

## **ANALYSIS OF COMPETITION IN THE SPANISH RETAIL MARKET**

Report Presentation

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# Aims of the Report

- A. Evaluate **market power** in the food retail and wholesale supply markets
- B. Analyse the existence of **empiric evidence of the application of discriminatory margins** by retail companies in favour of white labels (WL) and to the detriment of manufacturer brands (MB)
- C. Evaluate the **effect on end prices and innovation** caused by the increased concentration in the retail sector and the growing prominence of white labels
- D. Identify **proposals to promote effective competition** in the Spanish distribution market

# Principal Conclusions (i)

## A. MARKET POWER AND PENETRATION OF WHITE LABELS

### *Retailer market power has increased in the last decade*

- ◆ Signs of **High Market Power (or Dominant Position)** in the retail market
  - Mercadona: **Valencia** (39.8% market share) and **Andalucía** (36.3%)
  - Eroski: **Basque Country** (42.7%)
- ◆ Possible existence of **significantly stronger dominant positions at the local level in Valencia, Andalucía and Basque Country (dominant positions at the local level in other regions cannot be ruled out)**
- ◆ The **increase in the economic dependence of manufacturers relative to retailers** does not allow us to rule out the existence of distortion of effective competition in the wholesale supply market

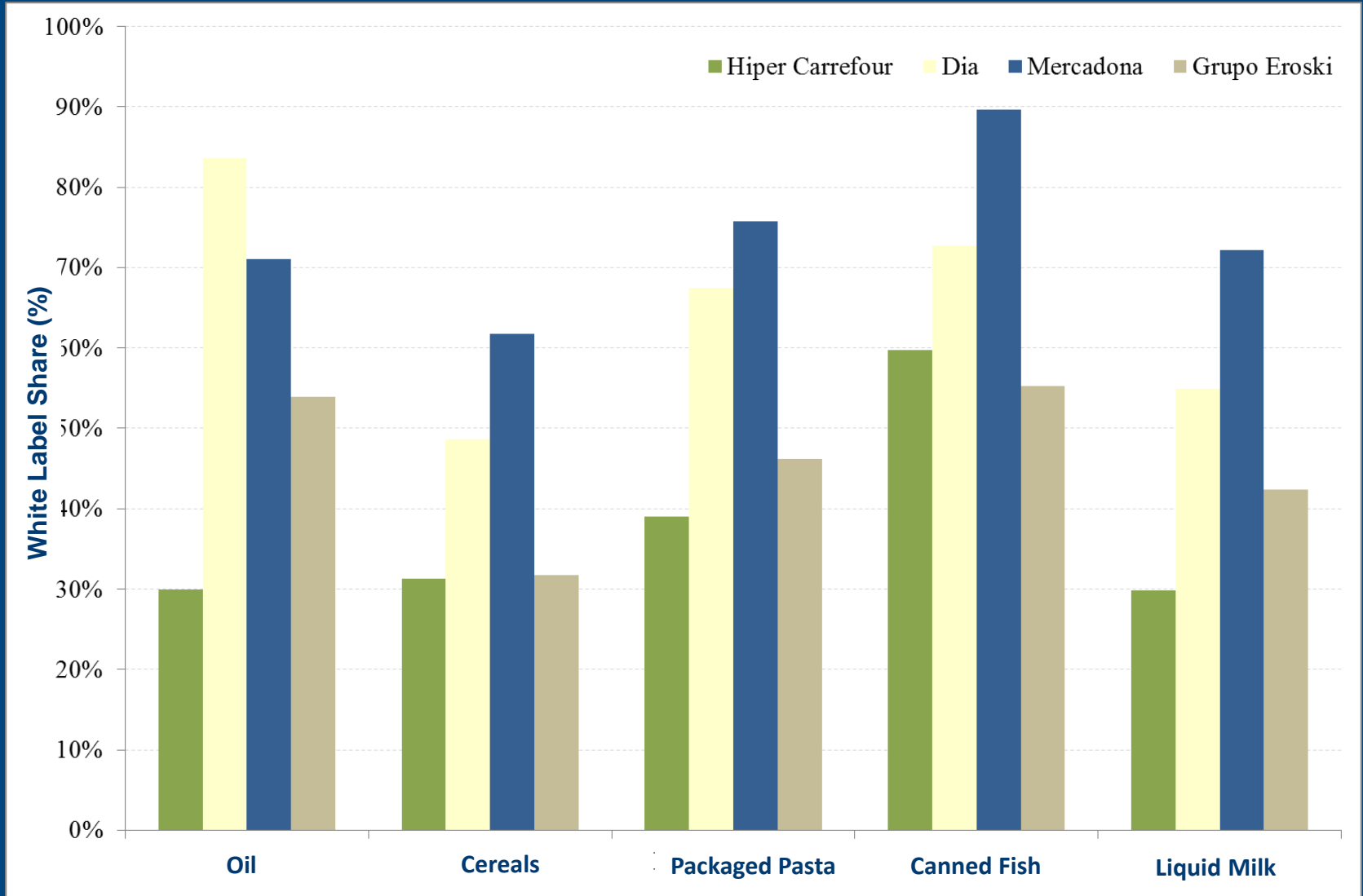
### *White label penetration continues on a growth trajectory (34.5% market share in 2011)*

# Table 2: Indices of concentration in the food retail market by Region (in sales value 2011)

			Market Share (%)						
Retail Group			Andalucía	Cataluña	Castilla-León	Madrid (Region)	Valencia (Region)	Galicia	Basque Country
Mercadona	1	KWP	36.3	23.8	23.9	25.0	39.8	12.1	1.2
Carrefour Group	2	KWP	12.1	11.4	12.4	14.7	14.9	7.9	11.5
<i>Hiper Carrefour</i>	3	KWP	11.3	10.0	11.6	13.5	14.6	7.4	10.8
<i>Dia</i>	4	KWP							
<i>Rest of Carrefour Group</i>	5	max[2]-[3]-[4];0)	0.8	1.3	0.8	1.2	0.3	0.5	0.8
Eroski Group	6	KWP	2.9	13.4	7.0	4.2	2.1	20.5	42.7
<i>Eroski Supers</i>	7	KWP	1.6	0.6	4.8	1.6	0.3	19.1	42.7
<i>Hiper Eroski</i>	8	KWP	1.1	1.8	2.1	1.1	1.8	1.4	20.0
<i>Caprabo</i>	9	KWP	-	11.0	-	1.5	-	-	-
<i>Rest of Eroski Group</i>	10	max[6]-[7]-[8]-[9];0)	0.1	-	0.0	-	-	-	-
Dia*	11	KWP	10.3	8.7	13.9	9.0	6.1	8.7	8.3
Auchan Group	12	KWP	3.3	4.6	4.8	9.8	3.0	7.9	9.9
<i>Alcampo</i>	13	KWP	3.3	3.5	1.1	8.7	2.9	7.9	2.1
<i>Simply Market</i>	14	KWP	-	1.1	3.6	1.1	0.1	-	7.7
<i>Rest of Auchan Group</i>	15	max[12]-[13]-[14];0)	-	-	0.1	-	0.0	-	0.1
Lidl	26	KWP	6.3	5.6	3.4	4.5	4.7	4.0	5.8
El Corte Inglés Group	27	KWP	2.6	2.4	2.7	5.7	1.6	2.3	1.2
<i>Hipercor</i>	28	KWP	1.5	1.0	0.8	3.3	0.7	1.0	-
<i>Rest of El Corte Inglés Group</i>	29	max[17]-[18];0)	1.1	1.5	1.9	2.4	1.0	1.3	1.2
Consum Cooperativa	30	KWP	-	3.5	-	-	14.0	-	-
Ahorramas	21	KWP	-	-	-	10.1	-	-	-
Gadisa	22	KWP	-	-	2.1	-	-	16.0	-
El Arbol	23	KWP	0.2	-	6.2	-	-	0.3	-
Aldi	24	KWP	0.8	1.2	0.9	0.7	1.9	-	-
Rest of Groups	25	See Notes	25.2	25.3	22.7	16.4	11.8	20.2	19.4
Total	26	See Notes	100.0	100.0	100.0	100.0	100.0	100.0	100.0
IHH (by Retail Group)	27	See Notes	1643	1030	1054	1192	2084	1051	2163
RC4	28	See Notes	65.0	57.3	57.1	59.6	74.9	57.4	72.4

Source: Own, based on data from independent market research company

## Figure 11: White Label Share by Retail Group and Product Category



# Principal Conclusions (ii)

## B. IMPOSITION OF DISCRIMINATORY MARGINS

*Retail chains apply higher margins to manufacturer brands than to white labels, with the aim of inciting end consumers to purchase white labels*

- ◆ In some products, the margin applied to manufacturer brands was between 2 and 18 times higher than the margin applied to white labels
- ◆ This practice distorts competition between manufacturer brands and white labels
- ◆ In the medium and long term, the increasingly stronger negotiating power of retailers will imply
  - A rise in the price of white label products;
  - The disappearance of second-tier manufacturer brands; and
  - The reduction in manufacturers' ability and incentive to innovate

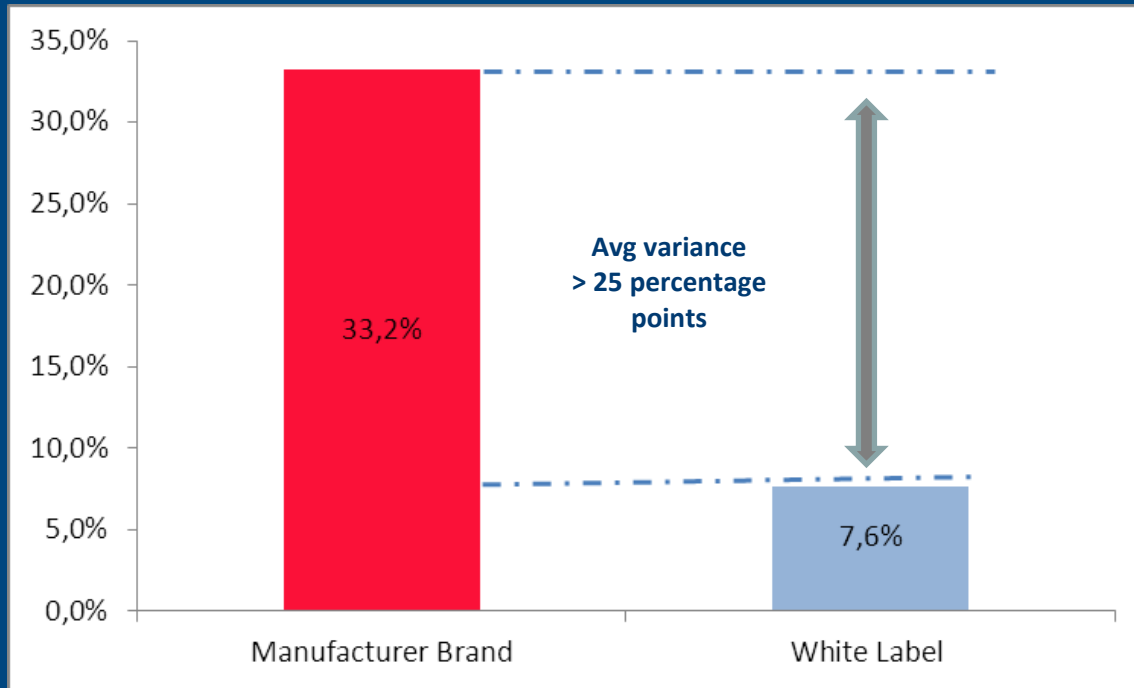
# Principal Conclusions (ii)

## B. IMPOSITION OF DISCRIMINATORY MARGINS

### Examples

- ♦ ***Extra virgin olive oil (2007-2008)***: the retail margins applied to the wholesale transfer price were approximately 22% in the case of manufacturer brands, versus 1% in the case of white labels
- ♦ ***Milk (2008)***: the retail margins applied to the wholesale transfer price were approximately 48% in the case of manufacturer brands, versus 30% in the case of white labels
- ♦ ***Product F (2011)***: the retail margins applied to the wholesale transfer price of packaging format  $\beta$  in 2011 were approximately 66% in the case of the manufacturer brand, versus 18% in the case of the white label

# Average Retail Margin in Manufacturer Brands and White Labels (%)





# Table 7: Comparison of Sales Prices and Margins per Unit for Manufacturer Brands and White Labels

Product		Year	Brand Type	Transfer Price	RRP excl VAT	Margin per Unit	
				(Index)	(Index)	(Index)	(%)
				[A] See Notes	[B] See Notes	[C] [B]-[A]	[D] [C]/[A]
Product A	[1]	2011	MB	100	125	25	25%
			WL	44	46	2	5%
Product B Type 1	[2]	2011	MB	100	132	32	32%
			WL	80	88	8	10%
Product B Type 2	[3]	2011	MB	100	155	55	55%
			WL	82	89	8	10%
Product C	[4]	2011	MB	100	137	37	37%
			WL	59	64	4	7%
Product D Format X	[5]	2011	MB	100	114	14	14%
			WL	76	76	0	0%
Product D Format Y	[6]	2011	MB	100	115	15	15%
			WL	71	76	5	7%
Product D Format Z	[7]	2011	MB	100	115	15	15%
			WL	68	75	7	10%
Product E Format a	[8]	2011	MB	100	149	49	49%
			WL	73	99	25	34%
Product E Format b	[9]	2011	MB	100	166	66	66%
			WL	93	110	17	18%
Extra Virgin Olive Oil	[10]	2007-2008	MB	100	122	22	22%
			WL	84	85	1	1%
		2008-2009	MB	100	137	37	37%
			WL	83	67	-16	-19%
Olive Oil	[11]	2007-2008	MB	100	116	16	15%
			WL	83	85	2	2%
		2008-2009	MB	100	134	34	34%
			WL	86	79	-8	-9%
Milk	[12]	2008	MB	100	148	48	48%
			WL	79	103	24	30%

Source:

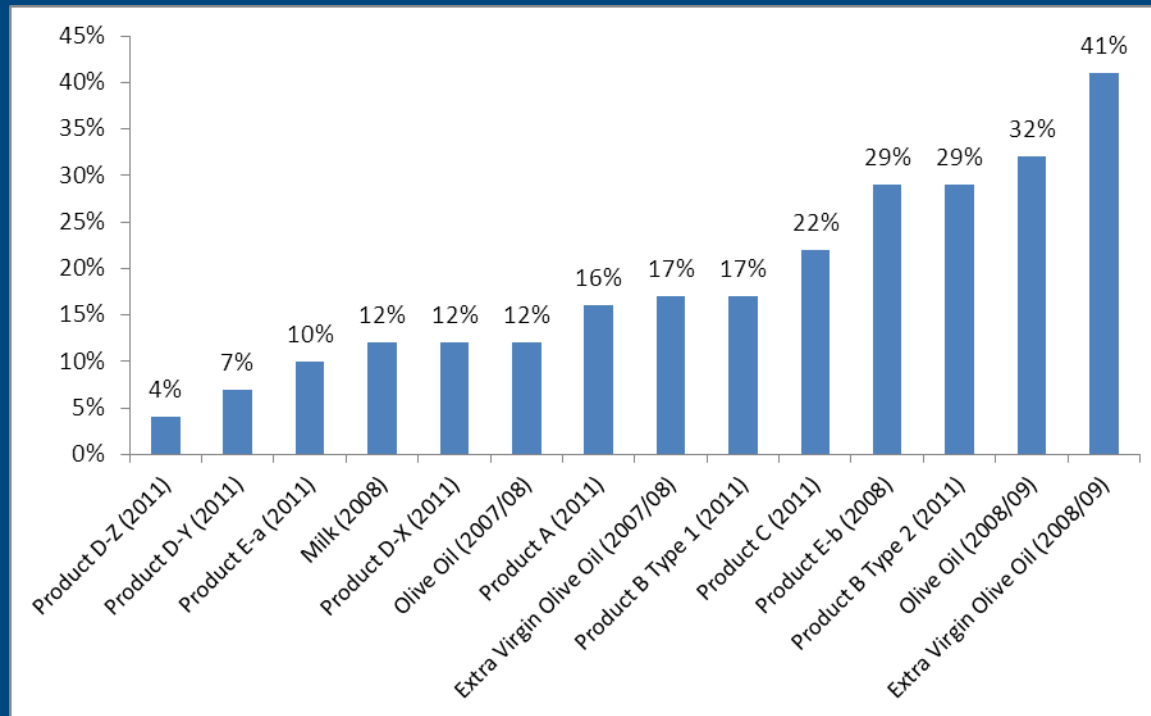
[1] to [9]: Information obtained by *Brattle* by means of direct conversations with companies and associations in the sector

[10], [11]: Food Price Observatory, MARM, Study of the Value Chain and Price Formation for Olive Oil, January 2010 and June 2011

[12]: Food Price Observatory, MARM, Study of the Value Chain and Price Formation for Packaged Liquid Milk, April 2009

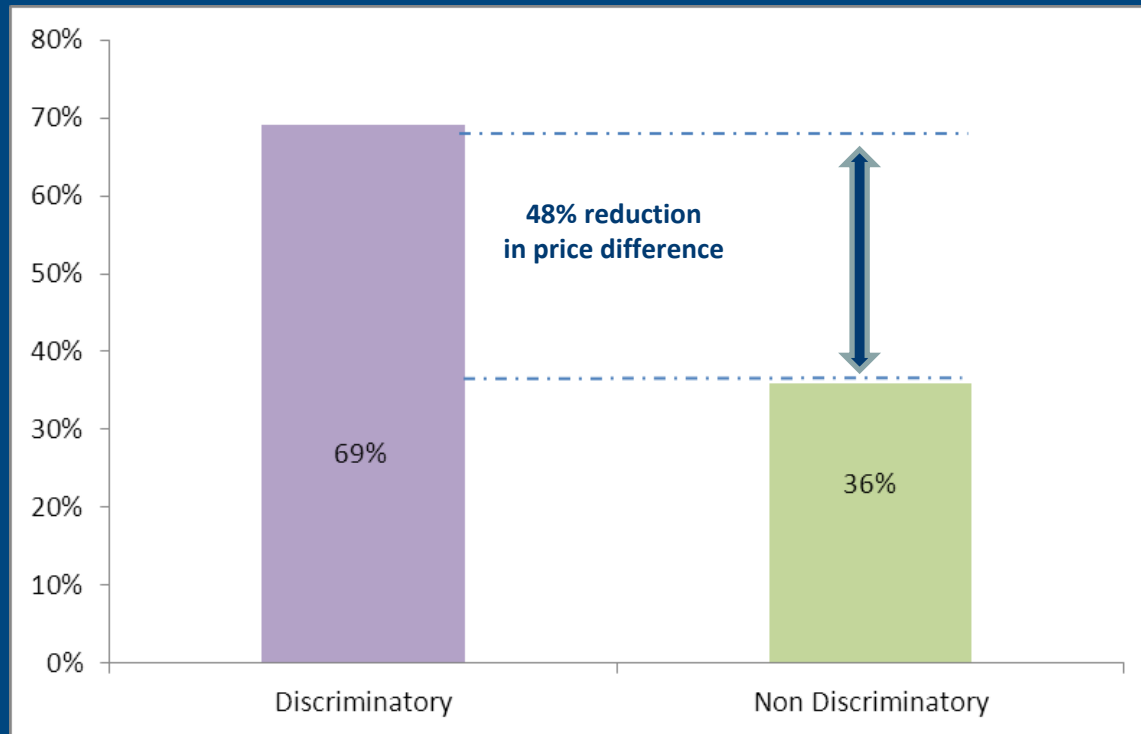
# Elimination of Discriminatory Practices (i)

The elimination of discriminatory practices, assuming that retail chains will apply margins to manufacturer brands equivalent to those currently applied to white labels, **could reduce the price of manufacturer brands by between 4% and 41% based on the products analysed**



# Elimination of Discriminatory Practices (ii)

The reduction in the price of manufacturer brands could **reduce the price difference between white labels and manufacturer brands, in the products analysed, by nearly 48%**



# Reduction in RRP in the Absence of Margin Discrimination

Product	Year	Margin per Unit			RRP (excluding VAT)							Reduction in RRP (excl VAT)
					(with discrimination)			without discrimination				
		MB (%) [A]	WL (%) [B]	Variance (% points) [C]	ML (Index) [D]	WL (Index) [E]	Variance (%) [F]	MB (Index) [G]	WL (Index) [H]	Variance (%) [I]	Variance (%) [J]	
		Table 7	Table 7	[A]-[B]	Table 7	Table 7	[D]-[E]/[E]	100X(1+[B])	[E]	[G]-[H]/[H]	[D]-[G]/[D]	
Product A	[1]	2011	25%	5%	20%	125	46	169%	105	46	126%	16%
Product B Type 1	[2]	2011	32%	10%	22%	132	88	50%	110	88	25%	17%
Product B Type 2	[3]	2011	55%	10%	45%	155	89	73%	110	89	23%	29%
Product C	[4]	2011	37%	7%	30%	137	64	115%	107	64	68%	22%
Product D Format X	[5]	2011	14%	0%	14%	114	76	50%	100	76	32%	12%
Product D Format Y	[6]	2011	15%	7%	8%	115	76	51%	107	76	40%	7%
Product D Format Z	[7]	2011	15%	10%	5%	115	75	53%	110	75	47%	4%
Product E Format a	[8]	2011	49%	34%	15%	149	99	51%	134	99	36%	10%
Product E Format b	[9]	2011	66%	18%	48%	166	110	51	118	110	7%	29%
Extra Virgin Olive Oil	[10]	2007-2008	22%	1%	20%	122	85	44%	101	85	20%	17%
		2008-2009	37%	-19%	57%	137	67	106%	81	67	21%	41%
Olive Oil	[11]	2007-2008	16%	2%	14%	116	85	37%	102	85	20%	12%
		2008-2009	34%	-9%	43%	134	79	71%	91	79	16%	32%
Milk	[12]	2008	48%	30%	18%	148	103	44%	130	103	27%	12%
MINIMUM			14%	-19%	5%	114	46	37%	81	46	7%	4%
AVERAGE			33%	8%	26%	133	81	69%	108	81	36%	19%
MAXIMUM			66%	34%	57%	166	110	169%	134	110	126%	41%

# Principal Conclusions (iii)

## C. EFFECTS ON PRICE

### Data analysed

- ◆ Sales volumes, sales value and prices (quarterly) of 15 of the most representative products in the shopping basket
- ◆ For each product, price analysis has been performed on the white label and the three principal manufacturer brands in the 7 largest retail chains in Spain
- ◆ Analysis period: From Q1 2008 to Q4 2011
- ◆ 7 regions: Andalucía, Cataluña, Castilla-León, Madrid, Valencia, Galicia and Basque Country
- ◆ Data provided by a prestigious international company specialised in the analysis of consumer behaviour in the consumer products sector

# Principal Conclusions (iii)

## C. EFFECTS ON PRICE

*The growth in market power of retail chains and in penetration of white labels does not translate into lower prices for the end consumer*

- ♦ White label prices increase as their level of penetration grows
- ♦ Manufacturer brand prices also increase in accordance with increased penetration of the white label
- ♦ As the level of penetration of the white label increases, the price difference between the white label and manufacturer brands is reduced, due to higher rise in price of the white label

# Principal Conclusions (iii)

## C. EFFECTS ON PRICE

### Examples

- ◆ A 10% growth in penetration of the white label caused a price increase in the manufacturer brand of 5.5% for canned fish, 4.0% for toothpaste, and 3.0% for dishwasher detergent
- ◆ A 10% growth in penetration of the white label is associated with a price increase of over 6% for white label chocolate and soft drinks, and over 5% for white label shower gel and dishwasher detergent
- ◆ The 10% difference between manufacturer brands and white labels in the event of increased penetration of the white label, diminishes by approximately 5% in the case of chocolate and instant coffee, and by nearly 13% in the case of detergent

# Table 5: Impact of the market share of retailer chains on the price of manufacturer brands and white labels

	Manufacturer Brand Price	White Label Price
Bath Gel	0	+
Beer	0	+
Biscuits	0	+
Canned Fish	0	0
Cereals	0	-
Chocolate	-	0
Cocoa cream	-	+
Coffee	0	0
Detergents	+	0
Dishwasher Detergent	-	0
Milk	0	0
Oil	0	+
Pasta	0	+
Soft Drinks	0	+
Toothpaste	0	0

Source: own, based on data from a independent market research company. «0» means that the market power does not have an effect on the price of the given product; «+» means that the greater the market power, the higher the price; and «-» means that the greater the market power, the lower the price. Level of significance is 95%.



**Table 6: Impact of penetration of white labels on the price of manufacturer brands and white labels and the relative price of manufacturer brands vs. white labels**

	Manufacturer Brand Price	White Label Price	Relative Price MB vs WL
Bath Gel	0	+	-
Beer	+	+	-
Biscuits	0	+	-
Canned Fish	+	+	+
Cereals	+	0	0
Chocolate	-	+	-
Cocoa cream	+	-	+
Coffee	-	+	-
Detergents	-	+	-
Dishwasher Deterg	+	+	-
Milk	+	-	+
Oil	+	+	+
Pasta	+	0	0
Soft Drinks	+	+	-
Toothpaste	+	+	0

Source: own, based on data obtained from independent market research company. «0» means that the market power does not have an effect on the price of the given product; «+» means that the greater the market power, the higher the price; and «-» means that the greater the market power, the lower the price. Level of significance is 95%.

# Principal Conclusions (iv)

## D. EFFECTS ON INNOVATION

*Evidence suggests that it is manufacturer brands, and not white labels, that drive innovation and growth in the consumer products sector in Spain*

- ◆ Increased concentration in the retail market, higher retailer negotiating power, and the penetration of white labels
  - Limit the development of innovation by manufacturers
  - Will negatively impact the end consumer in the medium and long term

# Proposals for Reform (i)

## 1. ENFORCEMENT OF COMPETITION DEFENCE LAW (CDL)

- ◆ **Retail Market:** Enforcement of Article 2 of CDL to category management practices in retail markets where a dominant position exists (.e.g Andalucía, Basque Country and Valencia)
- ◆ **Wholesale Supply Market:** Enforcement of Article 3 of CDL to the relationships with manufacturers where a growing economic dependence exists
- ◆ Specifically, white labels should be limited in terms of:
  - Imposition of discriminatory restrictions (excluding effect on manufacturer brands)
  - Privileged access to confidential and sensitive information belonging to the manufacturer

# Proposals for Reform (ii)

## 2. REGULATION OF CNC RECOMMENDATIONS

### Regulations mandatory for all operators

- Obligation to establish written contracts between manufacturers and retailers
- Establishment of a model contract to serve as a basic framework
- Establishment of reasonable notification periods for modification of supply contract terms
- Limitation of privileged access by the retailer to manufacturers' confidential and sensitive information
- Prohibition of retroactive changes to contracts

### Regulations mandatory for operators with market power

- Prohibition of certain clauses, such as the “most preferred client” clause
- Regulation of commercial payments and prohibition of retroactive payments
- Obligation to provide information periodically to the public administration to facilitate thorough monitoring of market evolution and the profitability achieved by retailer chains in the different stages of the supply chain

### Creation of an Independent Control Body

- To monitor the evolution of the sector, and
- To solve disputes between manufacturers and retailers
- With the authority to act *ex officio* and powers similar to the CNC

# Proposals for Reform (iii)

## 3. MEASURES AIMED AT CONTROLLING RETAILER INCENTIVES IN THE CONTEXT OF THEIR DOUBLE ROLE AS RETAILER/MANUFACTURER

- A. First, we propose the **limitation in the supply of information** by producers of manufacturer brands to retailers, through the establishment of an *express prohibition to supply a certain type of information related with the private intentions of companies regarding their future conduct in the context of strategic variables such as pricing, cost structures, future promotions, new formats, etc.*
- B. Second, we suggest the **establishment of FRAND type obligations** (“Fair, Reasonable and Non-Discriminatory”) for the sale on equal terms of manufacturer brands and white labels, such that the retailer would perform category management in accordance with pre-determined criteria and in a proportionate, objective and non-discriminatory manner (in relation, for example, with commercial margins, product placement ... )

# Proposals for Reform (iv)

## 4. MEASURES FOR CONSIDERATION TO LIMIT MARKET POWER

- A. First, the establishment of obligatory structural disinvestment for establishments in areas with serious competition problems, based on an ex-post analysis of the competitive situation.
- B. Second, the establishment of measures to limit the expansion of retailers based on local competition conditions, through implementation of a «pro-competitive license» authorizing the establishment of stores that do not threaten the effective operation of the market