Private Labels: Challenges for Competition Law and Economics

Hila NEVO[*] & Roger VAN DEN BERGH[**]

This article deals with the competition concerns that arise from the continuing growth of private labels. It provides an overview of the existing knowledge in economics and discusses how competition authorities may profit from this knowledge in assessing potential anticompetitive effects in retailing markets. Private labels increase retailers' power by strengthening their gatekeeper's role. On upstream markets, private labels may enable large retailers to obtain more favourable contract terms from manufacturers that may put at risk the financial viability of the latter. On downstream markets, the popularity of private labels may allow powerful retailers to increase their market shares. Even though empirical research is still inconclusive in establishing a link between the growth of private labels and abusive buyer power, recent trends observed in groceries markets justify an analysis of likely anticompetitive effects. Insights from transaction cost analysis may help in clarifying the impact of buyer power as bargaining strength and improve the competitive assessment of private labels. The article suggests an inverse Small but Significant and Non-Transitory Increase in Price (SSNIP) test to define relevant markets and proposes a framework to balance pro- and anticompetitive effects of private labels, which could be used by competition authorities.

1 INTRODUCTION

Private labels are products that are developed, branded and marketed under a retailer's name, rather than by a manufacturer under its brand name. The retailer outsources the production of the goods to upstream manufacturers, with whom favourable contract terms for production and delivery are negotiated. Private labels are a growing business to European retailers, as the last couple of decades have witnessed an expansion in their role and scope across various product categories, most prominently in the food supply chain. This trend is mainly attributed to the prices of private label products. As the purchasing power of many households has been negatively affected by the economic crisis, thus making prices a main concern, private labels successfully challenge the prices of branded goods and satisfy altered consumption choices.

Side by side with the growth of private labels, the European food retailing industry has changed considerably, witnessing strong development coupled with an

[*] Tel-Hai College and University of Haifa.

[**] Erasmus University Rotterdam Email: nevohila@gmail.com and r.vandenbergh@law.eur.nl.

Nevo, Hila & Van den Bergh, Roger. 'Private Labels: Challenges for Competition Law and Economics'. *World Competition* 40, no. 2 (2017): 271–298.

increased share of grocery sales across many European countries.[1] In this process, the position of retailers has shifted, allowing large retailers to expand their market shares in many EU Member States and boost the overall degree of concentration. Whilst in 2000, the top ten European food retailers accounted for a 26% market share, in 2011 their market position climbed up to 31% of the food retailing market.[2] An important aspect of the above developments is the growth of discount stores.[3] Empirical research shows that discount stores have increased their sales areas by 81% between 2000 and 2011 across the EU, compared with a 46% increase in total sales areas of hypermarkets and 26% of sales surfaces in supermarkets during the equivalent period.[4] Such stores have further experienced a major expansion in their number of outlets, available floor space, overall sales and product variety.

The increasing concentration in the retailing sector, together with the continuing growth of discount stores, has shifted the balance of power in the traditional wholesale-retail relationship. In modern retailing markets, large retailers may occupy a 'bottleneck' position that allows them to control the interaction of brands. In upstream markets, where manufacturers sell to retailers, the latter may use their superior bargaining position to extract favourable contract terms from the former. In downstream markets, where retailers sell to end-consumers, vertically integrated supermarkets may prioritize their private labels to the detriment of branded goods. In extreme cases, powerful retailers may refuse access to the 'bottleneck', thus hindering the access of brand manufacturers to end-consumers. Viewed through a competition law prism, several important questions emerge. Do private labels broaden the scope for abuse of buyer power in upstream markets? Can private labels be used strategically to limit competition in downstream markets, so that the lower prices for consumers will not last? Does the introduction of private labels increase or reduce product quality and variety? Does an increasing share of private label sales negatively affect innovation? If competition concerns arise, are the current prohibitions of competition law able to prevent welfare losses and protect consumers' interests?

---

1 For an extensive review and analysis of current European food sector trends, *see* European Commission, *The Economic Impact of Modern Retail on Choice and Innovation in the EU Food Sector*, Final Report (Sept. 2014), http://ec.europa.eu/competition/publications/KD0214955ENN.pdf (accessed 22 Dec. 2016); *See also* European Commission, *The Impact of Private Labels on the Competitiveness of the European Food Supply Chain* (Jan. 2011).

2 European Commission, *supra* n. 1, at 31–32.

3 *See* generally: University of Oxford, Institute of European and Comparative Law in conjunction with the Centre for Competition Law and Policy, *Trends in Retail Competition: Private Labels, Brands and Competition Policy*, Symposium Report (May 2012).

4 European Commission, *supra* n. 1, at 25.

This article analyses the potential impact of private labels on the competitive dynamics of retailing markets and its implications for competition law. It follows a standard Law and Economics approach by investigating how economic insights on buyer power may inform competition law and contribute to an effective control of the potential anticompetitive effects of private labels. Following this introduction, Section 2 describes contemporary trends in retail competition. It discusses the reasons underlying the growth of private labels and the peculiarities of the underlying market strategy followed by large retailers. Thereafter, it assesses the potential impact of buyer power of supermarket chains on retail competition. In the economic analysis, particular attention is given to the question whether private labels may generate anticompetitive effects by reducing product variety and consumer choice. Section 3 analyses whether current rules of competition law (merger control, abuse of dominant position) are able to cope effectively with the potential anticompetitive effects of private labels and protect consumer welfare. Section 4 summarizes the article's main findings and proposes questions for further research.

2 THE GROWTH OF PRIVATE LABELS AND THEIR EFFECTS ON COMPETITION

In this section, the success of private label sales is explained by discussing the sales strategy of retailing firms (see 2.1). Thereafter, the potential anticompetitive consequences on both the upstream and downstream markets are described (see 2.2).

2.1 The marketing strategy of private labels

Retailers use private labels to provide consumers with better bargains, as well as to increase their profit margins. Private labels also allow manufacturers to diversify their production by offering parts of their output under retailers' brands. As indicated by recent empirical research:

> Offering lower prices is potentially a key reason why the market share of private label has increased in grocery sales over the years – with price being a primary concern of European consumers … [T]he market share of private label products has increased across most product categories in Europe. Key reasons for this likely include a perception among consumers that these products offer good value for money, the opportunity of higher margins for retailers, and a profitable way for manufacturers to make use of spare capacity.[5]

While most discussions emphasize the role of private labels as 'cheap' alternatives to brands, it should be noted that private labels compete across a wide range of

[5] *Ibid.*, at 54.

products and over a full range of product specifications. True, some private labels offer a 'budget' or a 'low-price/low quality' alternative to price-sensitive consumers and thus impose a competitive restraint on the pricing of branded products. This group includes generic brands of poor quality and 'copycat' brands, which imitate the quality and packaging of manufacturer brands. Not all private labels, however, are merely lower-grade substitutes to leading brands.[6] Some private labels are high-quality goods (often labelled 'fine' or 'premium'), which compete on the grounds of quality and innovation and are priced accordingly. Such high-quality products may be initiated and developed by a retailing firm as a direct response to newly identified consumer needs. Examples include catering niche-categories, such as fresh pasta, ready-to-eat meals or eco-friendly food. Moreover, some private labels are used to fill gaps in product categories that are insufficiently served by brand producers. Private labels may encourage innovation if they are introduced to expand supply at different levels of quality ('value innovators'), to enhance the retailer's offerings and to empower his added-value.

Typically, private labels are launched at the retailer's shop at a low entry price, and enjoy some promotional efforts, possibly including shelf-space priority. Empirical estimations confirm that private label lines cost on average 30% less than an equivalent national brand.[7] Further studies indicate that private label products accounted for nearly all of the growth in packaged food, beauty and home care categories during the first decade of the twenty-first century, and for over 30% of food retail sales volume across Western Europe.[8] Consumer surveys further reveal that in most Western European countries, supermarket brands are believed to be a good alternative to other brands, with a good value for money, and quality comparable to that of big brands.[9]

Several economic factors may explain the lower prices of private labels. These products may require lower investments in promotion compared to branded goods. Some retailers (e.g. the Dutch Albert Heijn offering a 'Pure and Honest' product line) attempt to create a 'blanket' promotion for all their private label products. Other retailers (e.g. the German 'Aldi' and 'Lidl') make a good example for high-value/low prices supermarket chains, providing high-quality products at attractive prices, while compromising other product characteristics such as

6 N. Kumar & J. Steenkamp, *Private Label Strategy: How to Meet the Store Brand Challenge* 3 (Harvard Business Press 2007).

7 SymphonyIRIGroup, *Private Label in Europe 2012, Is There a Limit to Growth?* (Oct. 2012).

8 University of Oxford, Institute of Retail Management, *Retail and Wholesale: Key Sectors for the European Economy* 9 (Apr. 2014).

9 A. C. Nielsen, *The Power of Private Label in Europe, An Insight into Consumer Attitudes* (2005).

packaging, designing and brand imaging.[10] Hence, in times of economic slowdown, with prices as a primary household concern, the market share of private label products is rising. The popularity of private labels among consumers will not automatically end when the economy strengthens and it may be expected that their market share will continue to rise, increasingly dominating supermarket shelf-space.

The success of private labels should not conceal the issue that low prices are not necessarily a positive competition factor. The entry of private labels may entail strategic pricing, which may present itself in several forms. The retailer may increase the price of a competing branded product in order to make the private label look cheaper and encourage consumers to experience it. The price of the private label may also be lowered in order to signal a better price-quality ratio compared to the leading brand. Alternatively, the retailer may keep branded products prices volatile, in order to confuse consumers and to indicate sustainability and predictability of the private label choice. Notably, retailers often try to promote private label sales at the expense of the competing branded product, inter alia by attempting to mimic (copycat) branded products packaging and appearance in order to exploit consumer ignorance and to manipulate actual decision-making. Common to all these scenarios is the existence of a visible price gap in favour of the private label, which is kept to foster consumer perception of private labels as a good alternative to branded products. Even when average market prices increase, consumers may not realize the extent of price rises to their full extent when they see the lower prices of private labels on the shelves.

2.2 The use of buyer power by large retailers

Traditionally, retailers were considered to be neutral merchants, whose position was simply to channel and distribute suppliers' goods to consumers. Modern retailers can no longer be viewed as mere purchasers and distributors of branded products. By contrast, large retailing firms (hypermarkets, supermarkets, discount stores) control a substantial part of the brand producers' access to a large number of end-consumers. This confers upon these retailers a considerable degree of bargaining power, which affects the outcome of the bilateral negotiations between retailers and manufacturers and may even enable large retailers to take unilateral decisions affecting prices, product variety and innovation. A modern view of the retail market should relinquish naïve perceptions of the retailers' role and

[10] In addition, the production and sale of private labels may achieve economies of scale and scope. These savings may be substantial when the retailer is vertically integrated in the manufacturing and/or distribution processes, compared to separate wholesale and retail supply chains.

investigate the consequences of a 'narrow group of competitive bottlenecks controlling interaction of brands and consumers'.[11] This interpretation of the current grocery trade goes together with a fear of large-scale abusive practices hurting consumers' interests. To assess whether this view is justified, a careful analysis of potential pro- and anticompetitive effects of supermarkets' buyer power is required.

It is important to note that, when private labels compete head-to-head with branded products, competition takes place at two distinct levels that are interrelated. At the downstream level (retail), private labels compete with branded products over consumers' choice. At the upstream level (wholesale), manufacturers compete for the supply of private label products to the retailer; this competition usually takes the form of a tender process.[12] In addition, there is also competition between suppliers for the retailer's shelf-space; many grocery products do not reach a sufficiently large group of consumers if they are not sold by large retailing firms. Both the tender process and the bilateral negotiations between manufacturers and retailers are influenced by the degree of buyer power on the part of the retail company, which – once offering also a private label –is active on both the upstream and downstream markets. In the tender process, a high retailer's market share on the wholesale market implies an increase in its buyer power and a resulting strengthened bargaining position. However, size in itself is neither a necessary nor a sufficient condition for exercising buyer power. On the one hand, also relatively small companies may enjoy substantial bargaining power if they follow a successful differentiation strategy and obtain at least a high market share on a narrowly defined geographic market.[13] To take one example, in 2014 the German discounter Lidl delisted Coca-Cola, one of the strongest and most favoured independent brands, following a disagreement over contract terms with the company.[14] On the other hand, the economic dependency of manufacturers does not follow automatically from the retailers' large market share, but mainly results from manufacturers' limited outside options (the 'bottleneck' position of supermarkets) and inability to develop alternative sales channels. Below, the competition effects of buyer power on the upstream and downstream markets are further elaborated upon (sections 2.2[a] and 2.2[b]). The welfare analysis,

---

11 J. Berasategi, *Supermarket Power: Serving Consumers or Harming* Competition 9 (Feb. 2014).

12 *See* e.g. Commission Decision of 31 Jan. 2001 in Case COMP M.2097 *SCA/Metsa Tissue* [2001], at paras 24–25, addressing some of the differences in private versus branded products procurement.

13 An example is the successful boycott of a large supermarket chain by two regional German breweries. *See* U. Heimeshoff & G. Klein, *Bargaining Power and Local Heroes*, DICE Discussion Paper No 87 (2013).

14 The Local, *Lidl Takes Coca-Cola of Shelves in Price War* (21 Jan. 2014), http://www.thelocal.de/20140121/lidl-takes-coke-coca-cola-off-shelves-in-price-war (accessed 22 Dec. 2016).

which is crucial to inform the competition law debate, concludes the second section of this article (see 2.2[c]).

2.2[a] *Upstream Market*

The conventional economic analysis of buyer power distinguishes two scenarios: monopsony power and countervailing bargaining power. In price theory, the importance of the monopoly model (a market with a single seller) as a theoretical basis for competition law is well-established; the mirror image of monopoly is monopsony: a market with a single buyer. Price theory also provides useful insights on the transfer of producer surplus and the deadweight loss caused by monopsony. Under monopsony, a single buyer is facing a (very) large number of suppliers. No supplier has the power to individually negotiate better terms and this allows the monopsonist to strategically reduce demand, thereby forcing manufacturers to accept an acquisition price below the socially optimal level, leaving no supplier surplus. Monopsony thus causes allocative inefficiency and results in decreased welfare. It may be added that lower prices in the upstream market only increase the monopsonist's profits and will not benefit consumers. Since the marginal cost of a monopsonist exceeds that of a buyer exposed to competition, output in the downstream market will decrease and discounts will not be passed on to end-consumers.[15] In reality, very few markets correspond to the monopsony model. Often the supply side is also concentrated and there is scope for individual contract design. When large buyers enjoy 'countervailing power', the purchase price will be in-between the monopoly price charged by a would-be monopolist and the monopsony price required by a would-be monopsonist. Following Galbraith's seminal book, countervailing power is often regarded as a procompetitive force since it may prevent monopolistic pricing by powerful sellers and protect consumers.[16] However, the positive effects of countervailing power crucially depend on the intensity of competition in the downstream market. If the latter is restricted, large buyers may not pass-on (part of) the price discounts obtained from manufacturers and end-consumers will not gain any benefit.

Taking account of the major changes in the grocery trade described above, neither the former model (monopsony) nor the latter scenario (countervailing power) adequately describes the superior bargaining position of large retailers. Competition authorities have recognized that even leading brand suppliers may represent a very small percentage of the supermarket's overall volume of purchases.

---

15 For an elaborate technical analysis, *see* R. Blair & J. Harrison, *Monopsony in Law and Economics* 41–67 (Cambridge University Press, 2010).

16 J. Galbraith, *American Capitalism – The Concept of Countervailing Power* (Boston 1956).

As a consequence, the large retailer is far more flexible in deciding the range of products it keeps in store, compared to the producer's ability to adapt its production line.[17] Traditional economic theory is not able to explain the reasons of (non-monopsonistic) buyer power and its possible effects on welfare. Therefore, a different and innovative economic approach is required. Buyer power should be analysed and explained by using a bargaining theoretical model. First, a definition of bargaining power different from monopsony or countervailing power is needed. Second, the constitutive elements of buyer power (among which the marketing of private labels is an important factor) must be identified. Third, the welfare impact of particular practices through which bargaining power is exploited must be assessed.

Unfortunately, economic theory has not yet developed up to the point where it allows a full-fledged welfare appraisal of the use of buyer power by large retailing firms. Among the different economic approaches to competition,[18] transaction cost analysis seems most useful and is, therefore, the main focus of the discussion below. According to the economic definition, transaction costs include the costs of finding contract partners, the writing of contracts and their enforcement. The size of the transaction costs depends on the type of the transaction (simple or complex), its frequency and the need of specific investments required to carry out the transaction.[19] As further explained below, insights from transaction cost theory may both illuminate the factors underlying buyer power and contribute to its welfare assessment.

When analysed as bargaining power, buyer power can be defined as the ability of a buyer to reduce price profitably below a supplier's normal selling price or the ability to obtain terms of supply more favourable than a supplier's normal terms.[20] The normal price can be defined as the supplier's profit-maximizing price in the absence of buyer power. The proposed definition focuses on the economic dependence of manufacturers in their relation with retailers, rather than the market share of the latter. The degree to which manufacturers are economically dependent on retailing firms varies according to the outside options of the former. The retailers' bargaining position will be strong and may provide scope for 'abusive' behaviour if manufacturers have no access to sufficient and reasonably available alternative sales channels.

---

17 *See* Commission Decision of 3 Feb. 1999 in Case IV/M.1221 *Rewe/Meinl* (1999), para. 103. For the US, *see Toys 'R' Us, Inc. v. Federal Trade Commission*, 221 F.3d 928, 931 (7th Cir, 2000).

18 For an overview, *see* R. Van den Bergh & P. Camesasca, *European Competition Law and Economics* (London 2006).

19 O. Williamson, *Economic Organization, Firms, Markets and Policy Control* (New York 1990).

20 Z.Chen, *Buyer Power: Economic Theory and Antitrust Policy*, 22 Res. L. & Econ. 17 (2007).

Numerous factors may increase supermarkets' buyer power. Transaction cost theory highlights two types of costs that may explain the economic dependency of manufacturers: information costs (writing of contracts) and incentive costs (enforcement of contracts). If retailers are better aware of the marketing opportunities of particular products and/or are better placed to organize the distribution of these goods than the manufacturers, the resulting informational asymmetry strengthens the bargaining position of the former. There are several reasons why a retailer may be better placed to organize the promotion of consumer goods than the manufacturer. In several EU countries, consumers reveal a clear preference for 'one-stop-shopping'; they prefer to buy all products they typically need for their weekly household in a single large supermarket ('hypermarket'). Consumers' loyalty to supermarkets may thus become stronger than their loyalty to particular grocery brands. Research in the US indicates that, with the increasing popularity of private labels, brand loyalty declines and consumers become increasingly loyal to specific retailers, rather than a specific manufacturer brand.[21] This trend strengthens the market position of retail chains offering a full basket of weekly needed groceries.[22] In addition, territorial preferences of consumers may exacerbate buyer power. Retailers located in preferred shopping areas will enjoy the greatest bargaining power in their relations with manufacturers.

Next to information costs, incentive costs affect the degree of economic dependency of manufacturers. Incentive costs increase with the size of 'relation specific investments', which are expenditures for which there is no second-hand market. To improve their chances of winning tenders, supplying manufacturers may consider or be required to change the location of their factories (to save on transportation costs) or to adapt their production processes (for example, changes in packaging) to the needs of a large buyer. Complex transactions, due to information asymmetry, which occur regularly and must be supported by specific investments ('asset specificity') are the school example of high transaction costs. The resulting idiosyncratic investments[23] reduce the outside options of manufacturers and make them economically dependent on powerful buyers. Supermarkets may engage in 'hold up' behaviour to the detriment of small suppliers who relocated their factories and changed packaging methods to obtain a long-term supply agreement with supermarkets. Their increased economic

21 Kumar & Steenkamp, *supra* n. 6, at 14.
22 V. Daskalova, *Private Labels (Own Brands) in the Grocery Sector: Competition Concerns and Treatment in EU Competition Law*, TILEC Discussion Paper No. 2012-002 (2012), http://ssrn.com/abstract=1981958 (accessed 22 Dec. 2016).
23 The concept of idiosyncratic investments was introduced by Nobel Prize laureate Oliver Williamson as part of transaction cost theory. *See* Williamson, *supra* n. 19.

dependency makes them extremely vulnerable to excessive demands and threats to be de-listed.

The marketing of private labels by vertically integrated retailers weakens the manufacturers' bargaining position, for two reasons. First, at the upstream level, private labels give retailers additional outside options. In the food retailing industry, the bargaining power of retailers is positively correlated to a larger market share of their own-brand products.[24] Second, private labels turn retailers into competitors of the manufacturers' branded products in the downstream market. With increased concentration on the downstream market, large retailers may become a 'bottle-neck' for suppliers whose position has already been weakened on the upstream market. Major supermarkets may exploit the asymmetric dependency of brand manufacturers in several ways. A powerful retailer may utilize a broad range of practices to this end, from restrictive contractual obligations (e.g. access fee payments in exchange for entering a supermarket's product listing) to simply blocking access to its store. If branded products are de-listed, product variety will decline and price competition may dampen.

2.2[b] *Downstream Market*

The competition effects on the upstream market described above must be distinguished from the consequences on the downstream market, where retailers sell to end-consumers. Generally, the entry of private labels into an existing or a new product category is regarded as a factor that induces more competition. In most cases, private labels compete directly with well-known brands by offering cheaper alternatives to the consumer and thus restrain price increases.[25] Economic research shows that the entry of private labels has often forced leading brand producers to react with price reductions.[26] From a short term perspective, no harm can be seen if consumers prefer a private label product over a branded one, enjoy a greater selection of products and profit from better prices. From a long term perspective, though, the competition effects of private labels in the downstream market are uncertain.

For a long time, economists considered retailing as an industry that does not lend itself easily to collusion, given the large number of players and the ease of

---

24 R. Clarke, S. Davies, P. Dobson, M. Waterson, *Buyer Power and Competition in European Food Retailing* (Elgar: Cheltenham 2002).

25 *See* e.g. Judgment of the Court of First Instance of 15 Dec. 1999 in Case T-22/97 *KeskoOy v. Commission*, [1999] ECR II-03775, para. 130.

26 *See* e.g. R. Cotterill & W. Putsis, *Market Share and Price Setting Behavior for Private Labels and National Brands*, 17 Rev. Indus. Organ. 17 (2000); W. Putsis, *An Empirical Study of the Effect of Brand Proliferation on Private Label National Brand Pricing Behavior*, 12 Rev. Indus. Organ. 335 (1997); D. Mills, *Why Retailers Sell Private Labels*, 4 J. Econ. & Mgmt. Strategy 509 (1995).

entry. However, recent concentration levels in retailing have increased substantially, particularly in the food sector.[27] These increasing concentration trends may give rise to the establishment of local monopolies in the groceries sector. Consequently, collusion or unilateral price increases by large retailers, eventually after a merger, cannot be excluded and the retailing trade no longer features an industry that is totally free of competition concerns. In addition, the positive effects of buyer power as countervailing power should not be taken for granted.

A number of arguments question that buyer power results in low consumer prices. First, the extent to which lower wholesale prices are passed on to consumers may be dependent on the contract design at the upstream level. Two-part tariffs, which comprise a linear component reflecting list prices and a non-linear component reflecting additional favourable supply terms (e.g. compensations paid for hiring shelf-space or marketing efforts), may simply lead to a redistribution of rents between suppliers and retailers. Second, from a long-term perspective, a negative 'spiral effect' may materialize if only few retailers succeed in continuously strengthening their bargaining position at the upstream level. Lower retail prices at the downstream level will then reduce sales of less powerful buyers, which further weaken the bargaining position of the latter towards suppliers and threaten their survival. Third, small- and medium-sized retailers have argued that bargaining power creates a 'waterbed effect'. Suppliers have to compensate the loss of lower wholesale prices granted to powerful retailers by higher wholesale prices for smaller retailers. This results in higher average wholesale prices that in turn lead to higher consumer prices. It must be noted that both the spiral effect and the waterbed effect arguments may be criticized because they lack a theoretical economic foundation and include the risk of protecting inefficient retailing firms. Nevertheless, it may be concluded that the extent to which endconsumers may profit from buyer power is dependent on the degree of competition in the downstream markets. Since supermarkets selling private labels tend to have a group of loyal consumers and this loyalty is less pronounced towards manufacturer brands, powerful retailers enjoy discretion over price and the passing-on of discounts obtained in upstream markets is uncertain.

2.2[c] *Welfare Analysis*

Assessing the welfare effects of buyer power as bargaining strength is a difficult exercise, since it requires a balancing act of pro- and anticompetitive effects. This also applies to the use of private labels, which strengthen the buyer power of retailing firms and generate equally ambiguous economic effects. For the

[27] European Commission, *supra* n. 1, at 50.

normative analysis, both traditional notions of welfare economics and transaction cost theory are helpful. Traditional economic theory emphasizes improvements of productive efficiency (economies of scale), allocative efficiency (lower consumer prices) and dynamic efficiency (innovation). Transaction cost theory distinguishes between types of agreements among market participants that reduce transaction costs and other agreements that increase transaction costs. In the former case, a positive assessment of reduced transaction costs (efficiencies resulting from lowering the information and incentive costs of deals negotiated between manufacturers and retailers) may outweigh potential anticompetitive effects. In the latter case, the absence of reasonable trading alternatives creates 'small number exchanges', which give scope to opportunistic behaviour by market parties possessing superior bargaining power.

On the positive side, private labels may intensify price competition and offer consumers a larger variety and broader choice of products. The gains in terms of allocative efficiency (lower prices) and dynamic efficiency (innovative products sold under private labels) may be important. In addition, when used by a vertically integrated retailing company, private labels may offer a solution to problems of double marginalization.[28] This benefit can be understood as a reduction of transaction costs (in particular, incentive costs) of negotiations between traders who do not take account of negative external effects when each contract party sets its price independently. Double marginalization occurs in situations of successive monopolies. Both a manufacturer with market power and a retailer equally enjoying discretion over price may add a monopoly mark-up to their respective costs. These double monopoly profits lead to lower output and higher prices, thus harming both manufacturers and end-consumers. Private labels offered by vertically integrated retailers overcome this double monopoly mark-up problem.

On the negative side, restrictions of competition may go hand in hand with increased transaction costs. The buyer power of large retailers may enable them to transfer risks to suppliers even when the latter are not superior risk bearers. This behaviour may take the form of a 'hold-up', when large retailers can credibly threaten to discontinue the sale of branded goods if manufacturers refuse to accept lower purchase prices or the transfer of commercial risks. The potential foreclosure effect of these practices will be strongest for suppliers who mainly produce retailers' private labels; they will suffer more from buyer power than suppliers who also sell

[28] This argument was first advanced as an explanation of vertical maximum price-fixing. *See* J. Spengler, *Vertical Integration and Antitrust Policy*, 58 J. Polit. Econ. 347 (1950). However, it applies more generally to full vertical integration and vertical restraints in long-term contracts. For a potentially positive welfare assessment of vertical restraints, *see also* Commission Notice, *Guidelines on Vertical Restraints*, [2010] OJ C 130/1. at paras 106–109.

their own branded products. The bargaining position of the latter depends on the importance of the manufacturer brands and their product portfolio.[29]

Confronted with economically dependent manufacturers, large retailers may foreclose the downstream market for both existing and new brands (by requiring the payment of unreasonable access fees or de-listing branded products) and thus reduce product variety and quality. The foreclosure effect of these practices may outweigh the potential efficiencies generated by the reduction of transaction costs.[30] With the growing acceptance of private labels, the transfer of risks from retailers to manufacturers and the requirement of additional price discounts will further increase. This will put pressure on manufacturers to reduce their production costs. This causes a risk of reduced variety because economically dependent suppliers may decide to reduce their investments in quality and innovation to compensate their lower profit share at the wholesale level. With regard to the fresh food market, a 2010 European Commission Working Document has observed that in all Member States primary food producers – who have not been able to diversify into niche quality markets, nor consolidate into efficient wholesale cooperatives, nor integrate vertically, have seen their margins erode due to the existence of downstream buyer power.[31] The recent 2014 European Commission study on the economic impact of modern retail on innovation similarly mentions the concern that downward pressure on supply prices threatens manufacturers' short-term viability, as well as long-term choice, innovation and quality.[32]

Supermarkets often claim that private labels offer additional choices to consumers. However, there is a danger that private labels increasingly replace established brands because they are more profitable for large retailers. Even though the proliferation of private labels may be procompetitive in the short run, price increases in the long run cannot be excluded. Older empirical studies expect lower prices and a limited increase of product variety.[33] More recent studies expect and observe increasing prices of national brands as a negative consequence of the proliferation of private labels.[34] A long-term analysis of the German groceries sector (covering a six years period and several outlet formats, including

29 Bundeskartellamt, *Tätigkeitsbericht* 2009, 98–99.

30 *See* e.g. Commision Nacional de la Competencia, *Report on the Relations Between Manufacturers and Retailers in the Food Sector* 6 (2012).

31 European Commission, *Staff Working Document on Retail Services in the Internal Market, Accompanying Document to the Report on Retail Market Monitoring: 'Towards More Efficient and Fairer Retail Services in the Internal Market for 2020'* 44–45 (July 2010), ec.europa.eu/internal_market/retail/docs/working_document_en.pdf (accessed 22 Dec. 2016).

32 European Commission, *supra* n. 1, at 39–41.

33 *See* e.g. P. Dobson & M. Waterson, *Countervailing Power and Consumer Prices*, 107 Econ. J. 418 (1997).

34 For the US, *see* A. Bonanno & R. Lopez, *Private Label Expansion and Supermarket Milk Prices*, 3 J. Agri. & Food Indus. Org., Art. 1 (2005); for France, *see* C. Bontemps, V. Orozco, V. Réquillart & A. Trevisiol, *Price Effects of Private Label Development*, 3 J. Agri. & Food Indus. Org., Art. 3 (2005).

supermarkets and discount stores) finds a negative result on the overall price level. This is due to the fact that over time the number of private labels increases while the number of national brands declines. Consequently the total number of products continuously decreases. This negative effect goes together with an increase of the average prices of both private labels and national brands. From the perspective of manufacturers, the decreasing number of products weakens their bargaining position on the upstream market and increases the risk of being delisted. From the perspective of consumers, welfare losses due to price increases largely remain unnoticed because consumers only perceive that current prices of private labels are lower than those of national brands.[35] In the long run, the expansion of private labels may thus lead to reduced variety and higher average consumer prices. These negative welfare effects may outweigh the price decreases in the short run and justify scrutiny under competition law.

3 COMPETITION LAW AND PRIVATE LABELS

Traditional competition law is not well-equipped to deal with the anticompetitive effects of private labels. The reason is that the retailing sector has been generally considered highly competitive, because of its low profit margins, and not easily lending itself to monopolization, because of low entry costs. Hence, most of the competition practice consists of merger review, which should prevent the creation of single firm dominance in local markets, and competition advocacy urging for the removal of legal barriers to entry that exist in a number of EU Member States (e.g. France and Belgium[36]). Moreover, the buyer power of supermarkets has been seen as a positive competitive force, which may limit the power of branded good manufacturers to impose price increases. As a consequence, the prohibitions of competition law have been designed and interpreted mainly as instruments to curb market power on the supply side of the market. Current rules of competition law cannot easily cope with anticompetitive exclusionary effects of superior bargaining power of vertically integrated retailers. Such analysis boils down to a control of unilateral behaviour of a powerful company, which is not necessarily dominant in the traditional sense (Article 102 TFEU), because of its low market share.

The discussion below consists of two parts. First, the assessment of the degree of competition in antitrust terms implies an answer to the question whether private labels and branded goods belong to the same relevant market. The relevant practice

35 R. Olbrich & G. Grewe, *Consequences of Competition Between National Brands and Private Labels. Empirical Results from Different German Outlet Formats*, 37 Int'l J. Retail & Distribution Mgmt. 933 (2009).

36 France: Loi 73-1193 d'orientation du commerce et de l'artisanat (Loi Royer); Belgium: Wet op de handelsvestigingen (Law of 13 Aug. 2004 changed by the law of 22 Aug. 2009).

of the European Commission regarding market definition in merger cases is summarized. It is also argued that the economic insights explained above may improve the quality of the market definition exercise. Second, the difficulties encountered by competition law to prevent the exclusionary effects of private labels are highlighted. A comparison is made between traditional rules on abuse of dominant position and rules that aim at the protection of economically dependent market parties (as they exist, for example, in Germany).

3.1 The definition of the relevant market

In its merger decisions, the European Commission distinguishes between upstream markets, where manufacturers negotiate contract terms with retailers, and downstream markets, where retailers sell to end consumers. This practice is summarized and commented upon.

3.1[a] *The European Commission's Practice*

With respect to downstream markets the relevant question is whether private labels compete with branded goods. In many merger decisions taken in the period 1996–2008, the European Commission concluded that the prices of branded products were constrained by the prices of private labels. If downstream competition is sufficiently strong, branded products and private labels constitute a single product market.[37] A nice illustration is offered by the *Novartis/Alcon* merger case.[38] Evidence from the Commission's market investigation showed that the relevance of private label sales differed across Member States. If the merger was allowed, the parties would hold high market shares in a large number of countries, even when competition from private labels was considered. In the majority of Member States, the merger would combine a 'clear market leader with the current number two or number three'.[39] Hence, on the basis of high combined market shares, the fragmented market structure, as well as the strength of the parties' brands, the Commission identified serious horizontal doubts in a large number of countries. However, in other Member States downstream markets showed a relatively strong private label segment. Taken together with a low combined market share and the presence of other competitive pressures, the latter markets were cleared from further intervention.

37 Commission Decision of 16 Jan. 1996 in Case IV/M.623 *Kimberly Clark/Scott* (1996), at para. 48. For later discussions *see SCA/Metsa Tissue*, *supra* n. 12; Commission Decision of 17 Dec. 2008 in Case COMP/M.5046 *Friesland Foods/Campina* (2008).

38 Commission Decision of 18 June 2010 in Case COMP/M.5778 *Novartis/Alcon* (2010).

39 *Ibid.*, at para. 251.

With respect to upstream markets, the European Commission's approach, as reflected in recent case law, has been different. In *SCA/Metsa Tissue*, the Commission argued that 'the supply of branded and private-label tissue products is characterized by two different sets of competitors who have only limited economic incentives and financial capabilities to seriously challenge each other's product markets'.[40] Hence, the Commission believed that these products constituted separate product markets, given 'substantial difference in the way branded products and private label products are procured. Although supermarkets are the main buyers of both types of product, there is a clear distinction in how they are purchased'.[41] Most relevant to the Commission's assessment has been the fact that branded products and private labels are procured by retailers through a different procedure. The competitive conditions on the markets where retailers and wholesalers source their products may be fundamentally different. In the case of branded products, retailers and suppliers typically transact over various sale conditions such as prices, discounts and promotions. A supermarket can only choose between brands presently marketed by manufacturers in the country where the retailer is located, and the number of suppliers, in certain Member States, is very limited.

However, the story for private label products is inherently different. Here, usually a tender process takes place, followed by price negotiations among the retailer and the winning supplier. The marketing is left to the retailer who decides on issues such as packaging and promotional efforts. Compared to branded products, this process allows supermarkets more readily to switch private label volume between tissue manufacturers with excess capacity.[42] Therefore, the retailer typically enjoys a better bargaining position vis-à-vis the supplier, and can easily switch among suppliers. Accordingly, the Commission in *SCA/Metsa* concluded that at the upstream production and supply level, branded products and private labels belonged to separate markets. Still concerning tissue products, in *SCA/P&G,*[43] the Commission recognized that competitive conditions in the tissue business haven't changed dramatically. Despite the theoretical viability of supply-side substitutability in production, the Commission concluded that only some consumer tissue producers actually supplied both categories. This was due

---

[40] *SCA/Metsa Tissue*, *supra* n. 12, at para. 26. The Commission explicated further at para. 27: 'relative price changes at the wholesale level are not necessarily transmitted fully to the retail level. Retailers may, for instance, choose to reduce their margins instead of raising their retail prices fully in line with an increase in the wholesale price. This possibility was mentioned by some retailers as a likely response to a 5 to 10% increase in their supply price for private label products. The Commission therefore considers that branded and private label consumer tissue products can compete with each other at the retail level, while being in separate markets at the wholesale level.'

[41] *Ibid.*, at para. 23.

[42] *Ibid.*, at para. 25.

[43] Commission Decision of 5 Sept. 2007 in Case COMP/M.4533 *SCA/ P&G European Tissue Business* (2007).

to high entry costs into the branded segment, in the form of considerable investment and time needed to develop a brand and build consumer awareness. The competitive interaction at the procurement level was, in view of the Commission, asymmetric and very partial: brand manufacturers could exert competitive pressure on private label producers, but not vice-versa. In fact, upstream market players appeared divided into brand and private label manufacturers, with SCA as one of the few players having a relatively balanced presence in the production of both categories. Moreover, producers' margins were typically higher for branded products compared with private labels, implying that brand manufacturers were likely to focus mainly on the production on the former, while utilizing the latter to the extent afforded by spare capacity. These differences in market operation appeared to be indicative of separate product markets at the wholesale level. In line with this analysis, the Commission separated the supply of branded products from the supply of private labels for all three categories of tissue products (toilet paper, kitchen towels and handkerchiefs/facials) assessed in its decision.[44]

In the above cases, the European Commission concluded that, even though branded goods competed with private labels downstream, the latter constituted a separate market upstream because of the differences in procurement (tender process). Nevertheless, as it follows from the *Friesland Foods/Campina* case, private labels and branded goods may also competitively restrain each other if the degree of upstream competition heavily depends on the competitive pressures exerted between the two product categories downstream.[45] First, the degree of substitution from an end-consumer perspective may be taken into account in upstream negotiations. Retailers may allocate product volumes and source private labels to suppliers with reference to their expected profitability downstream, as this is affected by consumers' revealed preferences. Second, the more meaningful private label sales are, the greater the competitive pressure they impose on brand suppliers. This is particularly true for suppliers who supply both branded and private label products: these suppliers are more likely to consider, when supplying retailers, substitution between private labels and branded products among end-consumers. In the case at hand, private label sales constituted an important share of dairy product sales (e.g. in the case of fresh milk, close to double that of supplier brands), exerting a significant competitive pressure on brands. In particular, the parties were supplying the bulk of both private label and branded products into the market, and were hence presumed to take into account the substitutability of private label and brands in supplying retailers. The Commission concluded, therefore, that under

44 *Ibid.*, at paras 21–28.
45 *Friesland Foods/Campina*, *supra* n. 37, at paras 179–181.

these circumstances, private labels and branded products belonged to the same product market also upstream.

3.1[b] *Discussion*

The Commission's decisions on market definition in the above merger cases invite some comments. There are good reasons to analyse upstream and downstream markets separately, since the competition effects of private labels are not similar at the different levels of the distribution chain. Relevant upstream markets and relevant downstream markets may be quite different in terms of the products to be included, the geographic region to be covered, or both. Even though the European Commission's decision framework allows for an appropriate assessment of these differences, the methodology used to define the relevant market could be refined.

The definition of downstream markets can be carried out in the conventional way, which concentrates on product characteristics, uses and prices that make products substitutes in the eyes of consumers. However, the definition of upstream markets should focus on seller side substitutability rather than buyer side substitutability. The common Small but Significant and Non-Transitory Increase in Price (SSNIP) test asks whether a hypothetical monopolist would be able to impose a significant and non-transitory price increase above the competitive level. The products for which such a SSNIP would be profitable are to be included in the relevant product market. If a large group of end-consumers switch to private labels in case of a price increase of branded goods, the former constrain the pricing of the latter and both categories of goods must be included in the same relevant product market. This approach is not suitable for the definition of the relevant upstream market. The analysis of upstream markets needs some adaptation since the focus should be not on substitutability from the perspective of buyers but on the degree of substitution from the perspective of manufacturers. The SSNIP test should be adapted accordingly. The relevant question is which buyers are potential substitutes for sellers, taking account of their characteristics (cost structure, size, and product range), uses (consumers' shopping behaviour) and price. To answer this question a comparative assessment of alternative distribution options must be carried out. In an extreme case, where there are no outside options for sellers, the market may be characterized as a monopsony. Linking this exercise to the SSNIP test, the relevant inquiry is whether a hypothetical monopolist would be able to impose and sustain a significant and non-transitory decrease of the purchase price below its normal level. If manufacturers have outside options, the candidate market (distribution through supermarkets) will have to be expanded by including those alternative distribution channels (other buyers, increased production share of branded goods).

In its decisions in merger cases, the European Commission stresses the distinction as to how branded goods and private labels are sourced: through bilateral negotiations for manufacturer brands and through tenders for retailer brands. In the bidding process, so it is argued in the *SCA/Metsa Tissue* case, the retailer determines the quality and quantity of the products to be supplied. 'This process allows supermarkets more readily to switch private label volume between (tissue) manufacturers with spare capacity.'[46] In this way, the Commission is focusing on buyer side substitutability rather than seller side substitutability. However, the relevant question to define the boundaries of the relevant upstream market is not which sellers are comparable options for buyers but which buyers are potential substitutes for sellers. Using the theoretical framework of the SSNIP, the relevant question is whether a buying supermarket would impose a price decrease below the normal level and still remain profitable for a sustained period of time. A supermarket will not be able to impose a price decrease if suppliers can switch to alternative buyers (competing retailers and other large clients, such as canteens and schools) or increase the production and sale of their own brands. The suitability and effectiveness of these outside options depend on their characteristics, use and price: e.g. the size of the share bought by the supermarket, the use of the contract products as an input good and the marketing costs of the branded goods. A (close to) monopsony situation will be rare but it may exist at a regional (local) level when a large group of anonymous suppliers are confronted with a single regional (local) retail company, which also controls the distribution of the products on the downstream market. One could think of milk products as an example: in many EU countries farmers organize themselves in cooperatives to counterbalance the buyer power of supermarkets. However, most buying markets may be national rather than regional and this will make a price decrease unprofitable. Here one notices how important it is to delineate the product market and the geographic market simultaneously, rather than consecutively, to avoid the Type I error of too narrowly defined antitrust markets.[47]

3.2 Abuse of buyer power

In competition practice, one may notice an evolution from a positive assessment of retailers' market power to a more critical approach. In the past, competition authorities assessed buyer power as countervailing power in their competitive

[46] *SCA/Metsa*, *supra* n. 12, at para. 25.
[47] Van den Bergh & Camesasca, *supra* n. 18, at 106–140.

appraisals of mergers. Several mergers were allowed on the ground that post-merger price increases by manufacturers would be implausible thanks to the countervailing power of large retailers. More recently, the beneficial effects of buyer power are no longer taken for granted and concerns about the potential anticompetitive uses of private labels have been voiced. At the same time, it has become clear that the control of the anticompetitive (exclusionary) effects of buyer power may remain ineffective if it requires the existence of single firm dominance (Article 102 TFEU).

3.2[a] *From Countervailing Power to Anticompetitive Foreclosure*

Characteristic for the 'old' view is the trust put on large retailers' countervailing buyer power, which has paved the way for the clearance of mergers between branded good manufacturers in concentrated groceries markets. A good illustration is offered by the Irish *Kerry/Breeo*[48] case, reviewed by the Irish High Court in 2009. The important question from a competition law perspective was whether retailers were in a position to utilize their buyer power to prevent the merged entity from raising prices post-merger. Market evidence indicated that alternative brands did exist (albeit with considerably low market shares), that private labels did compete with the parties' own brands, and that large international players entered the Irish market prior to the merger. While Kerry and Breeo were indisputably each other's closest competitors, the question remained whether these alternative sources of supply were sufficiently credible to allow retailers to exercise countervailing buying power that would restrain the parties post-merger. The parties argued that such countervailing buying power was effectively exercised by retailers on several instances. Their argument was based, among others, upon the retailers' refusal to accept price increases, threats over product delisting, and demands for promotional funding.[49] The Court concluded that post-merger supply was no obstacle to the exercise of disciplinary buyer-power and that retailers' countervailing power was sufficient to deter a price increase by the merged entity.[50]

Recently, competition authorities seem less willing to accept the countervailing power argument, as is illustrated by the *AG Barr/Britvic* merger reviewed by

48 Irish High Court Judgment of 19 Mar. 2009 in Case 2008 145 MCA, *Rye Investments Ltd. v. The Competition Authority*, [2009] IEHC 140. Another example is the *Kerry/Headland* merger concerning the frozen-ready-meals market, reviewed in 2001 by the UK Office of Fair Trading: Decision of 12 July 2011 in ME/4893/11 *Kerry Headland* (2011), at para. 105.

49 Irish High Court Judgment of 19 Mar. 2009 in Case 2008 145 MCA, *Rye Investments Ltd. v. The Competition Authority*, [2009] IEHC 140.

50 For criticism on this decision *see* P. Gorecki, *The Kerry/Breeo Merger: Two Views of Countervailing Buyer Power – The Competition Authority and the High Court*, 5 Eur. Competition J. 585 (2009).

the OFT in 2013. In this case, the Office of Fair Trading (OFT) argued that private label products were not generally present across product categories and that no evidence was provided that the existing buyer power was sufficient to prevent price rises.[51] Over time, competition authorities have become more critical towards buyer power and now stress the potentially 'abusive' practices of large retailers when using their superior bargaining strength vis-à-vis manufacturers. In particular, anticompetitive effects stemming from a growing dominance of private labels have been identified. The European Commission has warned that 'manufacturers (…) suggest that private label brands are undermining investment in innovation by shortening or even eliminating the lead times when "new" innovative products can earn premium returns for the brand'.[52] This view has been further reinforced by the recent European Commission empirical study, which measured the impact of modern retail on choice and innovation, and their evolution over time.[53] The study has shown that while innovations continued to be developed and introduced to consumers across the EU, the number of innovations declined after 2008, and the share of innovations in the total number of products decreased steadily (with a trend towards more packaging innovation).[54] While no general negative correlation could be drawn between large share of private labels and innovative activity, the study did point out that 'beyond a certain level (which varies depending on the product category) it appears that a higher share of private labels is associated with fewer innovative products being offered'.[55] Along similar lines, the UK Competition Commission has expressed its concerns over supply chain practices, due to their possible negative impact on suppliers' incentives to invest in product quality and innovation.[56] If these concerns are justified, there may be a gap in current EU competition law that, outside the field of merger control, does not allow control of anticompetitive uses of private labels in the absence of a dominant position.

---

51 OFT, ME/5801/12, *A.G. Barr plc/Britvic* (13 Feb. 2013).

52 *Staff Working Document on Retail Services in the Internal Market, Accompanying Document to the Report on Retail Market Monitoring: 'Towards More Efficient and Fairer Retail Services in the Internal Market for 2020'*, *supra* n. 31, at 46.

53 European Commission, *supra* n. 1.

54 *Ibid.*, at 28.

55 *Ibid.*, at 37.

56 UK Competition Commission, *The Supply of Groceries in the UK, Market Investigation* para. 9.67 (2008), http://webarchive.nationalarchives.gov.uk/20140402141250/www.competition-commission.org.uk/our-work/directory-of-all-inquiries/groceries-market-investigation-and-remittal/final-report-and-appendices-glossary-inquiry (accessed 22 Dec. 2016). *See also* University of Oxford, Institute of European and Comparative Law, *Trends in Retail Competition: Private Labels, Brands and Competition Policy* (May 2015), https://www.law.ox.ac.uk/sites/files/oxlaw/symposium_report_2015.pdf (accessed 22 Dec. 2016), suggesting at 21 that, as the private label penetration in the market increases, innovation decreases.

3.2[b] *The (In)ability of Competition Law to Control the Anticompetitive Effects of Buyer Power*

The analysis in section 2.2 has shown that a high market share is neither a necessary nor a sufficient condition to show the existence of buyer power. Market shares reflect the concerns of the theoretical monopsony model that has little relevance in reality. It makes more sense to define buyer power in terms of bargaining strength in bilateral relations. Such an approach does not fit the legal dominance concept of Article 102 TFEU. Even though the definition in the case law of the European Court of Justice mentions the degree of independence vis-à-vis other market participants,[57] in daily competition law practice a dominant position cannot be shown in the absence of high market shares. If market shares on the relevant market do not exceed a certain threshold level,[58] the potential exclusionary effects of private labels cannot be scrutinized. The requirement of a high market share does not figure in a number of competition laws of EU Member States (Germany, France, Italy), which aim at protecting market parties who are economically dependent on particular suppliers or buyers. Obviously, if no dominant position must be proven, there are far greater possibilities to control unilateral behaviour of powerful retailers.

Within the limited scope of this article, a detailed comparative overview of national competition laws is not possible; the German Act against Restrictions of Competition ('Gesetz gegen Wettbewerbsbeschränkungen (GWB)') is taken as a clarifying example. The GWB distinguishes between 'absolute' market power ('Marktbeherrschende Unternehmen') and 'relative' market power ('Unternehmen mit relativer oder überlegener Marktmacht'). The abuse prohibition, which includes exploitative behaviour (price abuses) and exclusionary behaviour, applies to firms possessing either of both types of market power. German law includes a broad prohibition of 'unfair' exclusionary behaviour ('unbillige Behinderung') and discrimination without objective justification ('ohne sachlich gerechtfertigten Grund') protecting firms that are economically dependent. These are small and mid-sized companies, which do not have sufficient and reasonable possibilities ('ausreichende und zumutbare Ausweichmöglichkeiten') to conclude contracts with other suppliers or buyers (§ 20, 1 GWB). German law entails a presumption that a supplier is economically dependent of a buyer if this buyer regularly obtains extraordinary benefits that are not granted to comparable buyers (§ 20, 1 *in fine*). A buyer who enjoys relative market power may not abuse this position by demanding benefits without

57 Judgment of the Court of 14 Feb. 1978 in Case 27/76 *United Brands v. Commission*, [1978] ECR 207.

58 The European case law indicates that the lower bound of this threshold is approximately 45%. However, if the market share is not very high (60% and more) additional competitive advantages must be shown to prove dominance.

objective justification. The decision practice of the German cartel authority (Bundeskartellamt) shows the following examples of benefits that are not objectively justified: long payment periods that systematically grant supplier credit to the large retailer and 'wedding rebates', which are retroactive adjustments of buying conditions after the conclusion of a merger.[59]

Compared to EU competition law, German rules better enable a control of buyer power. The German definition includes superior bargaining power and thus reflects the important insight that a market share approach grounded in the monopsony model may be inappropriate to control the anticompetitive effects of buyer power as bargaining strength vis-à-vis economically dependent manufacturers. As explained above, private labels are an important constitutive element of such power. An unresolved issue remains. The German experience shows that, in spite of a broader prohibition (§ 20 GWB),potential claimants still tend to refrain from bringing actions under the competition law paragraphs relating to abuse of economic dependency, because of fear to jeopardize the trade relationship and because of the implicit (and sometimes explicit) threat that their products will be de-listed. To overcome this difficulty, informal procedures (e.g. mediation by an Ombudsman[60]) may be considered.

3.2[c] *The Assessment of Abuses*

Thanks to the broader definition of German law, also the anticompetitive effects of private labels can be better controlled. However, this does not imply that German law is optimal from a consumer welfare perspective. Defining buyer power is one thing; it is quite another thing to establish an abuse of such power. The impact of the German rules on consumer welfare crucially depends on how the analysis of the competition effects is made. The presumption of economic dependence (§ 20,1 GWB) says nothing about the exact causes and effects of buyer power. If a supermarket exercises buyer power (by claiming special benefits or de-listing products), a full analysis of the causes, effects and a potential quantification of these effects are indispensable to judge the ultimate impact of the exercise of buyer

---

59 *See* the EDEKA case (2013), http://www.bundeskartellamt.de/SharedDocs/Meldung/DE/Pressemitteilungen/2013/24_07_2013_Edeka.html (accessed 22 Dec. 2016).

60 Compare the proposal of the UK Competition Commission to draft a Code of Conduct and the handling of conflicts regarding unfair trade conditions by an ombudsman (Competition Commission, *The Supply of Groceries in the UK Market Investigation* 241–244 (Apr. 2008),http://webarchive.nationalarchives.gov.uk/20140402141250/www.competition-commission.org.uk/our-work/directory-of-all-inquiries/groceries-market-investigation-and-remittal/final-report-and-appendices-glossary-inquiry

power on consumers.[61] In the competitive assessment the concept of objective justification plays a crucial role, for example to decide whether additional payments for the marketing of private labels can be imposed on manufacturers. If the analysis of an objective justification is poorly performed, German competition law runs the risk of protecting inefficient firms.

Economic analysis illuminates the ambiguous effects of buyer power; concomitantly the welfare effects of private labels are equally indefinite. Competition authorities cannot escape from balancing pro- and anticompetitive effects. Private labels may offer consumers better bargains but may also negatively affect the manufacturers' profit margins and their incentives to innovate. Another lesson from economics is that buyer power cannot adequately be controlled by competition rules that were drafted to tackle abuses of market power (which is defined by calculating market shares) on the supply side of the market. Buyer power must be assessed as buyer power and should not be controlled indirectly by prohibitions addressed to manufacturers who may be the prime victims of abusive practices.

Assuming that the initial hurdle to define market power (in either absolute or relative terms, see 3.2[b]) is met, the assessment of abusive practices could be done along the pathway suggested below. The first step for the claimants would be to identify the abusive practice, i.e. the risk of market foreclosure. This may result from the imposition of 'harsh' delivery conditions on manufacturers in the upstream market. If the latter grant such conditions, their financial viability may be endangered and they may run the risk of becoming unprofitable. This, in turn, may force the manufacturers to reduce their expenses on innovation. If they do not honour the demands of the powerful buyers, their products may be de-listed and product variety in the downstream market may be reduced. To assess the likelihood of foreclosure, use can be made of the insights from transaction cost economics (see 2.2[a]). If manufacturers have made transaction-specific investments ('asset specificity') to engage in frequent transactions with a single buyer, then the latter may engage in opportunistic behaviour ('hold-ups'). Manufacturers who do not have an own brand but merely supply goods to a retailing firm are most vulnerable to opportunistic behaviour by the latter. Think of farmers supplying milk products and cheeses to a local supermarket enjoying a large market share on a local market, as an example. These farmers may become victim of 'hold-up' behaviour, as they are locked-in to a single buyer being able to imposing its delivery terms unilaterally. Even though not dominant in the traditional sense (Article 102 TFEU), the supermarket may possess 'relative market power' (in the

[61] J. Haucap, U. Heimeshoff, G. Klein, D. Rickert & C. Wey, *Bargaining Power in Manufacturer-Retailer Relationships*, DICE Discussion Paper No. 107 (2013).

sense of the German GWB), which enables it to engage in opportunistic behaviour.

Based on the above insights, a decision framework for judging pro-and anticompetitive effects of buyer power on both upstream and downstream markets may be suggested. Evidence of 'abusive' behaviour on the upstream market could consist of reduction of quantities, retrospective discounts (so-called wedding rebates) and/or transfer of commercial risks (e.g. payments after customer complaints). If these practices go together with threats of de-listing, the (attempt to) foreclosure of private label manufacturers may be considered proven. The burden would then shift to the defendant retailing firm, which should rebut the anticompetitive concerns or advance pro-competitive justifications, including efficiency savings. Reducing product variety is not necessarily negative if it reduces the complexity of purchasing decisions for consumers who will still retain sufficient alternatives. Procompetitive justifications may include cost savings and lower prices in downstream markets. Additional efficiency justifications may result from information advantages enjoyed by retail chains that may better assess the viability chances of particular brands in downstream markets. For example, front access payments may contribute to an efficient allocation of shelf-space and overcome free-riding on retailers' promotional efforts by introducing sub-optimal products.[62] If either the claimant or the defendant is not able to satisfy the above burden of proof, a complex balancing of pro-and anticompetitive effects (and quantification of these effects) will not be necessary.

With respect to the competition effects in downstream markets, traditional competition analysis needs less adaptation. Insights from transaction cost analysis allow for a better understanding of distorted competition on upstream markets but do not generate similar added value when it comes to an analysis of retail competition. The anticompetitive effects of private labels in differentiated goods markets are similar to the unilateral effects of mergers. As explained above (see 2.2[c]) the expansion of private labels may be the consequence of de-listing branded goods and preserving a noticeable price difference between popular brands and private labels. This strategy leads to a general price increase for both branded and unbranded goods. The use of quantitative techniques, which is more developed in the context of US merger control than in the EU, may help to assess the seriousness of these competitive distortions. For example, in the *Kimberly Clark/Scott* case [63] the likely price effects of the proposed

[62] Commission Notice, *supra* n. 28.

[63] *United States and State of Texas v. Kimberly-Clark Corp. and Scott Paper Co.*, Civil No. 3:95 CV 3055-P (D.C. Texas). *See* the case discussion in J. A. Hausman & G. K. Leonard, *Economic Analysis of Differentiated Products Mergers Using Real World Data*, 5 Geo. Mason L. Rev. 335–336 (1997), also including a detailed description of the price-concentration analysis applied.

merger on the toilet tissue market were econometrically estimated using Nielsen supermarket scanner data from five major US cities for five years. They showed price increases of 2.4% for Kleenex (branded good), 1.4% for Cottonelle (branded good), and 1.2% for Scot Tissue (private label), assuming no cost efficiencies. As these are very low figures the merger was consequently approved. The availability of such data may also allow to conclude that the presence of private labels in downstream markets does not raise concerns about market foreclosure. By contrast, with higher elasticities of demand, high profit margins and high diversion ratios the de-listing of branded goods will likely warrant close antitrust scrutiny.

4 CONCLUSIONS

In times of economic crisis, private labels have gained popularity as a 'good value for money alternative' to branded goods. Private labels may satisfy newly identified consumer needs and are a profitable way for manufacturers to make use of spare capacity. In spite of these benefits, competition authorities have voiced concerns about the increasing importance of private labels. The growing concentration in the retailing sector has strengthened the bargaining power of large retailing firms. This buyer power may be 'abused' by forcing manufacturers in upstream markets to grant ever increasing price reductions (also indirectly, e.g. access fees) or accept the transfer of commercial risks that may threaten their survival and reduce their incentives to innovate. In downstream markets, large retailing firms may engage in exclusionary behaviour by using forms of strategic pricing or de-listing branded goods. The potential long-run anticompetitive effects of private labels should be controlled in order to avoid that they outweigh their advantages in terms of reduced prices in the short run.

Conventional economic analysis offers little help for a better understanding of the causes and effects of buyer power. The monopsony model does not describe real-life upstream markets (manufacturers vis-à-vis retailers) and the view of buyer power as countervailing power does not capture the risk that large retailers gain a 'bottleneck' position enabling them to limit competition on the downstream markets (retailers vis-à-vis consumers). A different view of buyer power defined as bargaining strength is needed and the welfare analysis should be adapted accordingly. Buyer power can be defined as the ability of a buyer to reduce price profitably below a supplier's profit-maximizing price or the ability to obtain terms of supply more favourable than a supplier's normal terms. Buyer power increases with the degree of economic dependency of sellers, which is exacerbated by the use of private labels. The economic reasons for this dependency can be clarified by transaction cost theory, which explains 'small number exchanges' and the resulting 'hold-up problems' as the result of information costs and incentive costs resulting from idiosyncratic investments.

The analysis of retailers' buyer power, as it is currently done by competition authorities, needs some adaptation because the prohibitions of competition law have been designed to curb abuses on the selling side of the market. To define the relevant upstream markets (relation manufacturers-retailers), the focus should not be on substitutability from the perspective of buyers but on the degree of substitution from the perspective of manufacturers. The SSNIP test should be adapted accordingly. The relevant question is which buyers are potential substitutes for sellers, taking account of their characteristics (cost structure, size, and product range), uses (consumers' shopping behaviour) and price. To answer this question, a comparative assessment of alternative distribution options must be carried out. A rule prohibiting abuse of a dominant position (Article 102 TFEU) is not well-suited to control the behaviour of powerful buyers, since the latter may engage in anticompetitive practices even if their market share does not reach the threshold for establishing dominance. A rule protecting economically dependent suppliers from abusive practices by buyers enjoying superior bargaining strength (as it exists in Germany) may better enable the control of buyer power, but its ultimate effect on economic welfare remains unclear. The reason is that practices termed 'abusive' may also generate efficiency savings (economies of scale, solution to double marginalization problem, reduction of information asymmetries, protection from free-riding), which may outweigh their anticompetitive effects (degree of market foreclosure). As far as the downstream markets (relation retailers- consumers) are concerned, traditional competition law seems better able to cope with anticompetitive effects of buyer power by preventing significant impediments to effective competition on narrowly defined geographic markets through its merger control provisions. The unilateral effects analysis developed in the merger control context may also help in assessing the anticompetitive effects of market foreclosure caused by the de-listing of branded goods and increasing market shares of private labels.

Private labels will continue to pose important challenges for both competition economists and competition lawyers. The questions in the Introduction regarding the potential anticompetitive effects of private labels require nuanced answers. Private labels increase the bargaining power of large retailers and may broaden the scope for abuse of buyer power in upstream markets. The increasing size of discounts to be granted and the transfer of commercial risks may weaken the financial viability of manufacturers and reduce their incentives to innovate. Private labels can also be used strategically to limit competition in downstream markets (de-listing of branded goods), so that the overall price level of goods will increase in the long run. However, the empirical findings are yet indecisive in setting a clear correlation between private label and abusive buyer power. There is no significant relationship between the share of private label sales and customer choice but the likely negative impact on product innovation warrants caution.

Economists should conduct more empirical analyses regarding the effects of private labels, in order to identify markets of particular concern (e.g. particular food products) and assess whether continued supervision of the retailing trade is warranted. Lawyers should further develop the comparative legal analysis to identify the rules that may best deal with the anticompetitive effects of private labels. By these joint efforts, the Law and Economics of private labels may make substantial advances in the near future.