



FMCG Issues

A series addressing fast moving consumer goods issues

PRIVATE LABEL BRANDS, “MUST-HAVE” BRANDS, AND THEIR IMPACT ON RETAILER BUYER POWER

In December 2008, the European Commission adopted a Communication, *Food Prices in Europe*¹ (the Communication), in which, *inter alia*, it identified a number of practices in the retail supply chain that may give rise to competition concerns. The Commission's comments in relation to such practices are applicable, beyond food supply, to the retail sector as a whole.

In the first of a series of advisories that will examine competition in the retail supply chain, we focus on private label brands (PLBs), “must-have brands,” and their impact on retailer buyer power.

The competitive relevance of PLBs in the retail sector is not a new issue. The Commission has considered the topic in a number of mergers involving fast moving consumer goods (FMCGs).² The Commission has consistently found that, whilst PLBs and branded products are likely to have limited competitive interaction at the wholesale level, PLBs can act as a competitive constraint on branded goods at retail. In a limited number of FMCG merger cases, the Commission has recognised that PLBs can contribute to the countervailing buyer power of retailers. Outside the merger context, the Commission acknowledges in the Communication that PLBs can be used by retailers to increase and/or re-enforce their buyer power to foreclose existing and potential suppliers of branded products from the market, thereby reducing consumer choice.

This advisory examines, using previous merger decisions of the Commission as guidance, the factors most likely to be relevant in an assessment under EC competition law of: (a) the impact of PLBs on the countervailing buyer power

1 COM(2008) 821, *Food Prices in Europe*, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, 9 December 2008.

2 See, for example: *Kimberley-Clarke/Scott Paper* (Case No IV/M.623); *Swedish Match/KAV* (Case No IV/M.997); *Sarah Lee/Courtaulds* (Case No COMP/M.1892); *SCA/Metsa Tissue* (Case No COMP/M.2097); *Pernod Ricard/Diageo/Seagram Spirits* (Case No COMP/M.2268); *SCA/P&G (European Tissue Business)* (Case No COMP/M.4533); and *Bongrain/Sodiaal/JV* (Case No COMP/M.4761).

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of retailers in the assessment of mergers between suppliers of branded goods; and (b) whether a retailer can be said to abuse a dominant position through its use of PLBs to foreclose competition, as described in the Communication.

In both instances, the size of the retailer is important (although in neither case is it enough on its own). The other, most significant, determining factors relate to: the existence and prevalence of “must-have” brands; the extent to which those brands are concentrated in the hands of a small number of branded suppliers; and the presence of one or more manufacturers as suppliers of both branded and PLB products.

Conversely, as explained below, although asymmetry of knowledge on pricing has been mentioned by the Commission as a factor enabling retailers to price PLBs at competitive levels, this is not necessarily an indicator of retailer strength.

SIZE OF THE RETAILER

The size of the retailer, relative to the relevant market, is important both to a finding of abuse and to a finding that the retailer has countervailing power that could offset the market position of suppliers following a merger.

The use of PLBs cannot have the actual or potential effect of foreclosing the market to branded suppliers—thereby reducing consumer choice—unless the retailer concerned has sufficient market power to be considered dominant.

Dominance will be assessed by reference to the position of the retailer in the relevant procurement market. The Commission has taken a fairly broad approach to the definition of procurement markets for retail products—for example, considering there to be a single procurement market for confectionery as a whole, and one for all “preserved foods”. In light of the fact that product markets tend to be more narrowly defined at the retail level, it is appropriate to consider whether the purchasing product market should likewise be defined more narrowly. For example, in merger cases involving suppliers of confectionery products a distinction is drawn between sugar and chocolate confectionery. It seems logical that this distinction should be applied in the analysis of the procurement market as well. At the same time, the Commission has considered it appropriate to

distinguish between different retail channels when defining procurement markets. In particular, supermarket retailing has been distinguished from cash-and-carry stores and other smaller retail outlets.³ Finally, it may be necessary to distinguish a market for the purchasing of branded products from the purchasing of PLBs, given the Commission’s statements about the differences between purchasing of such products by retailers.⁴

In assessing the countervailing buyer power of retailers in the merger context, the Commission has recognized that size is important and that larger retailers are more likely than smaller retailers to be able to use PLBs. In its decision in *Procter & Gamble/Gillette*, the Commission discussed the possible portfolio effects arising from the merger of two strong branded product suppliers, and noted that the risk of portfolio effects was limited by the ability and incentive of retailers to exercise countervailing buyer power. The Commission said that, in this respect, it would be more likely that large retailers could protect their interests through the use of PLBs or by sponsoring new entry through active in-store promotion (although it did not expand on how this would strengthen buyer power and it is not obvious that this approach is current.)⁵

The UK Competition Commission’s 2008 report on the UK Groceries Market (the Groceries Report) provides helpful guidance on how to measure the buyer power of a retailer. It states that the size of a grocery retailer relative to (a) the market; and (b) the supplier is a key influence on a retailer’s power in relation to the supplier.⁶

According to the Groceries Report, where there are multiple suppliers and retailers paying a “market price” for their products, size should be measured by reference to the retailer’s share of the national sales of all competing products at retail. A reasonable proxy for this may be the retailer’s share of the retail sales of *all* grocery products. Where the supply market is more concentrated, and prices are negotiated individually with suppliers, it may be more appropriate to consider the extent to which the

³ *Rewe/Meinl* Case No. IV/M.1221, *Rewe/Adeg* Case No. COMP/M.5047

⁴ See, for example, *SCA/P&G* Case No. COMP/M.4533

⁵ See *Procter & Gamble/Gillette* (Case No COMP/M.3732) at paragraphs 122 and 123.

⁶ Competition Commission Groceries Market Investigation, Final Report, paragraph 9.7

retailer is reliant on the supplier, and *vice versa*. Relevant factors would include the extent to which the retailer has alternative sources of supply, the percentage of the supplier's sales accounted for by the retailer, and the alternative routes to market available to the supplier.

“MUST-HAVE” BRANDS

Why must-have brands are important to the analysis

The sale of PLBs generally produces higher margins for retailers than branded products. Retailers therefore have every incentive to increase the sales of PLBs. Nevertheless, many retailers consider that it is necessary to display some branded products in order to generate footfall.

The introduction of a range of PLB products, or their expansion into new price points, will therefore likely result in a reduction of the size or quality of the shelf space allocated to competing branded products and, in some instances, to the delisting of branded products. In deciding which branded products to sell, the retailer will select the brands that are likely to attract consumers to the store. The brands most likely to be deselected will be the brands with the lowest brand recognition. Suppliers who only offer such brands are therefore much less likely to be able to defend against threats of delisting than suppliers with must-have brands. This is consistent with the views expressed by the Commission in its Communication to the effect that food producers of internationally recognised brands with must-have status tend to have a stronger position versus retailers, but that producers of non-differentiated products for which brand awareness is not high are likely to be in a much weaker position. It is also consistent with statements by the Commission that PLBs act as a stronger competitive constraint in relation to products in low price segments than in relation to premium products.⁷

In mergers between branded FMCG competitors, the ability of the parties to claim that retailers can use PLBs to exercise countervailing buyer power to prevent them from raising prices will depend on whether the merger will concentrate a significant proportion of must-have brands

in the hands of the merged enterprise. This is consistent with a number of recent merger decisions including most notably *Kraft/Danone*⁸ and *Danone/Numico*.⁹ Similarly, retailer foreclosure of branded products through the increased use of PLBs is less likely in markets where brand awareness is high and where sufficient competition remains between suppliers of must-have brands.

What is a must-have brand?

In *Procter & Gamble/Gillette*, the Commission described “must-stock” brands very broadly as “brands with a strong spontaneous demand that most retailers have on their shelves.” In contrast, in *Kraft/Danone* the Commission defined “must-have” brands more narrowly as “brands with high recognition that must be kept on the shelves in order to attract consumers and remain profitable”. However, the definition leaves open the issue of whether the reference point should be the profitability of the retailer or the profitability of the product segment concerned. The additional reference to profitability appears to limit the definition to truly iconic brands. There can be few brands that would affect the profitability of a retailer and under such an approach many familiar brands would fall short of being must-have. However, it should be noted that neither decision involved a detailed analysis of the must-have nature of the brands concerned, both having been cleared in Phase I (with remedies). The Commission's determination in those cases that the merging parties had a large number of must-have brands was based on third party comments in the market investigation. An alternative view of a must-have brand would be one that has universal recognition in the relevant market or such other characteristics as to require a retailer to stock the item for fear of losing customers, or that is of critical importance as a traffic builder. This would still be a narrower definition than the one applied in *Procter & Gamble/Gillette*, but it would remove the requirement that the brand determine retailer profitability as referred to in *Kraft/Danone*. Also, where a retailer has been able to delist, or has credibly threatened to delist a brand as part of its price negotiations, this should be evidence that such brand is not a must-have.¹⁰

⁷ *Masterfoods/Royal Canin* Case No. COMP/M.2544

⁸ Case No. COMP/M.4824

⁹ Case No. COMP/M.4842

¹⁰ *Ibid.*

Concentration of must-have brands in the hands of few suppliers

Where the must-have brands are owned by a small number of suppliers, suppliers of non-must-have brands may be squeezed between the increased use of PLBs by retailers and the need for retailers to stock the must-have brands.

In the assessment of the effects of a merger between manufacturers of branded products, the ability of non-must-have brands to compete may be reduced where the merger further consolidates the ownership of must-have brands. This effect arises as a result of the merger, regardless of the PLB strategy of the retailer.

Outside the merger context, these non-must-have brands may be squeezed by the PLB strategy of a retailer. As indicated by the Commission, where the retailer is dominant, this may amount to a breach of the dominant retailer's obligation under Article 82 of the EC Treaty not to use its dominance to further reduce remaining competition. Whether this has the effect of appreciably harming consumer choice may then depend, in part, on the remaining level of competition between the must-have brands not being adversely affected by the PLB policies of the retailer.

BRANDED SUPPLIERS OPERATING IN THE PLB WHOLESALE MARKET

Where a supplier manufactures both PLBs and branded products, it may be in a stronger position vis-à-vis retailers. In its decision in *United Biscuits/Jacobs Bakery Limited*¹¹ the UK Office of Fair Trading (OFT) noted that the countervailing buyer power of retailers would be undermined if the merged (branded) supplier was also such an important supplier of PLBs to retailers that it could raise the price of such products and so reduce the competitive pressure from PLBs. However, the OFT nevertheless found that retailers could, and did, switch among branded manufacturers for their PLBs, and that the major retailers possessed a degree of countervailing buyer power that allowed them to resist attempts by manufacturers to increase prices.

¹¹ Anticipated acquisition by United Biscuits (UK) Limited of the Jacobs Bakery Limited, September 2004.

ASYMMETRY OF INFORMATION AND PRICING OF PLB BRANDS

In *Procter & Gamble/Gillette*, the Commission took the view that, because retailers know the trade prices of the goods purchased from branded suppliers, they can fix the retail prices for their PLBs at a level below those of branded products.¹² This dynamic provides a further means for retailers to exert significant competitive pressure on branded suppliers that cannot be reciprocated. The Commission noted that retailers have the capacity to counteract effectively against brands with their PLBs, whilst suppliers have “an asymmetry of information vis-à-vis prices for private labels”.

However, it would be incorrect to assume that the Commission intended that the fact of asymmetry of information on its own would be a significant factor to support a finding that PLBs can be used by retailers to exert buyer power. In markets where the prices of PLBs systematically follow the price of branded products, this may instead indicate that the strength of the retailer is limited. In *Kraft/Danone Biscuits*,¹³ the Commission found that PLBs were not sufficient to constrain the power of the branded suppliers, notwithstanding the fact that sales of PLBs had increased steadily to the detriment of branded products. In its decision, the Commission explained that more than 75% of the market still consisted of branded products, and—although retailers sold competing PLBs—they set prices by reference to branded products (i.e., they acted as price followers rather than as a competitive constraint). In conclusion, the Commission found that “any potential price increase on the wholesale market for branded biscuits is likely to lead to a price increase for private label biscuits.”

Given that, in most product sectors, the prices of PLBs are likely to follow the price of branded products, it seems very unlikely that such pricing practices would be sufficient to support a finding that PLBs can be used by the retailer as a means of exerting buyer power.

¹² Footnote 5, at paragraph 124.

¹³ Case No COMP/M.4824

CONCLUSION

Deciding where the balance of power lies between retailers and suppliers is a complex issue that may vary between countries and product markets and over time. Although the Commission decisions to date provide an insight into the factors likely to be relevant to the assessment, none of them appear to have involved an in-depth examination of the impact of PLBs on suppliers, the extent of the interaction between PLBs and branded products, or the true meaning of must-have brands in the retail context. Moreover, although the Communication states that retailer PLB strategies may harm competition, there is no guidance from the Commission on the circumstances in which this might be the case. Therefore, this issue will need to be addressed on a case-by-case basis both in future mergers affecting retail or FMCG supply markets and when considering whether the actions of a retailer concerning PLBs might infringe EU or national competition rules on abuse of dominance.

We hope that you have found this guide useful. If you have additional questions, please contact the Arnold & Porter European Competition team:

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