THE ANTICOMPETITIVE VERTICAL RESTRAINTS OF COMPETITIVE BOTTLENECKS: SUPERMARKETS AS A TEST CASE

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1 The Economic literature on supermarkets' competitive bottleneck nature and consumer welfare

The first economist who developed the theory of competitive bottlenecks in two-sided markets (Mark Armstrong) presented a stylised model of supermarkets as competitive bottlenecks and predicted that the underpayment of suppliers would exclude suppliers in a socially inefficient way (fewer products that it is socially desirable) whereas the treatment of consumers would depend on the level of supermarket competition[1]. Ever

[1] Mark Armstrong, "Competition in two-sided markets", RAND Journal of Economics, 2006, vol. 37, issue 3, 668-691: "*Other examples of this competitive bottleneck framework include: most people might read a single newspaper (perhaps due to time constraints), but advertisers might place ads in all relevant newspapers; consumers might choose to visit a single shopping mall (perhaps because of transport costs), but the same retailer might choose to open a branch in several malls; consumers might visit a single supermarket, but suppliers might wish to place their products on the shelves of several supermarkets; or a travel agent might use just one computerized airline reservation system, while airlines are forced to deal with all such platforms in order to gain access to each travel agent's customers. After analyzing a fairly general model of competitive bottlenecks, I shall present specific applications to newspapers and supermarkets.*

(…) A second application of the competitive bottleneck model is to supermarkets and similar kinds of retailers. A commonly held view about the supermarket sector is that, provided competition for consumers is vigorous, consumers are treated well by supermarkets but supermarkets deal too

since, other economists have also studied supermarkets as two-sided platforms offering shelf-space to their suppliers and brands to consumers[2]. Indeed, any formalistic distinction between market places offering services to both sides and retailers buying from one side and reselling to the other side would ignore the market reality and the nature of competitive bottlenecks. Nowadays, intermediaries may mingle the market place and the reseller business models (e.g., a multiproduct retailer may charge fees for several services and require guaranteed margins as much as a marketplace may charge access fees and a variable commission and even apply discounts on top of the vendor price as well as managing critical transaction parts such as product display, logistics, delivery, payment, product return) without affecting their competitive bottleneck status and the corresponding competition law assessment[3]. Indeed, some supermarket alliances

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aggressively with their suppliers. The model when applied to this industry can generate these stylized features.

(…) As with all the competitive bottleneck models, in equilibrium the joint surplus of the platforms and the single-homing group is maximized (supermarkets and consumers in this case, as given in expression (36)), and the interests of the multi-homing side (the suppliers) are ignored. The low level of compensation in (36) will exclude some relatively high-cost suppliers whose presence in the supermarkets is nevertheless efficient. (A supplier should supply if $\alpha 2 < \alpha 1 - c$, whereas the equilibrium price p2 in expression (36) is strictly lower than $\alpha 1 - c$ and supply is inefficiently restricted.) In other words, payments to suppliers are too low from a social point of view and there are too few products on the shelves. How well consumers are treated depends on competitive conditions on their side."

2 Timothy Richards and Stephen F. Hamilton, "Network externalities in supermarket retailing", European Review of Agricultural Economics, Volume 40, Issue 1, February 2013, Pages 1–22: "*As intermediaries between manufacturers and consumers, retailers must manage a two-sided demand for their services. Consumers demand the products retailers stock on their shelves, while manufacturers demand shelf space for distribution purposes. In this study, we present a theoretical model of indirect network effects in supermarket retailing and estimate how these effects impact pricing and assortment strategy among a small set of competing retailers.*"

3 The US Supreme Court has concluded in Apple v Pepper case, No. 17-204, 587 U.S. ___ (2019), https://www.supremecourt.gov/opinions/18pdf/17-204_bq7d.pdf, that Apple is a retailer for the purpose of an antitrust damage claim related to the price (set by app developers) of the apps bought in the Apple market place, rejecting the relevance of the market place/retailer distinction in the context of the Apple's business practices with app developers and Iphone users: "*Second, in addition to deviating from statutory text and precedent, Apple's proposed rule is not persuasive economically or legally. Apple's effort to transform Illinois Brick from a direct-purchaser rule to a "who sets the price" rule would draw an arbitrary and unprincipled line among retailers based on retailers' financial arrangements with their manufacturers or suppliers. In the retail context, the price charged by a retailer to a consumer is often a*

only offer services to unaffiliated brands and they have to buy them in order to be able to enter into supply contracts with the supermarkets members of the alliance. On the other hand, the observed capacity of leading (even though not dominant) supermarkets to apply UTPs to all their suppliers irrespective of their size /market share is perhaps the best evidence of their competitive bottleneck status[4] and the concerns expressed by

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result (at least in part) of the price charged by the manufacturer or supplier to the retailer, or of negotiations between the manufacturer or supplier and the retailer. Those agreements between manufacturer or supplier and retailer may take myriad forms, including for example a markup pricing model or a commission pricing model. In a traditional markup pricing model, a hypothetical monopolistic retailer might pay $6 to the manufacturer and then sell the product for $10, keeping $4 for itself. In a commission pricing model, the retailer might pay nothing to the manufacturer; agree with the manufacturer that the retailer will sell the product for $10 and keep 40 percent of the sales price; and then sell the product for $10, send $6 back to the manufacturer, and keep $4. ***<u>In those two different pricing scenarios, everything turns out to be economically the same for the manufacturer, retailer, and consumer.</u>***"

[4] See, for example, the Bundeskartellamt's decision against EDEKA for abusing the economic dependence of its suppliers (upheld by the Supreme Court). EDEKA imposed its terms to "about 500 suppliers" of all sizes. The Bundeskartellamt identified anticompetitive effects on the procurement and retail markets: "*The Bundeskartellamt takes a particularly critical view of those demands that were not met with corresponding compensation by EDEKA: • The "cherry picking" of individual preferential conditions granted to Plus by suppliers in the past. • The application and extension of the preferential conditions granted to Plus to the entire range of products purchased by EDEKA from the respective supplier. • The demand of special bonuses on account of cost and turnover benefits allegedly resulting from the Plus takeover for suppliers, without sufficient explanation or substantiation of such benefits. • The fact that the demands were made retroactively. Such demands have negative effects not only for the suppliers. A large company such as EDEKA can also use them to further expand its market power to the detriment of smaller retailers. Competition is also hindered by the fact that such demands induce suppliers to abstain from offering preferential conditions to smaller trading companies. This has been confirmed by the Bundeskartellamt's investigations. The suppliers fear that in the case of a future merger or purchase cooperation between retailers, they will be forced to offer such individual conditions to a significantly larger extent to the new partner as well.* (https://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemitteilungen/2013/24_07_2013_Edeka.html?nn=3600108). The BKT emphasized that its decision helped preserving effective competition in the market without undermining hard bargaining: "*Andreas Mundt, President of the Bundeskartellamt: "(...). Our decision is to maintain viable competition and thus the protection of smaller competitors, suppliers and consumers. The procedure also helps to set the border between antitrust permissible "hard bargaining" and inadmissible behavior of market-dominant trading companies*." (https://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemitteilungen/2013/24_07_2013_Edek

public authorities[5] and the growing number of UTP regulations in the food/FMCG sector worldwide (e.g., most Member States of the EU and Chile, Japan, Kenya, Korea and South Africa amongst other non-EU countries) respond to solid economic efficiency considerations (see Armstrong and even the European Commission's observations to the OECD roundtable on "two-sided markets"[6]).

Furthermore, as multiproduct retailers have grown aware of their competitive bottleneck status, they have developed their own (affiliated) brands and promoted them at the expense of third-party (unaffiliated) brands. This market evolution has led other economists to factor vertical integration in the theory of competitive bottlenecks and they have predicted anticompetitive effects on all the variables of consumer welfare. As early as in 2003, Bergès-Sennou, Bontems and Réquillart reviewed the existing economic literature on affiliated brands and cautioned against the traditional pro-competitive views on supermarket brands. They questioned the alleged increase in

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a.html?nn=3600108). "*Andreas Mundt, President of the Bundeskartellamt: "(...). Our decision helps to maintain effective competition and thus protects smaller competitors, suppliers and consumers. The proceeding contributes to establishing, also for the future, the borderline between "tough negotiations", which are admissible under competition law, and inadmissible practices used by powerful retail companies. And, last but not least, the decision will provide a valuable contribution to the debate on the problems of buyer power exerted by food retailers, both in Germany and at the European level."* (https://www.bundeskartellamt.de/SharedDocs/Meldung/EN/Pressemitteilungen/2014/03_07_2014_edeka.html?nn=3600108).

5 See, for an overview of the global dimension of this problem, Peter Cartesten, *Competition Plicy and the Control of Buyer Power: A Global Issue,* Edward Elgar, 2017. Public authorities' reports on this topic include, amongst others: OECD Roundtable on "Buying Power of Multiproduct Retailers", 1999, https://www.oecd.org/daf/competition/abuse/2379299.pdf; OCED Roundtable "Monopsony and Buyer Power", 2009; ICN, "Report on the Abuse of Superior Bargaining Position", 2008; OECD Roundtable "Competition issues in the Food Chain Industry", 2013, https://www.oecd.org/daf/competition/CompetitionIssuesintheFoodChainIndustry.pdf; UNCTAD, "Enforcement of competition policy in the retail sector: Competition issues in the food retail chain", 2016, https://unctad.org/meetings/en/SessionalDocuments/ciclpd38_en.pdf.

6 European Commission, "Roundtable on two-sided markets", OECD Competition Committee, DAF/COMP/WD(2009)69: "*Armstrong points out that even if the platforms do not make excessive profits overall, the multi- homing side faces too high a charge from the point of view of social welfare. Bolt and Tieman (2006) in a comparatively simple two-sided platform model, obtain a similar result.… It follows that even adequate competition policy enforcement alone may not always lead to best outcomes. This suggests, at least in some instances regulation may be pertinent.*"

choice (affiliated brands replace unaffiliated ones), innovation (supermarket brands are less innovative than unaffiliated brands) and even retail prices (prices of leading unaffiliated brands may increase rather than decrease in response to the introduction of affiliated brands and the presence of affiliated brands allow for more price differentiation among retailers)[7]. Other economists have reinforced the remarks of

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[7] Bergès-Sennou, Bontems and Réquillart (Université de Toulouse, INRA, IDEI), "Economic impact of the development of private labels", 1st Biennal Conference of the Food System Research Group, University of Wisconsin, Madison, June, 26-27, 2003, https://pdfs.semanticscholar.org/94af/c5b0d57e0a64cc837972bd6a2ce8b0a508b5.pdf: "*Most of the models agree on the positive impact on welfare of the development of PLs in the short term. In these models, PLs are frequently considered as additional goods that allow the retailer to increase his profit to the detriment of the upstream producer, either by decreasing the wholesale price or by capturing a larger share of the surplus of the industry. In these models, consumers benefit from the increase in the number of goods available and from the positive impact of the reduction in double marginalization.20 In practice in the shop, a PL generally replaces another product, for example a regional brand. In this case the positive impact linked to the increase in the number of goods available for the consumer in a shop disappears. However we have shown that the strategic choice of product quality by a retailer or a producer is not identical. For a given quality of the NB, the retailer designs a less differentiated good than an upstream producer would. Thus the consumer will benefit from an increase in competition between the two products but could be penalised by the lower degree of differentiation between products. Thus, in a more realistic framework, it is not certain that the introduction and development of PLs lead to an increase in consumer surplus and to an increase in welfare. For example, Caprice (2000), using a framework of non-linear pricing, showed that when the choice of characteristics of the PL is strongly irreversible, the introduction of PL decreases welfare as compared to a case where the characteristics are chosen by the integrated vertical structure. In a longer term analysis, even if no specific work has been done on this topic, the impact of PL could well be less positive. The argument is the following: the development of PLs leads to a different share of profits within vertical structures. A decrease in the profits of the upstream producers could lead to less innovation and thus reduce the variety of goods available to consumers. This mechanism is reinforced by the strategy of retailers who develop 'me-too' products. This strategy is nothing else than free-riding on research and development of new products. This free-riding will discourage the efforts devoted to the development of new products in the long term. Moreover, the development of PLs can modify competition between retailers in the long term. For example, PLs enable greater differentiation between retailers and thus lower price competition among retailers which is detrimental to welfare (for a discussion on long-term effects, see Dobson, 1998).*

A lot of questions remain to be answered. While most of the theoretical models agree on a decrease in the price of NBs in response to the development of PLs, some recent empirical works conclude exactly the opposite. If these results are confirmed by other studies (for example, in other countries) it will be vital to develop alternative models in order to explain the mechanisms involved. First, it is important to consider

Bergès-Sennou, Bontems and Réquillart. Inderst and others focused on innovation as a competition driver and concluded that leading supermarkets' vertical integration undermines overall innovation and retail competition, both to the detriment of consumers[8]. Compass Lexecon has reached similar conclusions[9]. Indeed, supermarkets'

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non-linear pricing rather than linear pricing between manufacturers and retailers. Among other reasons, the existence of fixed fees justifies doing so.21 Second, a PL should be considered as a good which is a substitute for an existing good rather than an additional one. Third, we should take into account that in many cases the manufacturer of the NB is also the producer of the PL. Thus the producer will try to keep his products differentiated in order to better discriminate the demand. Fourth, the impact of PLs on competition between retailers remains an unexplored question. "

8 Roman Inderst and others, "Buyer Power and Functional Competition for Innovation", 2015 https://mpra.ub.uni-muenchen.de/61214/1/MPRA_paper_61214.pdf: "*Our analysis starts from the observation that with progressive consolidation in retailing and the spread of private labels, retailers increasingly take over functions in the vertical chain. Focusing on innovation, we isolate various reasons for why when a large retailer grows in size, this can lead to an inefficient shift of innovation activity away from manufacturers and to the large retailer. One rationale for this is the retailer's control of access to consumers, which gives rise to a rent-appropriation motive for innovation, next to a hold-up problem. With retail competition, through crowding out the manufacturer's innovative activity, a large retailer obtains a competitive advantage vis-à-vis smaller retailers. We further analyze when inefficiencies are aggravated in case a large retailer's presence threatens the manufacturer with imitation of his innovations*."

9 Jorge Padilla, Kadambari Prasad and Bernardo Sarmento (Compass Lexecon), "A primer on the welfare implications of quasi-vertical integration in retailing", paper prepared for PROMARCA, 2017, it will be provided to the Commission separately: "*A vicious circle: increasing dominance in downstream markets*

1.12 The changes in the structure of the FMCG industries have dampened competition in downstream markets, thus setting in motion a vicious circle which can be described as follows:

a. Increased concentration in retailing, together with the emergence of quasi-vertically integrated retailers, has increased retailer's relative bargaining power vis-à-vis suppliers.

b. As a result, retailers have appropriated a greater share of the results generated in FMCG markets. This has in turn reduced upstream suppliers' ability and incentive to innovate as well as their ability to sponsor non-integrated retailers.

c. Increased entry barriers in downstream retail markets together with the exit or marginalisation of non-integrated retailers has led to increased market concentration downstream and an increase in the market shares of quasi-vertically integrated retailers.

d. This in turn has increased the bargaining power of retailers and so on and so forth.

1.13 This vicious circle is illustrated in Figure 1 below.

Consumer welfare implications and policy recommendations vertical integration only aggravates the negative effect on innovation, choice and consumer demand that supermarkets' buyer power may engender even in the absence of vertical integration, as posited by Battigalli, Fumagalli, and Polo[10].

2 The empirical evidence of supermarkets' effects on consumer welfare

Academics have acknowledged the difficulty of proving the harm on innovation caused by competitive bottlenecks such as online platforms[11]. The unique thing about the

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1.14 The vicious circle we have just described is bound to harm consumers.6

a. First, consumers will be harmed because of the reduction in product innovation. Innovation is beneficial to consumers as they value quality and product variety.

b. Second, consumers will be harmed because the vicious circle reduces downstream competition. Reduced competition will result in higher retail prices, reduced quantity and reduced quality for consumers.

1.15 We propose three policy initiatives that could mitigate the problems identified in this paper:

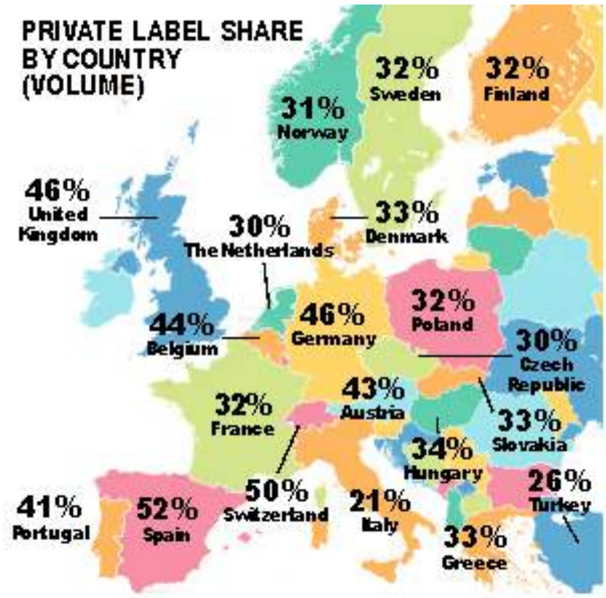
(…)

c. Distribution neutrality. Governments should consider requiring quasi-integrated vertical retailers to treat national brands equally to their own brands."

[10] Battigalli, Fumagalli and Polo, Buyer Power and Quality Improvements." Research in Economics 61: 45-61, 2007, https://pdfs.semanticscholar.org/9b47/1e887a003acac31c2f179352a1ed95b81875.pdf: "*This paper analyses the sources of buyer power and its effect on sellers' investment in quality improvements. In our model retailers make take it-or-leave-it offers to a producer and each of them obtains its marginal contribution to total profits (gross of sunk costs). In turn, this depends on the rivalry between retailers in the bargaining process. Rivalry increases when the retailers are less differentiated and when decreasing returns to scale in production are larger. The allocation of total surplus affects the incentives of the producer to invest in product quality, an instance of the hold-up problem. An increase in buyer power not only makes the supplier and consumers worse off, but it may even harm the retailers, that obtain a larger share of a smaller surplus. A repeated game argument shows that efficient quality improvements can be supported as an equilibrium outcome if producer and retailers are involved in a long-term relationship*".

[11] Fiona Scott Morton, Pascal Bouvier, Ariel Ezrachi, Bruno Jullien, Roberta Katz, Gene Kimmelman, A. Douglas Melamed, Jamie Morgenstern, "Report of the Market Structure and Antitrust Subcommittee", Committee for the Study of Digital Platforms, George J. Stigler Center for the Study of the Economy and the State, The University of Chicago Booth School of Business, 2019: "*Very often the uncertainty involved in evaluating harms to innovation will be high, especially in contrast to the analysis of price forecasts. It is possible to measure pipeline projects and current R&D to obtain a sense of competitive overlap or trajectory, but the tools do not yet exist to accurately forecast the speed and direction of innovation in the longer run. Likewise, obtaining quantitative evidence about the innovations*

supermarket sector is that the economic models that explain the anticompetitive effects of the vertically integrated supermarkets' practices have been vindicated by empirical data. Lower innovation, less choice, higher retail prices and lower output can and do emerge from the supermarkets' practices aimed at unaffiliated brands. To place these effects in context, first it has to be looked at the rapid growth of affiliated brands across Europe in the past years. According to the last reports of the Private Labels Manufacturers Association (PLMA) based on Nielsen data, affiliated brands' market share (measured by volume) exceeds 30% in most EU Member States (the notable exception being Italy) and it even exceeds 40% in Belgium, Germany, Spain, UK and Portugal (market share in Switzerland is not depicted but stands at 51%):



Source: PLMA, https://www.plmainternational.com/industry-news/private-label-today

If one were to believe PLMA's unsupported and unfair claims that affiliated brands (also identified as Private Labels or PLs) use the same or better ingredients than unaffiliated brands (identified as manufacturer brands) and are cheaper[12], the growth of

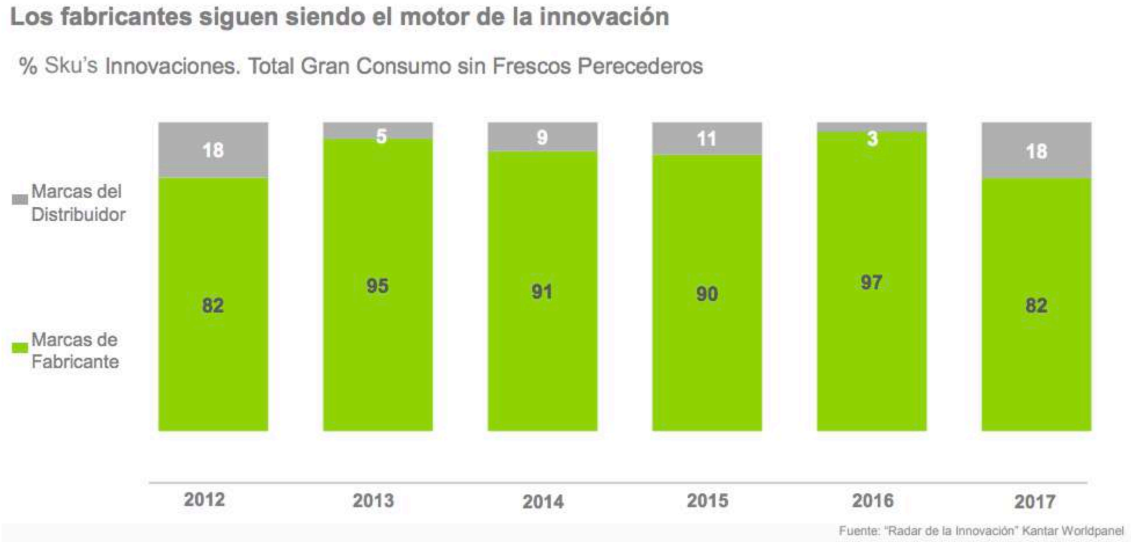
or products that would have been offered to consumers in the absence of the conduct is often not possible".

[12] PLMA, https://www.plmainternational.com/industry-news/private-label-today, "*WHAT ARE THE ADVANTAGES OF PRIVATE LABEL? For the consumer, private label represents the choice and opportunity to regularly purchase quality food and non-food products at savings compared to manufacturer brands, without waiting for promotional pricing. Private label items consist of the same or better ingredients than the manufacturer brands, and because the retailer's name or symbol is on the*

affiliated brands would be a natural and even desired outcome. However, market data reveals a very different picture from a consumer welfare standpoint.

2.1 Consumer harm reflected in less innovation

Yearly reports by Kantar WorldPanel reveal that unaffiliated brands innovate more (measured in first-to-market innovations) than retailer brands in Spain.



However, unaffiliated brands have complained about discriminatory category management practices, unfair use of sensitive commercial information, refusal to list innovations, copycats and higher retail margins amongst other practices that foreclose them at the expense of affiliated brands. Many of these practices are opaque but public data on the extremely low weighted distribution of innovations (i.e., the aggregate market share of the retailers distributing a specific innovation) - 17,9% in 2018 - and the very low level of distribution of innovations in specific supermarkets (e.g., the leading retail chain Mercadona barely listed 14% of innovations by unaffiliated brands in 2017) reveal a deliberate pattern of refusal to list innovations that may outcompete affiliated brands:

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package, the consumer is assured that the product meets the retailer's quality standards and specifications".

Cae la distribución de la innovación del fabricante con respecto a años anteriores

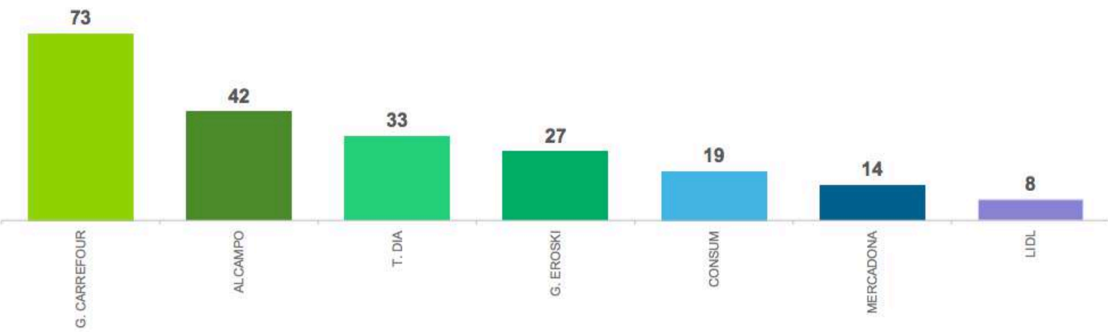
Distribución ponderada promedio de la innovación de fabricante

2013	2014	2015	2016	2017
25,4%	20,3%	20,0%	20,4%	↓ 17,9%

Fuente: "Radar de la Innovación" Kantar Worldpanel

Carrefour sigue siendo la cadena que más referencias trabaja la innovación de fabricante

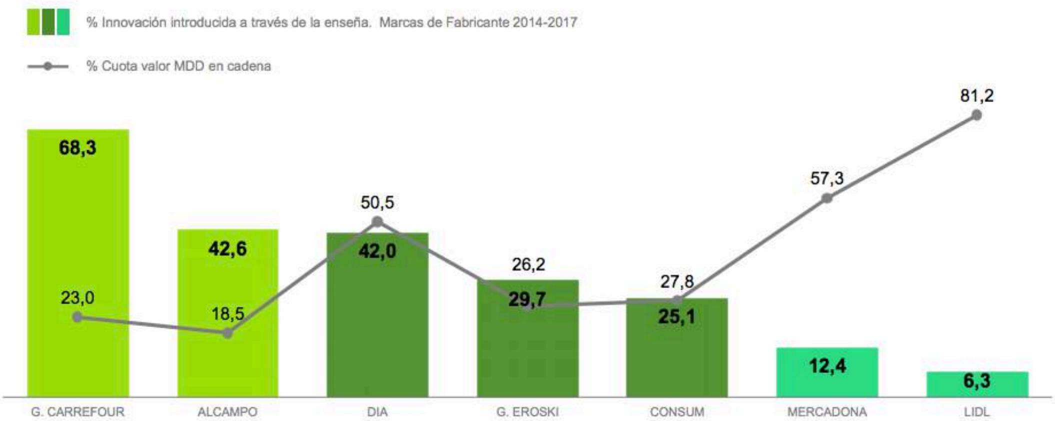
% Innovación introducida a través de la enseña. Marcas de Fabricante 2017



Fuente: "Radar de la Innovación" Kantar Worldpanel

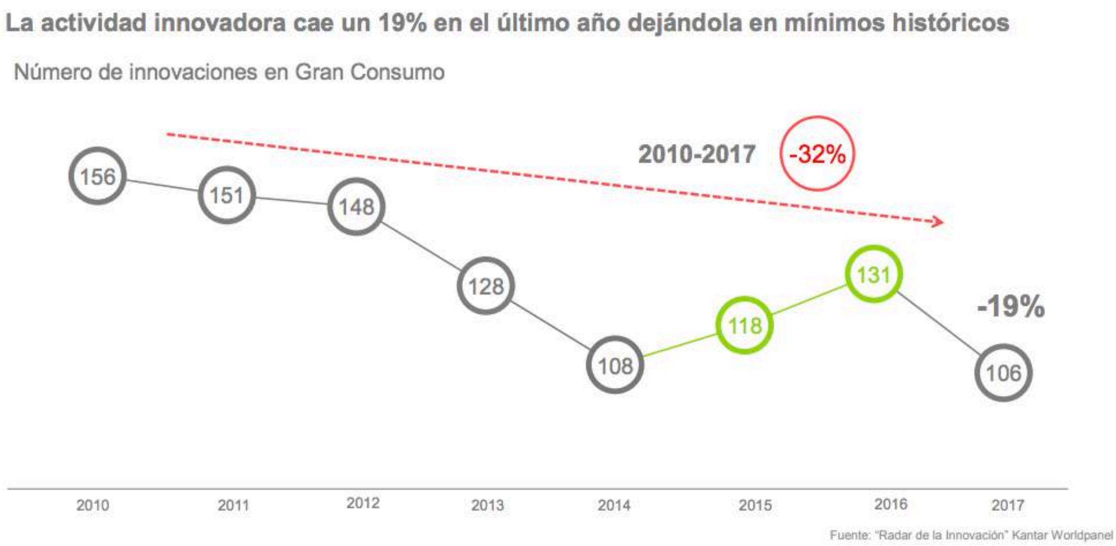
Indeed, Kantar WorldPanel identifies a negative correlation between the affiliated brand's share in the supermarket and the listing of unaffiliated brands' innovations:

La política de marca propia influye en el apoyo a la innovación

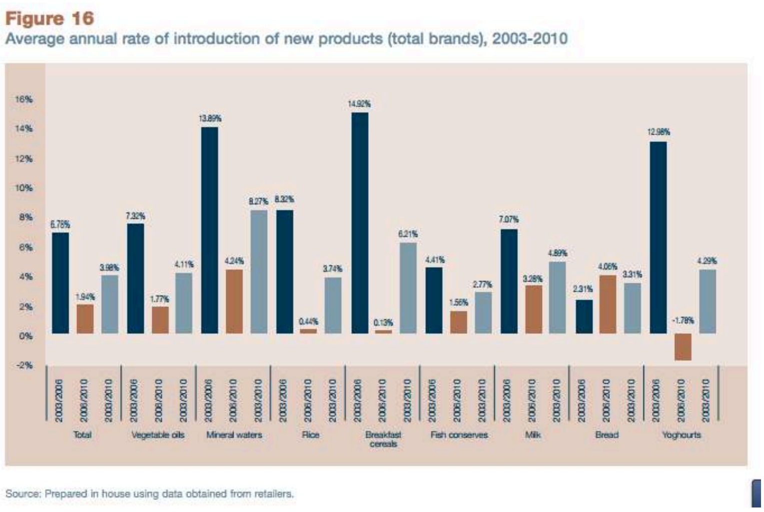


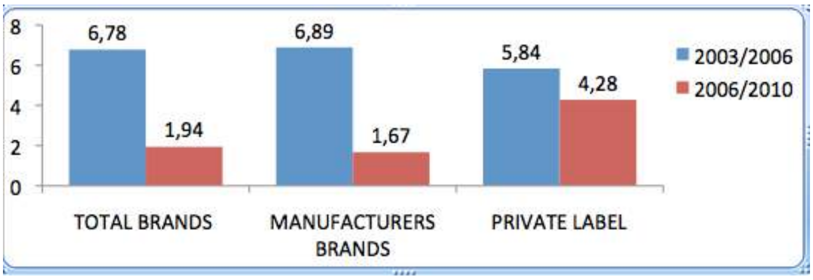
Fuente: "Radar de la Innovación" Kantar Worldpanel

It is impossible to estimate to what extent these practices account for the growth of the affiliated brands' market share to 52% but the end result is that overall innovation in the market (comprising the innovation of both unaffiliated and affiliated brands) has progressively declined for a long period of time. As predicted by the economic literature, overall innovation follows a downward trend in the Spanish market (-32% in the 2010-2017 period):



This harm on innovation was also identified in a market investigation of the food supply chain published by the Spanish Competition Authority in 2011. The report found a 71% decline over 2006-2010 as compared with the 2003-2006 in the eight product categories analysed:





Source: PROMARCA based on the report's tables.

This led the Competition Authority to conclude that "*in summary, although for the time being the indicators are not conclusive, there are reasons to surmise the existence of medium to long-term risks that the current Spanish retailing model may reduce innovation in the grocery industry*"[13].

The data and conclusions on the Spanish market can be extrapolated to the whole of the EU because the competitive bottleneck status of the leading supermarkets and their practices vis-à-vis their suppliers are the same across the EU. Indeed, the study "*The economic impact of choice and innovation in the EU food sector*", commissioned by DG COMP and published in 2014, found a reduction of innovation[14] – despite the unduly broad definition of innovation used, which included me-too products and was not limited to first-to-market ones - and a tipping point of private label market share in each Member State around 35%, above which choice and innovation face a progressive reduction[15]. The study incurred in some other methodological flaws/limitations (e.g.,

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[13] Spanish Competition Authority, "Report on relations between manufacturers and retailers", 2011, p. 6.

[14] Commission press release, "Commission publishes results of retail food study", 2 October 2014, http://europa.eu/rapid/press-release_IP-14-1080_en.htm: "*However, the number of innovations reaching the consumer each year has decreased since 2008 by 6.5%. In 2004 innovation essentially consisted of new-to-the-world products and range extensions (e.g. new flavour), whereas in 2012, roughly a third of all innovations merely concerned the packaging of a product*".

[15] Commission press release, "Commission publishes results of retail food study", 2 October 2014: "*Moreover, the share of private labels in the assortment does not have a significant impact until it reaches a high level (depending on the category) at which it may become detrimental for choice and innovation*". The importance of this finding led the European Commission to ask the authors of the study to conduct further work to refine their analysis on the impact of private label penetration on choice and innovation. The European Commission forwarded to the participants in the public presentation of the Report the new findings on this issue: "*In the conference on the report in October, it was highlighted that the relationship between private label penetration and the measures of choice and innovation appeared to be non-linear. Specifically, graphical analysis of the relationship (see section 9.6 the report) suggested that after a certain "tipping point", private label penetration is associated with a decrease in*

highly concentrated Member States were not included, the measurement of supply concentration and bargaining power - based on comparison of supply/retail concentration – were flawed by the exclusion of affiliated brands from the supply concentration analysis and procurement alliances were not included) that, if corrected, would only aggravate the reduction of innovation, the tipping point and the supermarkets' bargaining power[16].

Kantar WorldPanel applied the same econometric analysis in the Spanish market and extended the sample of categories to account for the largest part of the market, reaching almost identical results. The benchmark analysis of 103 categories in the period 2011-2013 lead Kantar to conclude that private label market share above 35% (in value terms) penalises innovation and growth in the market[17].

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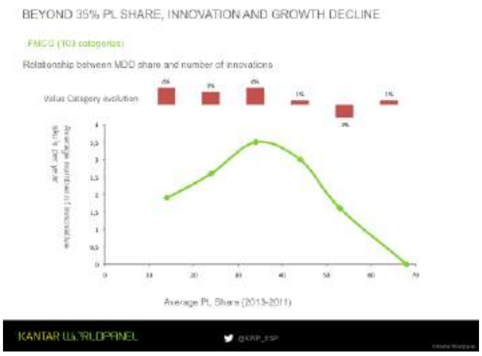
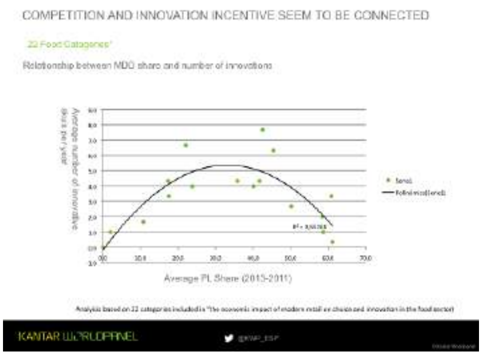
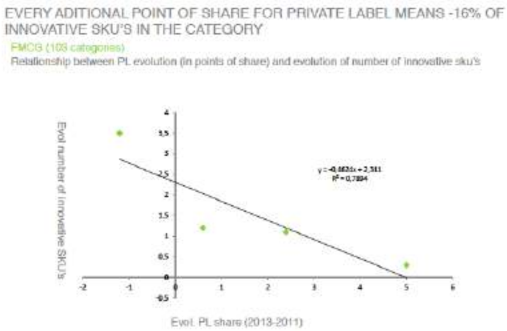
innovation. This relationship would have been inadequately captured in the initial analysis however, which tested for a linear relationship. In order to refine the analysis, the Consortium has now tested for a non-linear relationship between private label penetration and our measures of choice and innovation. Under the refined analysis, the results suggest that there is a statistically and economically significant negative relationship between private label penetration and innovation. Moreover as the relationship is non-linear, the higher the level of private label penetration, the steeper the decline in innovation. The refined analysis suggests however that the impact of private label penetration on choice was not economically significant." Accordingly, the final version of the Report now reads as follows in page 35: "*High shares of private labels were associated with less innovation. We found evidence that a larger share of private labels at local level was associated with less innovation, an effect which is larger for cases with higher shares." Annex 9.6 of the Report has also been amended accordingly and now the authors acknowledge a significant negative impact of incumbent labels on innovation and, to a lesser extent, on choice*".

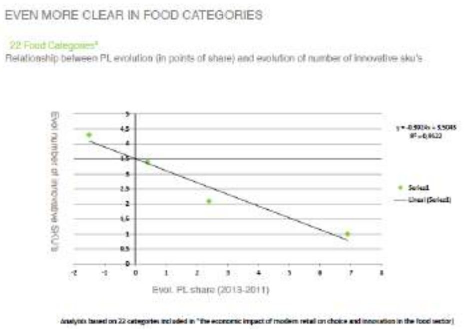
16 See AIM's comments to the public consultation on the study available at the European Commission Competition Directorate's website, http://ec.europa.eu/competition/sectors/agriculture/overview_en.html.

17 See PROMARCA's comments to the public consultation on the study, available at the European Commission Competition Directorate's website, http://ec.europa.eu/competition/sectors/agriculture/overview_en.html. The Kantar WorldPanel study is included in Annex 3 of the Promarca's comments.

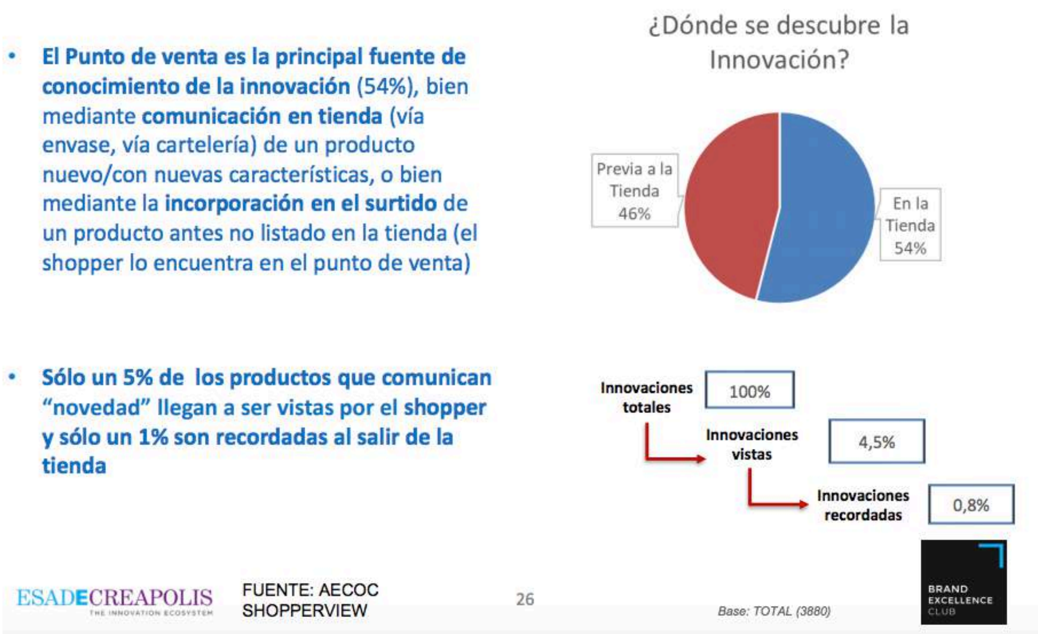








Finally, it is worth mentioning that several of the supermarkets' practices and market dynamics are opaque. In particular, consumers are not aware of them or unable to discipline them (behavioural economics explains how consumers exhibit inertia/loyalty to their preferred supermarket and in-store purchases). For example, consumers learn about innovations primarily in-store (54%), therefore, access of the innovation to the shelf is vital to reach the consumer and a favourable shelf-placement is also vital because only 5% of the innovations on the shelves are identified by in-store shoppers (ESADE, “Análisis del acceso de los consumidores a la innovación en el mercado español de gran consumo”, 2018):



2.2 Consumer harm reflected in less choice

As claimed by the economic authors quoted above, the introduction of affiliated brands has come at the expense of and not to supplement unaffiliated brands. Indeed, since leading supermarkets are vertically integrated, they have the incentive to exploit and foreclose unaffiliated brands to the benefit of their own brands and to the detriment of other retailers. The study commissioned by the Commission also found that the growth of affiliated brands beyond a tipping point also decreased choice but without a statistically relevant impact. One can only wonder if the impact found would have been higher absent the methodological limitations (exclusion of highly concentrated national retail markets) and flaws.

In support of this proposition, an ESADE report on choice in the Spanish retail market (leading 15 retailers) in the 2007-2013 period found that the total number of SKUs listed had decreased by 3%. This negative figure reflected a substantial decline of the unaffiliated brands’ SKUs listed (-9%) which was not compensated by the increased number of affiliated brands’ SKUs listed (+15%). This reduction in choice contrasted with the increase in the available shopping space (+15%) and the number of stores

(+6%), which should have led to an increase in the number of SKUs all else equal[18]. Supermarket stores accounted for the largest reduction in SKU´s (-9%), whereas hypermarkets only reduced variety by 3% and discounters increased it by 18% from a very low level. The leading Spanish retailer, Mercadona, accounted for a large proportion of the decline in the SKUs of independent brands. It expelled 30% of the SKUs of independent brands and increased by 19% its own SKUs. Not surprisingly, bearing in mind that Mercadona is only present in the supermarket segment, the decline of the independent brands' SKUs is more marked in supermarkets (-17%) than in hypermarkets (-7%).

Furthermore, the report did not account for the fact that many retailers source their own brands from a single supplier. Sourcing of supermarkets' brands from common suppliers undermines substantive variety/choice (i.e., only the brand and packaging are different). This sourcing strategy by supermarkets and their alliances not only undermines variety but also harmonises costs across retailers' own brands and reduces competition among them.

2.3 Consumer harm reflected in higher (quality adjusted) prices

Bergès-Sennou, Bontems and Réquillart cautioned against the traditional view that affiliated brands pushed retail prices down and noted how some studies had shown price increases for both affiliated and unaffiliated brands. A comprehensive report of the Spanish retail market by the Brattle Group showed that prices of affiliated brands increase over time as they grow in market share but it also showed that prices of unaffiliated brands also increased (although relatively less) reflecting an increase in the retail margins earned on them rather than an increase in their procurement costs[19].

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18 ESADE, "Estudio sobre Surtido" (2014), annex 4 of the Promarca's comments to the "The economic impact of choice and innovation in the EU food sector".

19 The Brattle Group, "Competitive Assessment of the Spanish Food Supply Chain", 2012, Annex 1 and 2 of the Promarca's comments to the public consultation on the study "The economic impact of choice and innovation in the EU food sector": "*The results of the econometric study, performed to determine the effect of market concentration and the introduction of ROBs on consumer prices, allow us to conclude that:*

(1) The increased market power of retailer chains in Spain does not translate into lower consumer prices. Moreover, in the case of ROBs, in almost half of the products analysed the price has increased.

Brattle found that unaffiliated brands could be sold to consumers at considerably lower prices if their retail prices reflected the same retail margins earned by supermarkets on their own brands:

According to our analysis, retailer chains do not appear to pass on to their customers the lower wholesale prices that they may obtain due to their increased bargaining power with suppliers;

(2) In general, ROB prices increase in line with the increased penetration of the ROB;

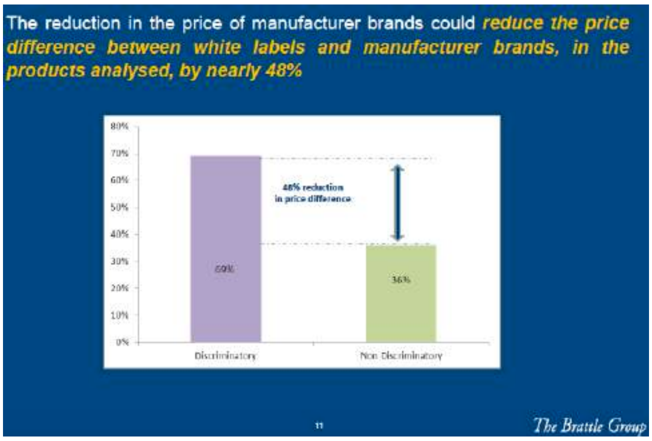
(3) MB prices also increase in line with the increased penetration of ROBs. The limited degree of effective competition in the retailer market allows retailer chains to increase manufacturer brand prices with the aim of widening the competitive advantage of their own retailer own brand products;

(4) In several products, we observed that, as ROB penetration increases, the price difference between ROBs and MBs decreases. This is because the price increase of ROBs is generally higher than price increases in MBs when ROB penetration grows.

The report presents empirical evidence that vertically integrated retail chains have the incentive to increase the margin on manufacturers' products versus equivalent ROB products to encourage the consumer to purchase ROB products. This usually occurs in MBs with a loyal client base. This practice places MBs at a competitive disadvantage and distorts competition between MBs and ROBs, because the ability of the MBs to compete is weakened due to the retailer's commercial policies. The commercial policy of "cross-subsidies" harms consumers who are loyal to a MB when the price of this brand goes up. In the medium and long term, it is logical to think that the growth in retailer bargaining power will result in an increase in the price of ROB products, which will negatively affect ROB consumers. Discriminatory policies may also result in the disappearance of second-tier MBs, and a reduced ability and incentive for manufacturers to innovate.

Evidence suggests that MBs, and not ROBs, are the drivers of innovation and growth of the basic consumer goods sector in Spain. It is therefore important to ensure that effective competition exists between manufacturers, in order to promote innovation and investment in the Spanish food sector.

The growing concentration of the retail market, the increase in their bargaining power, and the penetration of their own brands, all limit innovation by manufacturers, and will negatively impact Spanish consumers in the medium and long term."



Indeed, leading supermarkets which grow into competitive bottlenecks have all the incentives to launch their affiliated brands because they serve to differentiate them and reduce price competition between them and other supermarkets and they also focus supermarkets' efforts on ensuring that unaffiliated brands' overall procurement and retail prices are high (price-signalling)[20]. This reduces the capacity of unaffiliated brands to favour price-competition. Understandably, no economic study has ever showed that the growth of affiliated brands is correlated with lower retail prices. Indeed, Switzerland is the most expensive country (calculated using purchasing power parities) for food and non-alcoholic beverages and the share of affiliated brands in the country is the highest alongside Spain.

Furthermore, economists of the European Commission's Joint Research Centre found econometric evidence that Member States with more stringent rules on UTPs have enjoyed lower food price increases than Member States with less stringent rules in the 2005-2016 period[21]. This evidence points to a lack of pass-on of the rents unfairly

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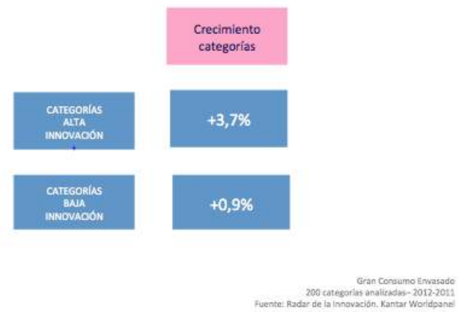
[20] Leading supermarkets do not have an incentive to outcompete each other and smaller supermarkets on procurement and retail prices but rather to grow the value of their own brands (in volume and prices) whilst extracting fees and charges from unaffiliated brands as long as they are listed.

[21] Commission staff working document impact assessment, Annex C.6 - Rules on UTPs and price evolution, pp. 111-113: *"One concern about regulating UTPs that is often referred to is that they could result in increased prices for consumers, in particular if they result in legislating practices which may result in efficiency gains at the chain level. Other views are that they could lead to efficiency gains and lower consumer prices if such regulation results in the building of trust and decreased transaction costs. Swinnen and Vandevelde (2017)367 group Member States based on how they have undertaken action to combat UTPs by considering two criteria (i) the type of legislation used (legal treatment of UTPs) and*

extracted by retailers from suppliers and the waterbed effect identified in the economic literature. The large retailers' practices that favour their affiliated brands at the expense of unaffiliated brands allow for the same rent capture (lack of pass-on) and facilitate the same waterbed effect.

2.4 Consumer harm reflected in less value (output)

Kantar WorldPanel's "Radar de la Innovación" in the Spanish retail sector has evidenced that FMCG categories with lower innovation rates exhibit lower/negative category growth:



Indeed, this shows that consumers do value innovation and are willing to pay for it. Sometime it is argued that mature categories are inherently less innovative and therefore offer a natural ground for affiliated brands. However, there are no such mature categories, it all depends on the existence of the right incentives to innovate. The sandwich bread category illustrates this reality:

(ii) the coverage of UTPs in their legislation. Then using these two criteria, they develop a ranking of MS on the base of the stringency of their UTP regulatory framework. A preliminary work by the JRC compared this ranking of Member States with the evolution of (deflated) consumer price for food for 2010-2016 (see Figure 11). The comparison shows that the correlation between the stringency of UTP rules (1) and consumer food prices is weak (Member States with the more stringent rules on the left in figure 10). Many factors other than rules on UTPs are at play in the determination of the evolution of food consumer prices. If anything, the poor correlation shows that Member States with more stringent rules seem to enjoyed lower food price increases than Member States with less stringent UTP rules. There are similar results for longer periods (2005-2016; see figure 11).

The fundamental problem with vertically integrated competitive bottlenecks is that their dual role distorts not only the competitive process within the platform, it also the competitive process in the platform market and in the markets for the products/services sold through them.

Innovation and quality improvement is the source of competitive rivalry and economic growth and "*the manufacturer strives to improve its product quality or to promote its brand because it believes this conduct will lead to increased demand despite higher prices*"[22]. In the FMCG sector, as in all other sectors of the economy, the Strategic Rivalry model associated with competition between unaffiliated brands brings more

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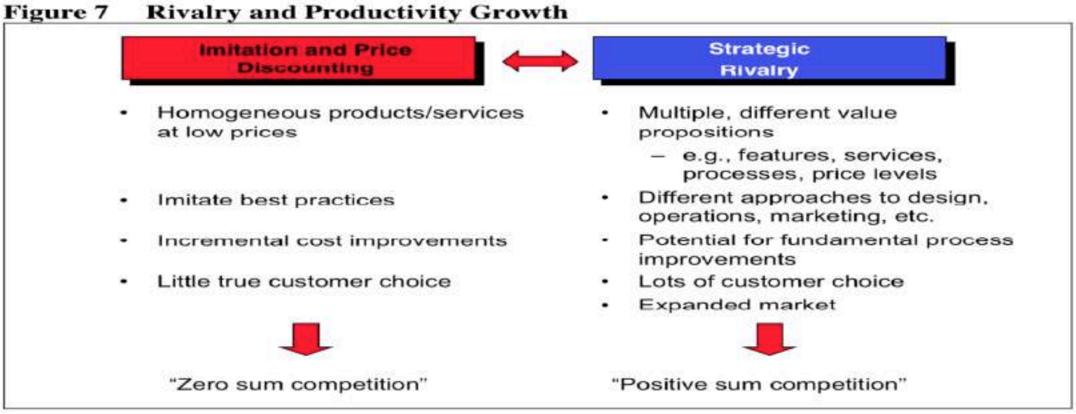
[22] See Orbach, "Antitrust vertical myopia: the allure of high prices", Arizona Law Review 50, 2008, p. 277: "*The underlying premise of antitrust laws is that, for any given product, consumer welfare is inverse to the product's cost to the consumer, which includes its nominal price, search costs, and other costs. This assumption is also one of the most fundamental working tools of standard economic analyses…While the premise that "paying less is better" seems rather straightforward, contradicting market phenomena are widespread and their causes are equally straightforward: many people are willing to pay a premium for a brand, irrespective of quality and other tangible benefits*"; p. 278: "*Prices sometimes even influence perceptions of quality: scientific evidence shows that increases in wine prices tend to affect positively the perceived flavor pleasantness of wines. These findings are consistent with other studies that show that information about beer brands affects the pleasure of drinking beer. Some studies indicate that, in certain circumstances, consumers who pay discounted prices may derive less actual benefit from consuming the product than consumers who purchase the same product for a full price*"; and p. 279: "*The resentment for loss-leader pricing among many manufacturers of branded goods is yet another reflection of manufacturers' preferences for high prices. They believe that, although in the short term low prices may boost sales and revenues, in the long term low prices would damage their product image and result in decline in demand*."

economic and consumer welfare than the Imitation and Price Discounting model associated with vertically integrated competitive bottlenecks[23]:

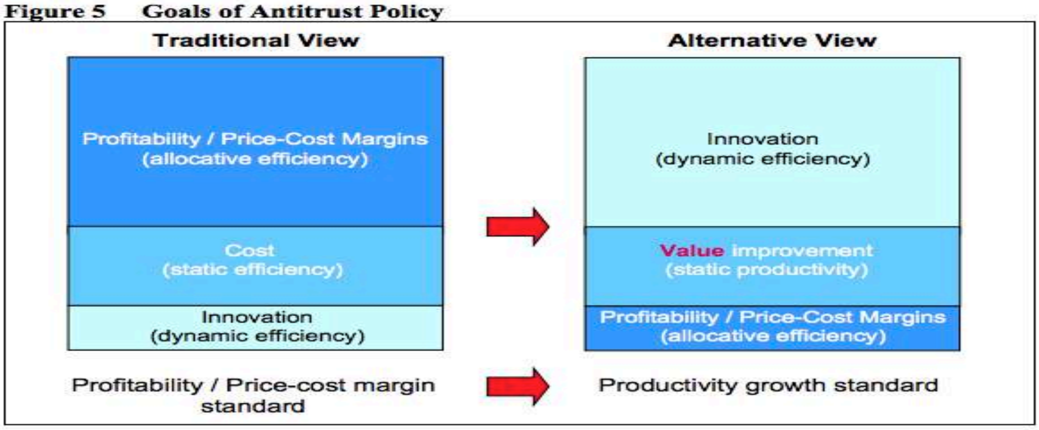
Figure 7 Rivalry and Productivity Growth



Source: Michael Porter, "Competition and Antitrust: A Productivity-Based Approach".

Understandably, the promotion of the Strategic Rivalry Model calls for an increased focus of competition policy on innovation and dynamic competition:

Figure 5 Goals of Antitrust Policy



Source: Michael Porter, "Competition and Antitrust: A Productivity-Based Approach".

3 Offline competitive bottlenecks such as Supermarkets show the way forward to online competitive bottlenecks

Supermarkets' competitive bottleneck status and their restraints on unaffiliated brands show the way to online competitive bottlenecks. Indeed, competitive bottlenecks such

[23] Porter, Michael E. "Competition and Antitrust: A Productivity-Based Approach to Evaluating Mergers and Joint Ventures." Antitrust Bulletin 46, no. 4 (Winter 2001): 919–958. (Revised May 30, 2002.), available at: https://www.hbs.edu/faculty/Pages/item.aspx?num=46903

as leading CRS/GDS[24], ISPs, credit card networks and marketplaces tend to exhibit the same dual role conflicts and exploitative abuses. Commissioner Vestager has expressed its concerns about the dual role conflicts exhibited by online platforms and the harmful effects on innovation. DG COMP has also opened a preliminary investigation into Amazon's dual role. Other national competition authorities have opened investigations into Google and Apple's market places for apps. These initiatives invite a comparison with the supermarkets' dual role.

The missing link in the supermarket sector is the finding of a single dominant position. That could also be the case in the online platform world (e.g., Amazon and Apple). However, the absence of a dominant position cannot mask the impact on consumer welfare of competitive bottlenecks' dual role. Google's market share in the mobile operating systems is substantially high whereas Apple's market share is relatively small. Yet both companies exploit their dual role and other operating systems would be able to do the same once they reached some relevance. Behavioural economics explains that consumer inertia/loyalty (categorised as single-homing in economic terms) reinforces this bottleneck status[25]. The leading supermarkets in the national markets play exactly the same competitive bottleneck role, favoured by consumers' one-stop shopping

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24 Council Regulation 2299/1989 provided for (1) open, fair and non-discriminatory terms of access by airline carriers and travel agents to the services of CRSs, subject to available capacity and technical constraints beyond control of CRSs; (2) fair and non-discriminatory competition within each CRS; (3) legal and functional separation between CRS and their parent airline carrier(s) These remedies resulted in airlines divesting their stakes in CRSs. It cam be concluded that the implicit prevention of vertical integration (though the prevention of dual role conflicts) led to a more competitive market outcome in the CRS and airline sectors.

25 Fiona Scott Morton, Pascal Bouvier, Ariel Ezrachi, Bruno Jullien, Roberta Katz, Gene Kimmelman, A. Douglas Melamed, Jamie Morgenstern, "Report of the Market Structure and Antitrust Subcommittee", Committee for the Study of Digital Platforms, George J. Stigler Center for the Study of the Economy and the State, The University of Chicago Booth School of Business, 2019: "*Additional barriers to entry are, ironically, generated by the very consumers who are harmed by them. Consumers do not scroll down to see more search results, they agree to settings chosen by the service, they single-home on one platform, and they generally take actions that favor the status quo and make it difficult for an entrant to attract consumers. In general, the findings from the behavioral economics literature demonstrate an under-recognized market power held by incumbent digital platforms*".

pattern and inertia/loyalty to the preferred store[26]. Therefore, FMCG form part of a single shopping basket comprising hundreds of products and, therefore, unaffiliated brands are dependent on the largest supermarkets (aggregators of FMCG in a one stop shopping point) to reach a sufficient number of shoppers and to be viable. Furthermore, the singularities of the FMCG retail sector make the emergence of pure online operators extremely difficult, if not impossible.

Competition authorities and academic experts warn against the potential impact on innovation and choice flowing from the practices of the online competitive bottlenecks but it is difficult to present any empirical evidence pointing to a reduction of innovation and choice, either because it is impossible to estimate the missed innovation or because online competitive bottlenecks are a relatively new phenomenon and the effects of their practices need time to materialise and are difficult to observe. However, there is no reason not to look at other competitive bottlenecks such as supermarkets and draw conclusions from their practices and their effects.

4 Competitive bottlenecks' dual role conflict demand similar remedies across sectors

Supermarkets and online platforms are perfect examples of competitive bottlenecks that follow a vertical integration path in order to exploit their market power. This dual role raises conflicts and leads to anticompetitive practices but the businesses that have vertical dealings with them have no choice but to formally or informally consent to these practices out of fear of being refused access to the competitive bottlenecks' platform for reaching consumers.

The challenge faced by competition policy is how to respond to the anticompetitive restraints imposed by the leading competitive bottlenecks in a concentrated, very often oligopolistic, market structure. Academics tend to favour sector-specific regulation over competition policy in order to deal with competitive bottlenecks[27]. The truth is,

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26 Supermarkets' shopping data cannot be matched by online platforms because it takes place primarily off-line and only they observe and can influence in-store shopping behaviour. Furthermore, they control shopping data for all unaffiliated and affiliated brands.

27 Fiona Scott Morton, Pascal Bouvier, Ariel Ezrachi, Bruno Jullien, Roberta Katz, Gene Kimmelman, A. Douglas Melamed, Jamie Morgenstern, "Report of the Market Structure and Antitrust Subcommittee", Committee for the Study of Digital Platforms, George J. Stigler Center for the Study of

however, that the practices of competitive bottlenecks across economic sectors (e.g., supermarkets and online platforms) are very similar, if not identical. The reform of the VBER offers a unique opportunity to adapt competition policy to the new market dynamics and the challenges posed by competitive bottlenecks. For decades, the assessment of vertical restraints has focused on supplier-led practices. The new economic paradigm calls for a new focus on competitive bottlenecks and a revision of the concept of agreement, the market share threshold and the vertical restraints.

4.1 The definition of agreement

Currently, the definition of agreement under Article 101 TFEU is interpreted expansively to cover seemingly unilateral practices of suppliers that require the express or tacit adherence of resellers. This interpretation should also cover seemingly unilateral practices of competitive bottlenecks that require the express or tacit adherence of resellers. In particular, suppliers need long-term relationships with competitive bottlenecks and they have no choice but to consent to the misuse of their sensitive commercial information, discriminatory category management practices and all sorts of fees in order to continue dealing with them.

4.2 The market share threshold

The current supplier-buyer threshold should be adapted to the competitive bottleneck framework. In particular, the threshold should apply to their activities on both sides (e.g., supermarkets may hold substantially higher shares in a certain retail market than in the procurement market). Furthermore, the Commission should evaluate whether a specific lower threshold (e.g., 20%) for two-sided operators (defined by the nature of their activities - e.g., those offering services to both sides – and/or the sectors covered – e.g., supermarkets, online market places and other two-sided markets) is required in order to take into account the nature of competitive bottlenecks.

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the Economy and the State, The University of Chicago Booth School of Business, 2019: "*Antitrust law has maintained legitimacy and widespread support for nearly 130 years in part because it applies to all forms of commercial activity and is not perceived as special interest legislation. In our view it is very important that antitrust law not have different rules aimed at different sectors—such as technology149 or agriculture150—that would differentiate industries and undermine political support for antitrust law in general. For this reason, the report outlines a number of useful digital platform interventions that can be undertaken by a sectoral regulator rather than falling to the task of antitrust enforcement*."

4.3 Competition restraints

The most flagrant anticompetitive restraints relate to the misuse of the sensitive commercial information provided/generated by the unaffiliated brand in order to favour the affiliated brand, category management that treats unaffiliated brands less favourably and the charging of fees for unwanted services or not borne by the affiliated brands. These practices raise costs of rival brands and are aimed at foreclosing them on the market based not on consumer preferences but on the privileges afforded by their competitive bottleneck status and their dual role. Unaffiliated brands engaged in a permanent relationship with competitive bottlenecks consent to these recurring practices as long as they are dealing with them because they cannot replace them. The supermarkets sector illustrates better than any other sector the practices that have raised concerns in the online world.