run by the chairman and managing director, elected by the board of directors, which are in turn elected by the shareholders.	1
The national consortium is the purchasing centre. It is a cooperative company based on a consortium governed by a board. At the head of the central apex is the board and a CEO elected democratically by the cooperatives.	1
Shareholders' meeting elects the supervisory board, which in turn elects the management, which consists of various committees.	1
Board of directors	1
Total number of responses	32

Source: Answer 5.4

5. Contractual agreements

Our survey asked participants to provide information regarding their contractual agreements with association members and independent retailers.

5.1 Background on agreements

5.1.1 Types of agreements

Respondents were asked to indicate the contractual agreements used by their organisations in respect of *association members* (i.e. the groups of independent retailers or individual retailer members of which the association/group is composed). Around 64% of respondents provided an answer to this question. First, we analysed whether the described contractual agreements were binding (e.g. obligations tied to the membership in the organisation) or voluntary. Of the organisations which answered, around 55% of the respondents stated that they had binding contractual agreements with their association members. Around 14% of respondents stated that the contracts offered by their organisation functioned on a voluntary basis, 14% answered that their organisation had no contracts in place with their association members and 17% stated that the question was non-applicable.

Second, we examined the answers to find the most common contractual agreements. These appear to be agreements mostly related to marketing/promotions and exclusive purchasing. Other contracts that were mentioned once include certain legal forms of retail price maintenance, license agreements (e.g. retail brand agreements), benchmarking contracts, exclusive territorial requirements, and obligations to purchase a minimum amount.

Respondents were further asked for further details in respect of the range of contractual agreements used in respect of independent retailer members. The contractual agreements listed include obligation to purchase, minimum and maximum prices (the former during promotion periods only for strictly limited numbers of products) and brand license agreements.

Respondents were also asked to indicate the form of contractual agreements their organisation uses in respect of *independent retailer members*. To evaluate the different answers given, the answers were divided into voluntary or binding contracts. Around 50% of the contracts described by respondents were binding for retailer members. Around 35% of agreements were suggested or recommended, 8% of the respondents stated that no contracts are used by the central organisation, and 8% of the respondents failed to provide a clear answer. Among the mandatory agreements, the most frequently listed contracts related to promotions and advertising, followed by exclusive purchasing and minimum purchasing obligations. Three respondents listed a broad range of contracts used in respect of independent retailer members covering exclusive purchasing, exclusive territory requirements, obligation to purchase, and logistics arrangements.

Respondents were further asked if there had any price agreements in place. The responses show that price agreements are relatively common. The clear majority of respondents (representing 18 organisations) answered that price agreements were in place. However, more than half of these price agreements were described as being non-binding (e.g. suggested retail prices), concerned with exclusive labels only (e.g. private label or exclusively supplied branded goods) or only applied to selected retailers (for the purpose of common retail branding). Nine respondents indicated that no price agreements were in place.

Respondents were further asked whether it is a condition of membership of their organisation that all independent retailer members have to agree to all of the agreements. Some 82% of respondents gave a meaningful answer to this question. Three-quarters (75%) of the respondents replied “No” to this question.

5.1.2 Benefits of agreements

We were also interested in the efficiency benefits of agreements. In order to have concrete estimates of the benefits of agreements, organisations were asked quantify the benefits of agreements. However, very few respondents could give quantitative indications. To cover all levels of the organisation, we asked respondents to indicate benefits for the association/group, association/group members, retailer members and customers.

First, our questionnaire asked respondents to indicate the benefit of each agreement for the respondent’s *organisation*. However, only two respondents gave a quantification of the benefits of each agreement – 30% more turnover and benefits of over €70 million. Most respondents described benefits such as economies of scope and streamlining of marketing and advertising related to the agreements. These factors allow retailers to compete more effectively against the integrated chains. Other benefits mentioned were price agreements for promotion-goods, better communication regarding prices, better recognition of the trade name by consumers, and benefits in logistics. However, only two answers given appear to be related to the benefits to the association/group itself – expressed as the relative freedom given to retailers enhanced by a slim (non-bureaucratic) management structure of the organisation.

Second, respondents were also asked to indicate the efficiency benefits of the agreements for the *association members*. The majority of respondents did not give a meaningful answer to this question, either interpreting the question as referring to individual retailers or indicating that the question was not applicable to them. Two organisations described efficiency benefits such as the central services offered by the organisation (including insurance and banking services) and efficiency benefits in purchasing, brand promotion and the construction of shops.

Third, respondents were asked to indicate the efficiency benefits of the agreements to the *independent retailer* members. In general, the described benefits were similar the benefits described for the association/group itself. Better purchase prices and support in terms of know-how and other consulting services were the two most commonly mentioned benefits. One respondent quantified the benefits as around 10-20% reduction in prices in purchasing and around 10-15% benefits in margins. Another respondent reported benefits estimated to be between €14 million and €129 million. Promotion of a single retail brand identity was another commonly mentioned benefit.

Finally, our questionnaire asked respondents to indicate the efficiency benefits for the end customers. The majority of respondents answered that customers benefit from lower prices – between 10% and 30% according to one respondent or annual benefits amounting to between €17 million and €36 million indicated by another. Larger choice of products was also mentioned by a number of respondents.

Respondents were asked if any of the suppliers they would want to use have, or could have, exclusive purchasing agreements with other buyers. The majority (65%) responded “No”. A few organisations that responded “No” noted exceptions, for example some agreements involving distributors’ branded products. Respondents that answered “Yes” mainly noted exclusive purchasing agreements involving distributors’ own-brand products.

The questionnaire further asked if organisations used written or oral agreements with suppliers. According to the indications given by respondents, the overwhelming majority of agreements are concluded in written form (the average proportion of written agreements was 98%).

5.1.3 Timescale of agreements

Regarding the practical minimum length of agreements, the majority of respondents indicated that the practical minimum length of most agreements is around one year. However, it was reported that in a number of cases, the timescale of the agreement depended significantly on the type of contracts. For example, one respondent noted that for “vertical contracts”, which imply more obligations for the retailer than “horizontal” contracts, the practical minimum length of agreements was usually longer. This organisation further noted that one exception were chain agreements, which are usually valid for 10 years.

We were also interested in how long these agreements typically last. The answers given by the respondents indicate that the actual duration is usually longer than the practical minimum lengths. However, some organisations responded that the contracts last for one year. In general, a majority of respondents appeared to be satisfied with the duration of contract (around 79% stated that they were satisfied with current length of contracts). However, respondents also stated that reliability is an important asset for all parties. Among the respondents who would prefer longer agreements, two respondents would prefer a longer duration of contracts with suppliers and longer franchise agreements with retailers to ensure that a consistent and reliable retail image could be effectively developed.

Regarding the ease of exit of agreements for *association members* (i.e. for groups within associations) in general, respondents replied that exit is relatively easy if members comply with notice periods. These range from 3 to 12 months. Usually respondents stated that there are no contractual penalties if association members comply with notice periods. Some organisations debar cooperatives from their organisation in case of exit of an agreement. Regarding the ease of exit of agreements for *independent retailer members*, the answers were fairly similar to those given for association members. Exit was generally considered to be easy if notice periods are complied with. Exceptions include supply agreements or if retailers are bound to cooperatives via lease-contracts for their outlets, which could be cancelled in case of exit. Three respondents replied that because independent retailers will lose their bonus if they purchase from unlisted suppliers, they do not exit anyway and the question of ease of exit is never posed in a practical sense.

5.1.4 Necessity of agreements

In order to estimate the necessity of agreements, respondents were asked to give examples of agreements that have been necessary for trades to occur. Most of the respondents did not mention specific examples of trades that would not have occurred but for agreements. Instead, they mentioned general benefits due to agreements that may have facilitated trades (by making the terms more favourable). For example, obligations to purchase between retailer members and association members are important for ensuring that the lowest prices are received from suppliers. A few specific examples of trades or situations where agreements are necessary were mentioned. One example was the existence of pre-emption rights of the organisation, which prevented the take-over of retailers in favourable downtown locations by competitors. Franchise agreements were also deemed to be necessary for the existence of franchises. Some respondents mentioned that their organisation has no agreements which are necessary for trades to occur but rather that the aim of the agreements is to generally facilitate retailers’ business.

We were also interested in services that respondents would be unable to provide because of the organisations’ structure and remit. The services listed included:

- Real joint/central purchasing due to a lack of purchase obligations;
- Setting up of a central cooperative warehouse, instead deliveries through a number of legally autonomous associated member companies (as a consequence no uniform computerized link would exist between all the members);
- Provision of business information across regions;
- Comparison of purchase prices across regions and countries;
- Uniform market presence (to ensure full market coverage and provide a universal service to the benefit of consumers);
- Entering into binding agreements (that provided security and legal certainty for all parties); and
- Uniform price policy (to enhance retail image and consistency of retail offer for the benefit of consumers).

Services that respondents' associations/groups are unable to provide because of present regulation, restrictions or prohibitions include:

- Fixed prices for end-consumers (which may harm the consistency of the retail offer and make it more difficult for independent retailers to compete with integrated chains, to the detriment of consumers);
- Purchasing of branded goods in the most inexpensive national market (which prevents independent retailers being able to compete on the same terms as multinational integrated retail chains, and generally prevents them serving their local customers with products at the lowest possible price);
- Parallel trading (which, again, prevents independent retailers being able to compete on the same terms as multinational integrated retail chains, and generally prevents them serving their local customers with products at the lowest possible price); and
- The use of purchase obligations (which prevents the group from being able to negotiate the best possible terms with suppliers for the benefit of retail members, in the process serving to place independent retailers at a competitive disadvantage and make retail prices higher than they would otherwise be).

Respondents further mentioned some services which they are unable to provide such as factoring, 100% purchasing, common advertising, internet sales, central buying on European level, Delcredere or ensuring that a range of products not in a catalogue will be available. One respondent mentioned that as a consequence of a new law (in its own country), it is more difficult for a group of independent retailers to reach the discount levels of associations integrated under a single legal entity. Another respondent further mentioned that its members cannot respond to invitations for tender, e.g. for public purchases, because members cannot make a unique offer with binding prices for all independent retailers.

Respondents were asked if there are agreements that they are unable to conclude with producers because they have insufficient control over their members. Most respondents did not give examples of specific agreements that did not occur. One problem mentioned were negotiations of supply contracts on a national level due to diverse product ranges. Another problem mentioned was that organisations could not oblige retailers to take part in certain promotions. One specific example of an agreement with products that an organisation was unable to conclude was if suppliers need an estimation of the trade/volume level before concluding agreements. Organisations cannot provide this estimation (at least with sufficiently guaranteed accuracy) and hence some potential trade agreements do not take place.

5.1.5 Benefits from agreements

We were further interested in the costs that were incurred by the respondents' independent retailer members if they should instead not be members of the organisation. Although the majority of respondents stated that these costs were significant, only few respondents could provide quantitative information. Those that did provide a quantitative answer indicated extra costs due to higher purchase prices of 1% of gross turnover or up to 5% – 25% of costs. One respondent noted that extra costs vary according to the size of the retailer, with the largest extra costs for the smallest members (around 15% – 20% extra costs). Medium-sized members would experience extra costs in the range of 10% – 20% and large members in the range of 5% – 10%. In general, the extra costs were considered to relate primarily to reasons such as higher purchase prices, fixed costs of negotiation and lower economies of scale.

The following additional reasons for higher additional costs facing unaffiliated retailers were mentioned:

- Higher purchase prices;
- Increased costs from advertising and marketing (one respondent indicated that the extra marketing costs would be as high as 70%);
- Having to buy more from regional suppliers (by not have the bargaining clout or scale to deal with national or international suppliers);
- Having to resort to selling brands which are less well known to consumers,
- Facing the disadvantage of not operating as an established retail brand (widely recognised by consumers)
- Having to operate with a smaller choice of products, including choice of imported products; and

- Availability of detailed business information.

Respondents were also asked to indicate how customers would be detrimentally affected if their organisation were forced to exit the group/association organisation. The most common answers given by respondents were smaller choice of products and higher prices for customers due to the exit of retailers. Respondents considered this to be a problem, especially in rural areas. With regard to alternatives ways to achieve the same benefits, the majority stated that alternatives do not exist. However, of the alternatives that were mentioned, independent retailer might have the possibility of joining another buying group or operate their own package of agreements with other independent retailers (i.e. as a “mini group”).

We were also interested in why independent retailer members wish to remain as independents. The most frequently listed reasons were independence, freedom and entrepreneurship. The responses indicate that independence is often seen as a value in itself. Reasons relating to tradition and cultural and community drivers were further mentioned.

However, respondents also noted that fully integrated firms have several advantages that their members do not have. The advantages of fully integrated retailers include:

- Internal financial balancing through appropriate capital substitution;
- Better communication (e.g. benchmarking figures which allow integrated firms to learn about best practices) and shop design (with a consistent approach, but if necessary adapted to best suit local conditions);
- Full control over retail prices with the possibility to set the same prices for branded products across all stores, or varying them according to their perceived local needs; and
- More leverage when purchasing products by being able to better guarantee certain levels of sales and provide guaranteed levels of in-store promotion.

In one country, a respondent indicated that compared to vertically integrated firms, which are taxed once, its group effectively had to pay a certain social tax twice, once at the level of the cooperative and once at the retail level. Only a very small minority of respondents indicated that integrated chains have no advantage compared to independent retailers.

6 Policy issues

6.1 National policy issues

Respondents were asked to indicate in what ways national or federal competition policy impacts their organisation and practice. Of those respondents that gave a meaningful answer slightly more than half of the respondents stated that either competition policy did not impact their organisation or referred to public policy in general (i.e. beyond the specific realm of competition policy). The remaining respondents stated that competition policy influenced their organisation because they engage in horizontal or vertical relationships that are assessed under competition policy.

Respondents were asked if there had been national decisions relevant to the retailing sector served by their members in respect of market decision, permitted/prohibited practices and/or mergers. Around the same number of respondents indicated that there had been national decisions as the number of respondents that indicated that this was not the case. Relevant national decisions related to retail price maintenance, customer loyalty systems, merger investigations and block exemption for retailers.

We were also interested in how current national competition policy affects the respondents' organisation. The majority of respondents indicated that national competition policy affects their organisation, citing previous answers. For example, one organisation mentioned that it is currently under review and that a narrow market definition would present a direct threat to the organisation. Another organisation noted that due to national policy, promotions involving fixed prices are not allowed, only promotion with a maximum price. A small number of respondents (specifically, four) stated that current national competition policy did not significantly affect their organisation.

Our questionnaire asked respondents whether there were any specific restrictions set out by their national competition authorities regarding co-operative agreements, buying organisations, association of independent companies such as market share limits or legislative restrictions. The proportion of

respondents that replied “yes” and those that stated “no” was roughly the same. Restrictions mentioned by respondents include minimum purchase obligations, cartel relevant policies, pricing of promotion goods, and legal restrictions relating to different horizontal and vertical structures.

Our questionnaire further asked respondents what elements of national policy impede their organisations with regard to co-operative agreements, buying organisations, or associations of independent companies. The following factors relating to policy in general were mentioned;

- Property law because it takes more time to open up a larger store than a small store, which might affect independent retailer groups developing large format stores (like hypermarkets) to compete against mid-size stores used by fully integrated discounters;
- The risk of being termed as a “mixed structure” (as a group using a mix of horizontal and vertical agreements), in which case it would be difficult for the organisation to use pricing mechanisms and benchmarking co-operations (as horizontal considerations would be pre-empt vertical considerations under existing competition law); and
- Environmental regulations.

Respondents were also asked if there had been any recent investigations or reviews by national competition authorities into sectors of relevance to the organisation. Around half of the respondents stated that there had been a recent investigation by national competition authorities into sectors of relevance, whereas the other half of respondents stated that this had not been the case. Merger investigations were among the most common investigations, with other investigations relating to exemptions from prohibitions of horizontal cooperation, retail price maintenance or availability of products for promotions.

Our questionnaire further asked respondents what, if any, horizontal and vertical relationships in their organisation had been reviewed, investigated or commented on by national competition authorities. Around two-thirds (67%) of the respondents replied that this had not been the case, while the other third replied that reviews and investigations had covered horizontal relationships related to joint purchasing and joint marketing, and vertical relationships related to supply agreements, terms and conditions of trade, and the extent of vertical control over retail members.

We were also interested if respondents knew of any policy benefits which were available in other Member States to equivalent organisations which their own organisations and members were unable to enjoy because of present national policy. Eleven respondents stated that they did not know of such benefits compared to four respondents that indicated that they knew of such benefits. Benefits that were available in other Members States included those relating to common pricing, environmental regulations, restrictions on selling goods below costs, group exemptions, and more regulation of large volume distributors.

Finally, respondents were asked if they knew of any imminent policy changes, industry reviews or company/merger investigations. Some thirteen respondents replied that they do not know of any changes, compared to five organisations that did. The regulation and investigations mentioned included merger investigations, investigation of a mixed structure (association of cooperatives involving horizontal and vertical elements), investigations into grocery prices and planned EU directives.

6.2 European policy

Our questionnaire asked respondents to indicate ways in which EU competition policy impacts their organisation and practice. If the organisation interpreted the question as inferring to EU public policy in general, the answer is not considered. Around eight respondents indicated the way in which EU competition policy impacts their organisation. The most commonly felt impact was due to EC regulation 2790/1999. Other effects mentioned were Article 81 §1 and §3, the examination of the organisation itself by DG COMP and the fact that the association/groups’ policies affected trade between Member States and that they would be subject to EU competition policy.

We also asked respondents what they would like have changed and why. The answers given by respondents varied widely, ranging from detailed suggestions on how to improve the market share calculation in the block exemption regulation to suggestions of a more general nature such as more objectivity in decision making. The majority of suggestions for improvements relate to the assessment of pricing arrangements (e.g. allowing price fixing for promotional goods or suggesting more clarity in

whether maximum pricing is allowed if the company falls outside of the block exemption). Respondents also criticised the market share limits in the block exemption on the grounds of their arbitrary nature and not taking into account crucial economic factors (like the population size and population density of Member States). A more general point made was that benefits available to franchises of multinational companies and of internationally operating integrated retailers should be extended to groups of independent retailers (to allow them to make cost savings in purchasing and the general operations of their retail businesses).

Respondents were asked whether there were dissenting views among their independent retailer members on the most urgently required policy changes. The majority of respondents stated that there was general unanimity in views across members. However, one issue mentioned where a divergence of views might arise was in relation to the opening hours of shops (where a group of independent retailers might have some members wishing to see restricted hours in place and other members wishing to see a relaxation of national rules allowing for longer hours).

Finally, respondents were asked what aspects of their organisation they consider may face possible challenges by competition authorities in the future, the consequences if the association/group were no longer able to use these arrangements and how this would affect the group organisation (i.e. the central office function), independent retailer members and end-customers. The areas of potential future problems or challenges mentioned included the collective size (i.e. turnover) of their independent retailer members (given existing competition policy rules and its focus of specific market share thresholds), restrictions on international trading agreements for groups, lowering of 80% of purchase commitments rule for groups with high collective market share, competition rules which are too strict or too unclear, and the possible discontinuation of the use of a pricing index in one country.

6.3 Summary of Policy Issues and Proposals

To draw together the national and EU-level policy issues and policy proposals indicated respondents, we conclude by showing these in respect of the rank order of the main categories highlighted.

Table B14 shows the common issues flagged up by respondents in regard to the impact of national and European policy on their organisations and group/retailer members. In particular, respondents indicated that the most significant impacts on the operation of groups of independent retailers arise from (1) the restrictions/prohibitions on agreements for common retail pricing, (2) the market share and turnover limits applicable to vertical and horizontal agreements, (3) the unequal policy/legal treatment of groups of independent retailers compared to integrated retail chains and other organisational forms, (4) restrictions on the use of purchasing obligations, and (5) the treatment of mixed arrangement structures involving both horizontal and vertical agreements (where assessment is typically made by examining effects in isolation rather than being considered collectively).

Table B14: Key means by which current national and European competition policy impacts detrimentally on the organisation and practice of groups of independent retailers

Policy Aspect	Rank Order (based on number of respondents citing the aspect)
Restrictions on agreements to allow for common retail pricing	#1
Market share and turnover limits (applicable to vertical and horizontal agreements)	#2
Unequal treatment of independent retailer groups compared to other organisational forms (notably integrated retailers and franchises)	#3
Restrictions on the use of purchasing obligations (and product selection)	#4=
Treatment of mixed structures (with separate rather than joint assessment of vertical and horizontal agreements)	#4=
Creating legal uncertainty (as to what practices are allowed/barred)	#6=
Failing to prevent “dumping” by internationally-operating integrated retailers	#6=

Market definition procedures (lacking clarity and failing to account for true nature of retail competition)	#8=
Restrictions on international agreements for groups in different Member States	#8=
Restrictions on customer loyalty systems	#8=
Restrictions on pre-emption clauses	#8=

Source: Answers 7.1- 7.9.

In respect of the key aspects of national and/or EU policy that groups/associations would like to see changed, respondents offered a wide range of specific suggestions. Table B15 groups these suggestions together under different broad headings and shows them in rank order according to amount of times they were cited by different respondents. Notable amongst the suggestions were (1) changes to the conditions for exempting vertical or horizontal agreements (e.g. suggestions that the turnover or market share limits should be raised), (2) making the assessment of common and fixed pricing less strict (especially with regard to fixed prices for promotions), (3) amending and clarifying market definition guidelines (e.g. contracts should be examined on an international basis for internally sourced products, clearer guidelines for the definition of the relevant market, product markets should be defined more widely), (4) a more permissive use of purchasing obligations (in regard to duration of agreements, product range coverage, and minimum required purchases as a percentage of total retail member purchases), and (5) greater freedom for independent retailer groups to use maximum prices (to cover the whole chain selection and with no market share limits). Many respondents stressed that these changes were necessary to allow groups and independent retailers members to reap efficiency benefits so that they can compete more effectively against fully integrated retailers.

Table B15: Suggestions on policy changes

Areas for policy change and review	Rank Order (based on number of respondents making the proposal)
Conditions linked to vertical or horizontal agreements should be changed (e.g. relaxing market share and turnover limits)	#1
More allowance for controlling retail prices (inc. common pricing, fixed pricing for promotions)	#2=
Market definition issues (on appropriate product/geographic scope of procurement and retail markets)	#2=
More permissive evaluation of purchasing obligations	#4=
Greater freedom for the use of maximum retail prices (applying to the whole chain selection and no market share limits)	#4=
Less discrimination of groups of independent retailers and cooperative societies compared to integrated retail chains	#6
Joint rather than separate evaluation of horizontal and vertical agreements used by mixed structures	#7
More permissive evaluation of international procurement agreements	#8=
Stricter evaluation of dumping (by internationally operating integrated retailers)	#8=

Source: Answers 7.1- 7.9

Finally, respondents were asked to provide very specific proposals on changes to existing competition policy that otherwise significantly impacted their organisation and members. The chief suggestions are summarised and ranked in Table B16.

Table B16: Specific proposals for changes to current policy

Specific policy proposal	Rank Order (based on number of respondents making the proposal)
Same legal and policy treatment of groups of independent retailers as franchise organisations and integrated retail chains	#1
Allowing fixed pricing for marketing campaigns and private label products.	#2=
Taking a broad market definition for procurement and retail markets (in respect of both geographic and product/retail service dimensions)	#2=
Vertical pricing arrangements should fall outside EC Article 81(1)	#2=
Purchasing obligations should be allowed until the result is reached where the economic foreclosure effect on the market is no different than for a company that has 30% market share	#2=

Source: Answer 7.12.