

Disappearance of Small Independent Retailers in South Africa: *The Waterbed and Spiral Effects of Bargaining Power*

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(The views expressed in this document are of the authors and not of the Competition Commission or any of the Competition Commission's divisions)

Abstract

Although bargaining power is generally accepted as a good factor disabling dominant suppliers from increasing prices to the detriment of consumers, it has become evident that under certain circumstances it may raise significant competition concerns. For example, there have been complaints in the South Africa's grocery retail market, where complainants allege that larger retail stores have bargaining power which inhibits smaller and medium enterprises development into the grocery retail market. It is also alleged that bargaining power is also resulting in independent retail outlets exiting the grocery retail market.

The main purpose of the paper is to further bring forth the impact of bargaining power as a likely cause of the inability of small independent retailers to compete and their ultimate exit from the grocery retail market.

1. Introduction

Competition authorities in South Africa and elsewhere have to date not been able to properly address the concerns raised by independent retailers in as far as the effects of larger retailers' buyer power in the grocery retail sector are concerned. The concerns raised include among others the effects that large retailers' bargaining power have on the ability of small independent retailers to compete in the market. It is alleged that as a consequence, a large number of independent retailers have even disappeared from some markets or became fringe players. In this paper, we assess whether bargaining power that large retailers have has any impact on the development of independent retailers in the grocery sector.

Although the discussion below has focused mainly on mergers creating a substantially large buyer and intervention from a merger review perspective, the paper does not exclusively assess the impact of bargaining power (that is created through mergers and acquisitions transactions) on independent retailers but also assesses whether bargaining power by retailers that are organically growing can be the cause of the exit of independent retailers in the grocery sector. Section 2 and 3 will look at monopsony and bargaining power's theories of harm. Section 4 and 5 assesses evidence on the exit of independent grocery retailers in South Africa and whether this is good or bad. Section 6 provides some policy implications by looking at the possibilities that exist in terms of the Competition Act No 89 of 1998 as amended ("Act") to deal with concerns arising from exercise of buyer power.

2. Monopsony Power

It is easier to see a merger that increases market power on the supply-side of the market as a course for concern. The difficulty occurs when a merger creates a substantially large buyer,

more especially when “...*the intention of the firm is then not to reduce quantity but to buy and sell more,...*”¹ at lower prices than would have been achieved by each firm individually. In this section we explore two bargaining power theories in terms of which buyer power could lead to harm to consumers, i.e. the spiral effect and the waterbed effect.

Before proceeding with the discussion it may be apt to distinguish bargaining power theories which are the subject of this paper from a situation where lower wholesale prices to a large buyer are as a consequence of an exercise of monopsony power, i.e. when a buyer has the ability to reduce the total wholesale quantity and thus affect wholesale prices. A merger can result in the creation of a substantially large retailer such that the retailer can by reducing the amount of its wholesale purchases also reduce the total quantity in the wholesale market. When this occurs supply will equate demand at a price that is lower than before the merger. The assumption is that the marginal costs of supply decrease as fewer products are supplied. Although a reduction in wholesale prices is desirable, the reduction in this case only takes place due to quantity reduction which is undesirable if it leads to quantity below competitive levels. Clearly this leads to inefficiency which the competition authority could take into consideration.

It is for this reason that monopsony power is seen as mirror image of monopoly power since they both lead ultimately to a reduction of output. Monopsony power, particularly when the wholesalers in the upstream are fragmented and have no substantial market power, can lead to undesirable transfer of wealth from wholesalers to the large buyer. If wholesalers are fragmented the wholesale price is likely pre-merger to be competitive or approximate a competitive price. The exercise of buyer power in such a market leads to prices that are lower than competitive levels, hence inefficient. Chen (2007 p. 20) recognizes this as the exercise of monopsony power. Chen (2007 p. 20), however, recognizes another form of buyer power referred to as countervailing buyer power. He notes that when the wholesale market is characterized by suppliers with market power, the exercise of buyer power can be seen as desirable countervailing power since it results in the transfer of wealth from suppliers with market power. It is not clear though why countervailing buyer power cannot be exercised by a monopsonist.

The view herein is that irrespective of whether the exercise of buyer power is against competitive or less competitive suppliers if it is an occasion where a buyer reduces wholesale purchases it is regarded as an exercise of monopsony power which is not the main concern of this paper.

To fix ideas we begin by revisiting the general bargaining theory which reveals that some discounts are given not due to cost savings of serving a larger buyer but are simply given because the buyer concerned has substantial bargaining power that it exercises without restricting quantity.

3. The theory of bargaining

Dobson and Inderst (2007) note that differential buyer power exercised without restricting quantity involves buyers negotiating with suppliers on a bilateral basis. Each buyer negotiates with the supplier based on each parties' bargaining power. The bargaining powers of the buyer and the seller are manifested through the size of the individual discounts. In order to understand

¹ Dobson, P. W. Inderst, R. (2007): Differential Buyer Power and the Waterbed Effect: Do Strong Buyers Benefit or Harm Consumers? *European Competition Law Review* Vol. 28; Issue 7, pages 393-400

how bargaining affects the outcome one should picture every negotiation as a discussion about how to split the profits to be made from the sale of the product. The seller of the product extracts profits by minimizing the discount and the buyer vice versa. Accordingly, buyer power is manifested through the size of individual discounts. In order to understand how buyers are able or not to extract greater discounts from sellers competition between sellers and competition between buyers must be taken into account. If, for instance, there are many buyers who are all viable outlets to which sellers can resort to, i.e. there are no constraints on any of the sellers to reach the ultimate consumer of the product, a buyer may find it difficult to obtain greater discounts from sellers. On the other hand if there are fewer sellers to whom buyers can resort to and/or if those alternative sellers do not offer highly substitutable products or are constrained in some way from expanding their sales a buyer's inferior bargaining power is further adversely affected.

In bargaining theory the alternatives available to each side of the bargaining table are called "breakdown payoffs" or "outside options". The size of the buyer does not necessarily mean that the buyer should get a bigger portion of the profits to be made from the sale of the product in the form of a large discount. However, large buyers can credibly threaten to search for alternatives or sponsor entry of new suppliers and generally large buyers will have more resources to employ sophisticated procurement methods. Accordingly, a merger creating a buyer of substantial size can enable the buyer to find alternatives. The other side of the coin is that a seller may become economically dependent on the large buyer for her continued viability in the market, especially if there are economies of scale to be exploited in their activities. There are indications that some grocery retailers have in fact gained 'gatekeeper' status as sellers pay slotting fees in order to obtain shelf space. However, the most important form of discount for our discussion is not discount given over a range of purchases but invoice discounts that result in lower wholesale invoice price for each unit of product sold since these affect marginal retail price and as such have a higher pass through rate.

It is now opportune to look at the theory behind spiral effects.

3.1. The spiral effect

Spiral effect is one part of the bargaining theory consideration of the exercise of buyer power to the detriment of competition and ultimately consumers. The other half is the waterbed effect discussed below. Unlike the exercise of monopsony power which is observed by a reduction in quantity, the exercise of buyer power through bargaining does not necessarily result in the reduction of quantity. The spiral effects exacerbate the concentrative effects of a merger between buyers as a result of the impact that the merger has on the competitiveness of rival buyers. The spiral effects are observed when due to the enlarged size of the merged entity, initially due to the combination of the merged entities' input procurement divisions, the merged entity is in a position to extract greater discounts from its suppliers than its competitors.

When a firm that achieves greater discounts as a result of its augmented size passes on to customers a portion or all of the discounts obtained from suppliers, it gains a competitive advantage over its rivals. By cutting prices in this manner a firm is likely to gain market share over its rivals. This further augmentation in size enables the firm to extract even more discounts from suppliers relative to its competitors. Accordingly, a merger does not only have a single once-off effect on discounts received by the merged entity but has secondary multiplier effects which account for an even greater size of discount received and further reduction in size of rivals beyond the initial round of discounts.

In order to establish the likelihood of spiral effects two conditions must be met. (i) there should be an assessment of the magnitude of the discounts on offer to determine the extent to which the merged business could cut prices and the likelihood that rivals could shrink in size and/or exit the market. (ii) there should be proof that the spiral effects are merger specific, thus all pre-existing spiral effects due to pre-existing sizes of players in the market must have been played out.²

It should be noted that the spiral effect theory assumes that discounts obtained by other smaller buyers remain constant despite the fact that these buyers are shrinking in size. Therefore, spiral effects can be regarded as partial explanation of the magnitude of the effect of buyer power on the competitiveness of other buyers. The waterbed effect presents a much more comprehensive account of the effects of differential buyer power.

3.2. The waterbed effect

The waterbed effects predicts not only that a merger that substantially increases the size of the buyer enables that buyer to extract higher discounts from sellers relative to other buyers but also predicts that the size of discounts granted to other buyers declines as a consequence thereof. Bedre-Defolie and Greg Shaffer (2010) note that:

“The problem is that the intuition that buyer power is good appears to rely on an implicit assumption of linear contracts. When contracts are non-linear, it appears as though buyer power has neutral effects or could even be harmful to consumers. And the situation is even more complex if downstream firms are asymmetric – because then one has to worry about possible adverse effects on other (weak/small) downstream firms – e.g., may have “waterbed effect”, where lower purchasing costs for powerful retailers might be at the expense of higher costs for other retailers. Buyer power may not be so good after all.”³

In short, larger discounts negotiated by larger buyers have a consequence for discounts negotiated by smaller buyers.⁴

Dobson and Inderst (2007) discuss three theories that seek to explain the mechanism of the waterbed effects.⁵ There is a mechanical view of the waterbed effect in terms of which a seller that grants a greater discount to one buyer will need to make good for a decrease in profitability by reducing discounts granted to other buyers. Dobson and Inderst (2007) justifiably observe that this theory is not satisfactory from an economic logic perspective. Note that the assumption thus far is that sellers can discriminate between buyers. The mechanistic theory of the waterbed effect does not account for the fact that a profit maximizing seller may already be maximizing profits with the smaller buyers by charging them a different price which represents the position

² CRA Competition Memo, *Buyer Power*: http://www.crai.com/ecp/assets/Buyer_Power.pdf

³ Bedre-Defolie, Ö., and Shaffer, G. (2010): Countervailing Power Hypothesis and Waterbed Effects, Working Paper, European School of Management and Technology, Forthcoming <http://sites.google.com/site/ozlembedre/>

⁴ Smith, H. and Thanassoulis, J. (2008): Upstream Competition and Downstream Buyer Power <http://www.cepr.org/meets/wkcn/6/6670/papers/Thanassoulis.pdf>

⁵ Dobson, P. W. Inderst, R. (2007): Differential Buyer Power and the Waterbed Effect: Do Strong Buyers Benefit or Harm Consumers? *European Competition Law Review* Vol. 28; Issue 7, pages 393-400

of their demand curve, i.e., willingness to pay. Accordingly, if a supplier was not able to increase the price (reduce the discount) to these buyers before a larger discount was granted to one buyer, how should the seller be able to do so now after the discount is granted, without reducing its profitability.

Two more logically satisfying arguments for the operation of the waterbed effect have been provided. Firstly, the waterbed effect can operate due to the adjustment in the upstream market structure (increased concentration in the upstream) resulting in an adjustment of bargaining positions in favour of the remaining sellers. The second theory relates to the shift in retail market shares due to the price disadvantage of smaller players against players enjoying larger discounts. Below is a discourse on each theory separately.

3.2.1. Waterbed effect working through upstream market adjustment

When a retailer merges with another creating a substantially larger buyer than each retailer individually, the retailer can extract better terms from suppliers if its size makes its 'outside options' easily accessible. For instance, the fixed costs of accessing its outside options could be spread over larger volumes of purchases than before. As consequence the buyer's bargaining power is augmented from two fronts. Firstly, as noted above, the buyers outside options are more accessible. The more sellers there are in the market place and the easier it is to find alternatives the harder the buyer can bargain against each seller. Secondly, due to his size the buyer may have become important for the sellers. The merger would have reduced the sellers' 'outside options' by removing an outlet they would have turned to. Therefore, the sellers' margins are squeezed in two fronts.

The waterbed effect operating through upstream adjustment predicts that as the buyer grows some suppliers' margins will be so squeezed such that some suppliers find it difficult to continue competing such that they either merge with other suppliers or exit the market. In addition if the sellers' market becomes unprofitable due to the presence of high discounts entry into that market could be deterred. As a consequence concentration levels in the upstream increase. The remaining sellers become increasingly indispensable to buyers which means that the buyers' 'outside options' are becoming limited at the same time the increasing scale of sellers makes their 'outside options' more accessible. Although this process may reverse the large buyer's initial gain in bargaining power, the small buyers certainly suffer as their terms of trade become worse than they were before. According to Inderst and Valletti (2008) the upstream adjustment theory does not require that small buyers be in direct competition with the large buyer in the downstream in order for smaller buyers to experience the waterbed effect due to an increase in the bargaining power of the larger buyer.⁶ Concentration upstream affects every buyer irrespective of the relationship to the hard bargaining large buyer.

It should be noted that the large buyer can still continue to enjoy larger discounts than before the merger depending on the proportion of the reversal of fortunes due to an increase in upstream concentration levels. Therefore, in the end the merger is likely to result in improved purchasing terms for the larger buyer and worsening conditions for the smaller retailers.

⁶Inderst, R. and Valletti, T.M. (2008): Buyer Power and the 'Waterbed Effect'. CEIS Research Paper No. 107. Available at SSRN: <http://ssrn.com>

3.2.2. The waterbed effect operating through shift in retail market shares

Unlike the mechanism of the waterbed effect operating through upstream adjustment, shift in retail market shares requires that the weak buyers be in direct competition with their larger and more powerful counterpart.

Again a merger increases the merged entity's bargaining power against suppliers. The powerful buyer passes on some portion of the discount it obtains from sellers to its customers. Due to the size of the discount a powerful buyer offers a much lower price to its customers compared to other buyers and attains greater market share as it starts selling to some customers that were not buying the product at all before the merger and also to some customers that previously bought from other buyers and are now switching to the large buyer.

As small buyers' market share shrink their 'outside option' become less accessible hence adversely affecting their bargaining power against suppliers. The small buyers' prices become even less competitive against the large buyer's price offering. This further reinforces the loss of market share and ushers in another round of adjustment.

As noted above size does not necessarily translate into greater discount granted, however, if the relationship between size (market share) is not only positive but also steep the waterbed effect will be more pronounced. Accordingly, by observing existing differences in wholesale prices paid by large and small buyers a conclusion can be reached on the expected significance of the waterbed effect. In addition, if suppliers can price discriminate between buyers they should be in a position to exploit the deteriorating position of retailers.

3.3. Potential competitive harm arising from spiral and waterbed effect

Whilst the spiral effect enhances the observed increase in the size of the merged entity, it should be noted that the two mechanisms of the waterbed effect are not mutually exclusive but they work together to enhance the magnitude of the disadvantage suffered by weak buyers. It is clear that the competitive position of adversely affected buyers is eroded quickly with the waterbed effect than without. The waterbed effect can also cause buyers to become more differentiated with small buyers becoming niche players to avoid head-to-head competition or even exiting the market. Entry may become discouraged due to lower margins and the size of the required scale of entry in order to effectively compete may be prohibitive.

Therefore, even though in the short-run consumers may enjoy lower prices, in the long-run a more concentrated retail market is likely to lead to higher prices. However, even in the short-run the waterbed effect can lead to higher general prices. Accordingly, the fact that the large retailer is discounting may in fact lead to higher general retail prices, a startling conclusion.

In order to understand how price increase can occur in the short-run due to the waterbed effect it should be noted that the waterbed effect has two opposing effects. Firstly, competitive pricing by the large and powerful retailer puts a downward pressure on the price charged by small and weak retailers. Secondly, deteriorating terms of trade for weak retailers (the waterbed effect), i.e. reduction in wholesale discount granted, puts an upward pressure on their prices. The larger the waterbed effect the more likely it is that retail prices of weak buyers will increase. The waterbed effect can be so pronounced such that there is a general market prices increase in the short-run.

There are other effects of the waterbed effect other than its effect on prices. The waterbed effect can result in consumers shopping at more distant locations instead of shopping locally since small retailers exit the local market. A related effect is when local small retailers, referred to as general dealers, move even closer to their consumers and hence become even more fragmented into local 'spaza shops' geared solely to exploit the convenience element for top-up sales. This is likely to be the differentiation effect aimed at avoiding head-on competition.

Other retailers may resort to a reduction in the product range in order to achieve the required quantities to obtain substantial wholesale discounts. Retailers selling a limited number of staple food and fast moving products are not an unusual phenomenon in some parts of the country where some of the major retail chains are present.

Whilst the theoretical framework developed above shows how powerful retailers can affect the competitiveness of weak retailers, competition between powerful retailers, for instance between retail chains, can ensure that prices remain competitive in both the short-run and long-run despite the exit of weak retailers. Accordingly, the evolution of the market in this manner may be beyond the competition authority's powers to protect competition since competition is not affected but small competitors are foreclosed but it can form part of a public interest debate related to the ability of small business to compete.

4. Exit of independent retailers in South Africa

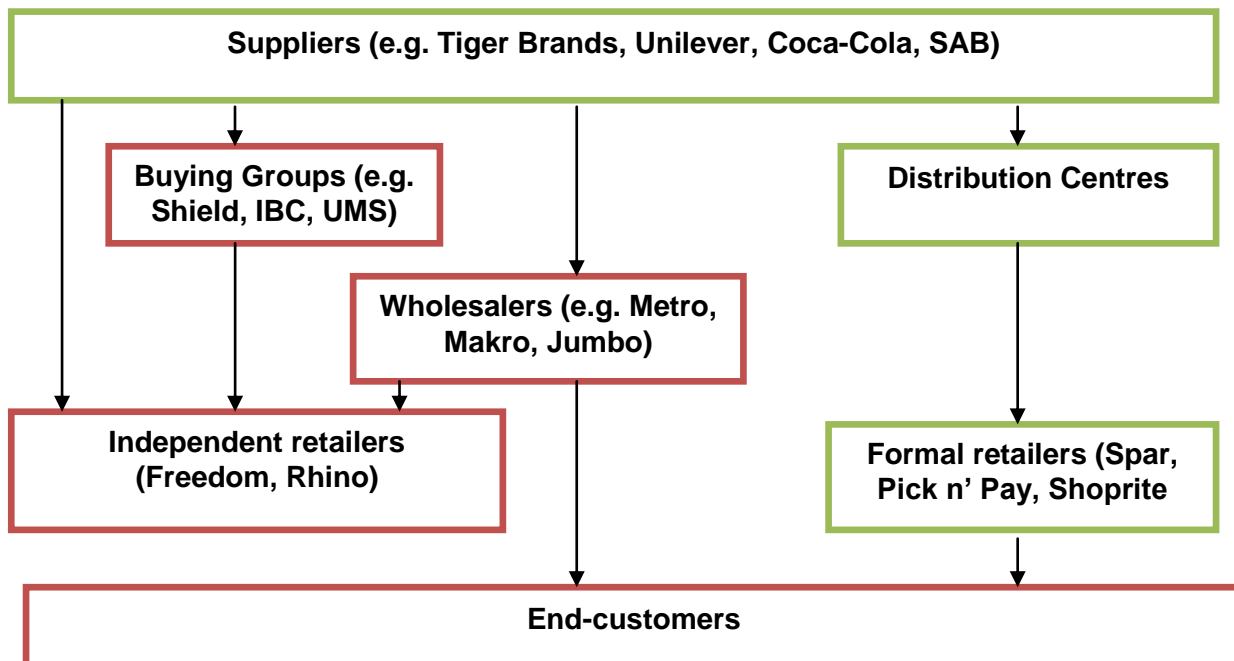
In this section, we assess the existence of any correlation between bargaining power of large retail outlets and the disappearance of independent retailers in South Africa. Since one can argue that the exit of independent retailers will in any event be unlikely to be caused by buyer power that large retailers have as independent retailers that are disappearing are those small informal retailers in townships and rural areas that generally source products from wholesalers because they do not have sufficient scale to source from suppliers, we see it appropriate to begin by providing some of the dynamics in the grocery supply chain in terms of where independent retailers source their stock.

It is true that independent retailers have in the past relied heavily on supplies by wholesalers. However, we understand there to be a dynamic that traditional customer base of wholesalers (independent retailers) are beginning to source directly from suppliers. In the case of *Masscash v Finro* in 2009, the Competition Tribunal (Tribunal) found that 52% of smaller retailers in townships and rural areas do actually make use of the direct supply channel.⁷ Suppliers that bypass the wholesale level include among others Coca Cola, British American Tobacco, Tiger Brands, ABI, Sasko, Simba and Willards. The Tribunal in the *Masscash v Finro* case noted that "This direct supply is significant: Masscash estimates that direct supply by grocery manufacturers into the relevant market amounts to approximately R600 million per annum (however, this figure includes some sales to formal retail chains)."⁸ Given this dynamic one would expect the grocery supply chain to be to some extent as depicted by Diagram 1 below:

Diagram 1: supply chain of grocery products

⁷ Tribunal Case NO: 04/LM/Jan09, para 159.

⁸ Tribunal Case NO: 04/LM/Jan09, para 155.



Research in 2008 by the Competition Commission in the UK (UK Commission) to the market investigation into the supply of groceries in the UK found that “if a waterbed effect were present in the UK grocery sector, we would have expected to see unambiguous evidence of an overall decline in convenience store numbers and revenues.”⁹ This means that the waterbed effect can well be explained by evidence of an overall decline in convenience store numbers and revenues.

While the investigation into grocery sector in the UK did not unearth any evidence of an overall decline in convenience store number and revenue, the situation is distinctly different in South Africa. Evidence in the report to the investigation into a large merger between Masscash v Finro¹⁰ shows the erosion of independent retailers’ customers to large retail chains: “...it is common cause that the wholesale food sector is under immense pressure (our traditional customers are being eroded by the expansion of the major retailers into these areas).”¹¹ As appears in the report, the evidence pointing to the exit of independent retailers was largely provided by Masscash Holdings (Pty) Ltd, a firm within the Massmart Holdings Limited, which controls a number of wholesalers throughout South Africa.¹² Further, in the same Masscash v Finro case, Mr. Fermino Gomes, Executive General Manager at Unitrade Management Services (“UMS”)¹³ testified that “the large retailers “took hold of the opportunities now available to access the markets normally generally operated by the previously disadvantaged communities. Sadly many smaller house shops, spazas, mobile shops, garage shops disappeared from the areas.”¹⁴

⁹ See p. 92, paragraph 5.43.

¹⁰ Tribunal Case NO: 04/LM/Jan09

¹¹ See p. 56, para 205.

¹² These wholesalers include, Jumbo Cash & Carry, Weirs Cash & Carry. Within the Massmart group, one other retail and wholesale store exists, Makro Cash & Carry.

¹³ UMS is one of the independently owned buying groups.

¹⁴ See pp 202.

Having considered the evidence, the Tribunal concluded that for independent retailers to remain in the market and compete effectively with the large formal retail, they need access to suitable product ranges at competitive prices. This suggests that the exit of independent retailers may well be a consequence of large formal retailers acquiring products from suppliers at more favourable prices than independent retailers.

Although the disappearance of independent wholesalers is not the focus of this paper, it is worth mentioning that the exit of independent retailers in the market also affects the viability of wholesalers' business, as independent retailers largely rely on wholesalers' supplies. Similarly, small suppliers are affected since they have to deal with retailers only if they are able to match bigger suppliers' discounts to large retailers. In cases where they small suppliers deal with large retailers, they end up extracting significantly and unsustainable low profit margins.

5. Exit of independent retailers – good or bad

As already indicated above, bargaining power has led to the exclusion of a number of independent grocery retailers in South Africa. But one can argue that the exit of independent retailers is not necessarily bad for consumers as large retailers will continue to offer competitive offerings in the market. This argument would be fair as competition authorities should not be concerned with the number of competitors in the market, but market competition (Motta, 2004). Although valid, an argument that large retailers face competition from each other is incompletely correct. What is important is the type of competition that formal retailers face from each other. There is a common understanding that competition in the grocery retail market is imperfect, given the lack of countervailing power, high transaction cost and information asymmetries. For example, a Research Paper in 1997 entitled "Competition in Retailing, prepared for the Office of Fair Trading by London Economics notes that "...competition problems are likely to be particularly prevalent in retailing, since markets tend to work imperfectly when there are asymmetries in bargaining power (consumers are small), high transactions costs (consumers are immobile), and information asymmetries (consumers are uninformed)."¹⁵

From a structural point of view, benefits to consumers are likely to be increased in an imperfect competitive market if entry and exit by independent retailers is free. Put differently, the fact that most players that have successfully entered the market for the retailing of grocery products entered as independent retailers, the exclusion of independent retailers potentially eliminates any possibility of effective entry into the market which would provide benefits to consumers. Players that entered the market of grocery retailing and competed effectively with large retail stores include among others Boxer Cash and Carry¹⁶, Cambridge Food and Rhino Cash & Carry. Research (Rhino Cash and Carry: 2008) has shown that Rhino has grown from single store in *Kokstad, KwaZulu-Natal*, in 1992, to the 30-store group that it is today.¹⁷ Boxer, formerly established under *KwaZulu Cash & Carry* name, was established in April 1977, in the centre of Empangeni, KwaZulu Natal, South Africa.¹⁸ It follows that the impediment of entry or expansion by small players would do consumers more harm than good. However, the exit of independent retailers may not necessarily be regarded as a competition concern because large retailers are

¹⁵ Section 2: "Economics of Retailing".

¹⁶ Boxer is now part of Pick n Pay.

¹⁷ <http://www.rhinogroup.co.za/>.

¹⁸ Boxer Superstores, <http://www.boxer.co.za/>.

entering into areas they have not traded before (like townships). Expansion by large retailers can in the short run be good for total welfare and consumer welfare since large retailers will tend to be large discounters and suppliers of larger quantities. However, lack of competitive constraints can adversely affect consumer welfare in the long run and total welfare benefits may decline even to below pre-expansion level. Therefore, the disappearance of independent retailers becomes a concern not only from consumer welfare perspective but also from total economic welfare perspective.

6. Conclusion and policy implications

We find that the disappearance of independent retailers is bad for consumers as most of the retailers that have successfully entered and competed effectively with major retail outlets entered the market as independent retailers. Then, if the exclusion of independent retailers is bad for competition, the question is whether competition authorities can do anything to enforce the use of bargaining power or to limit the creation of bargaining power in the market.

In South Africa, competition matters are regulated by the Act. In the Act, there are two main chapters that provide rules that ensure the maintenance of competition in the markets, namely chapter 2 and chapter 3. Chapter 2 focuses on the prohibition of conducts that distort competition and those that harm consumers directly whereas chapter 3 focuses on the prohibition of creation of market structures that enable firms to engage in conducts that distort competition and/or harm consumers. As we have read above, by their nature, bargaining power's effects distort competition by excluding rivals in the market. From chapter 2 perspectives, conducts that can be embarked upon by one firm and/or through agreements between firms in a vertical relationship, which in their nature can have exclusionary effects, are prohibited under section 5 (1), section 8 (c) and section 9 (1). We will briefly assess whether chapter 2 and 3 of the Act can be used to prohibit the exercise or limit the creation of bargaining power that can have the exclusionary effects in the market

6.1. Enforcement and Bargaining power - Sections 8 (c), 5 (1) and 9(1)

Section 8 (c) of the Act prohibits any exclusionary act of a dominant firm that has an anti-competitive effect that is not outweighed by its efficiencies.¹⁹ As indicated above, bargaining power can well lead to the exclusion of competition in the market. This implies that a firm with bargaining power relative to its competitors can have the ability to exclude competition (that is market power as defined in the Act²⁰). However, given that every transaction involves negotiation between a buyer and a seller, it would be difficult to differentiate between the negotiation process intended at excluding competitors and a negotiation process that inhibits a dominant supplier from charging anti-competitive prices. For example Raymond Ackerman, former Chairman of Pick n Pay, stated that "Pick n Pay has been specifically built on the premise of fighting for consumers, not maximising profit. If we did not consistently enter into robust negotiations with our suppliers, food prices would have increased significantly more than

¹⁹ Exclusionary Act is defined as an act that prevents a firm entering into, or expanding within, a market. Wherever this paper refers to exclusion of rivals, it would be referring to both the impediment of a firm to expand within or enter into the market.

²⁰ Market power means the power of a firm to control prices, or to exclude competition or to behave to an appreciable extent independently of its competitors, customers or suppliers. The definition of market power applicable to the use of bargaining power would be the one meaning the ability to exclude competition.

they already have as a result of global food inflation.”²¹ Therefore, competition authorities may generally have difficulties in concluding a case of abuse of bargaining power under section 8(c) of the Act.

Even if the analysis of the effect of the exercise of bargaining power were to be done under section 5(1) or section 9(1) of the Act, it is unlikely that competition authorities would find a contravention of the Act. Competition authorities are required to show in terms of section 5(1) and 9(1) that the prohibited practice has the effect of substantially preventing or lessening of competition. In the grocery retail market, it would be difficult for competition authorities to conclude that an exclusion of independent retailers through the use of bargaining power is likely to lead to a substantial prevention or lessening of competition precisely because in order for foreclosure to occur prices should initially decline.

Therefore, from enforcement point of view, it is unlikely that competition authorities would establish that large retailers have contravened the Act by negotiating better buying conditions. However, although it may be difficult to enforce the abuse of bargaining power, it remains the fact that bargaining power, whether used to sell at competitive prices or not, can have the exclusionary effects that can harm consumers. The main consideration to a finding that competition is likely to be harmed rest on showing that the remaining large retail chains are, for one or two reasons not effective competitors to each other. Establishing that each retail chain has the ability to charge higher prices can be one such requirement.

6.2. Merger Control and bargaining power – Section 12 (A) of the Act

Section 12(A) of the Act prohibits a merger between firms or an acquisition of a firm that has an effect of substantially preventing or lessening of competition in the market.²² Bargaining power acquired by the merged firm can also be prohibited if it would have an effect of substantial prevention or lessening of competition. Surely, merger control can do something to prevent the creation of bargaining power that can have the effect of substantially preventing or lessening competition in the market. For example, Gordon Mills stated that “Merger policy has been used to limit the increase in retail concentration and therefore buyer power, but of course that does not control existing buyer power.”²³

The effect of bargaining power on competition has been investigated in a number of merger transactions. Within the grocery retail market, the Commission of the European Communities (EC) investigated the anti-competitive effects of bargaining power in the Carrefour/Promodes merger - Case No COMP/M. 1684. The EC approved this merger subject to conditions that remedied the anti-competitive effects of buyer power. In the merger between *Imperial Group (Pty) Ltd and Midas Group (Pty) Ltd*²⁴, the Tribunal requested the Commission to do the assessment of the impact of rebates on the competitiveness of competitors.²⁵ However, it was found that not all suppliers offer rebates and when they do offer them the rebates are relatively small in relation to total purchases. This suggests the absence of correlation between

²¹ See Financial Mail of 19 June 2009, p 9.

²² We take note of the fact that the Commission will still be required to weigh the competitive effects of the merger against its efficiencies and positive public interest.

²³ See a paper by Gordon Mills, Honorary Professor of Economic, University of Sydney, on “Buyer Power of Supermarkets”: <http://epress.anu.edu.au/agenda/010/02/10-2-A-4.pdf>

²⁴ Case No: 31/LM/Mar09

²⁵ “We also requested the Commission to investigate the effect of rebates by suppliers on the competitiveness of distributors.” See page 10, paragraph 29.

purchases and purchasing terms between suppliers and customers in the markets in which Imperial and Midas were active.

Merger policy can also be used to assess the impact of bargaining power on the ability of small businesses, or firms controlled or owned by historically disadvantaged persons, to become competitive in the market. The Act requires competition authorities to consider the impact of the merger on public interest issues, which include among others the ability of small businesses, or firms controlled or owned by historically disadvantaged persons, to become competitive.²⁶ Therefore, if the merger results in the merged firm acquiring significantly high buyer power relative to small business, which would have a significant impact on competitiveness of small businesses, such a particular merger could be prohibited or conditionally approved on public interest grounds.

6.3. Conclusion

We find that bargaining power leading to exclusion of competitors can be prohibited by both chapter 2 and chapter 3 of the Act if it led to a substantial prevention or lessening of competition. However, we find that it would be difficult for competition authorities to prohibit the use of bargaining power to negotiate better prices relative to smaller/independent players in the South Africa's grocery retail market. However, this does not take away the finding that the exercise of bargaining power will do consumers more harm than good as it prohibits entry into or expansion within the grocery retail market, which is currently dominated by few players who face imperfect competition from each other. This conclusion has some policy implications. Since competition authorities may be expected to intervene into the grocery retail market, there should be tools of intervention. Currently chapter 2 of the Act is not designed in such a way that it makes competition law enforcers' work easy in enforcing the exercise of bargaining power.

Therefore, amendment of the Act or establishment of code of conducts that could address the effects of bargaining power in the grocery retail sector is necessary. For example, Mills (2003, p155) stated that "Both the Australian and British governments have introduced formal codes of buyer conduct, and thereby have relieved beliefs that the general legislation (the UK Competition Act of 1998 and the Australian Trade practices Act 1974) is not likely to be sufficiently effective in this field"²⁷. South Africa may also consider introducing formal code of conducts in the retail grocery sector. A simple example on how competition authorities can ally bargaining power effects in this market is by prohibiting suppliers to offer purchasing terms to smaller/independent retailers that are dissimilar to those offered to large retailers.

REFERENCES

²⁶ See section 12(A) (3) (c) of the Act.

²⁷ See a paper by Gordon Mills, Honorary Professor of Economic, University of Sydney, on "Buyer Power of Supermarkets": <http://epress.anu.edu.au/agenda/010/02/10-2-A-4.pdf>

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