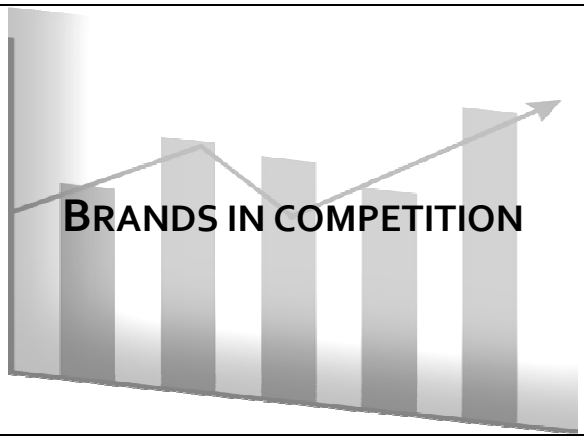
MARKENVERBAND



BRANDS IN COMPETITION

www.markenverband.de

MARKENVERBAND, founded in Berlin in 1903, is the leading organisation representing the brands industry in Germany. Its members are concentrated in the areas of foodstuffs, household goods, fashion, cosmetics, pharmaceuticals and telecommunications. They account for branded turnover of more than 300 billion euros in the area of consumer goods and around 200 billion euros in the services sector.

MARKENVERBAND provides companies, policy-makers and the general public with first-hand knowledge about brands and represents the interests of its members nationally and at European level. In Berlin and Brussels, it deploys its international networks, for instance as an active member of the European umbrella organisation "Association des Industries de Marques" (AIM).

Dear Sir or Madam,

Brands, competition and freedom are mutually dependent. Where brands stand for quality, where freedom is ensured, demand can make the best choice. This allows a prosperous society to be achieved and secured in competition. But freedom requires an effort, and has to be reasserted and defended on a daily basis. There is a constant danger that it will be abused by parties seeking to benefit through restrictions or distortion of competition. These falsifications of competition assume different and continually changing forms. Today it is particularly the high and sometimes still increasing concentration of delivery points, as in network operation, media agencies or in retail channels, that requires our attention.

The branded goods and services industry sees freedom as its mission and is committed to its protection. For that reason, Markenverband has been working tirelessly for market and competition for more than 100 years. In this paper, Markenverband describes the risks in the current situation for functioning competition on the merits as seen by the branded goods and services industry, and seeks to open a dialogue on the ways it identifies for ensuring this competition.

I hope that you find our positions interesting and useful.

Franz-Peter Falke
President

Executive Summary

Competition on the merits offering genuine choice between different suppliers and their respective goods and services on one side, and between potential buyers with their price offers on the other side, is the guarantee for an optimal economic outcome and the right division of profits within value chains. This means that, alongside private ownership, competition on the merits is a fundamental condition for prosperity. However, it is under constant threat of market power; power through agreements between competing companies which restrict competition or distort its outcome; through mergers that lead to competitors dropping out of the market and, not least, through abuse of action possibilities that would not exist in an environment characterised by competition.

All these situations have in common that they concentrate the choice of suppliers in a relatively small number of alternatives. This situation has to be countered. Hence, Markenverband makes the following demands:

- Stop concentration, prevent market dominance through effective merger control;
- Strengthen supplier protection by tackling the "naming and shaming" problem by introducing a right for associations to claim information based on competition law;
- Create clarity through definition of buyer power and abusive behaviour; establish a code of conduct;
- Make it easier for dependent companies to defend themselves against illegal behaviour;
- Clarify the antitrust listing right for suppliers vis-à-vis trading companies with buyer power;
- Remove the time limit on the tapping ban in § 20 paragraph 3 of the Act against Restraints of Competition (GWB).

Competition on the merits – core of the social market economy

The social market economy, together with protection of ownership, is based on the recognition that the greatest possible freedom of market participants in terms of their possibilities for commercial action leads to an optimum economic outcome and to a social balance. Competition on the merits for market participants' favor guarantees an optimal market outcome.

In this regard, decisive importance accrues to the choice options of market players on every side (both in their role as suppliers – competition between sellers – and in their role as customers – competition between buyers). If there is insufficient choice, for instance because of monopolies or oligopolies in certain parts of the business chain, competition can no longer guarantee the optimal outcome. For that reason, limiting concentration processes and restraining their impact is an essential criterion for a successful market-oriented competition policy and a central characteristic of the social market economy.

The German legislator rightly assigns macroeconomic advantages to the protection of competition. In addition to ensuring a balance between supply and demand as well as the success of the best product at the optimal price, functioning competition also ensures successful innovation activity and macroeconomic progress. As an institution, competition protects the sum of freedoms for competitive action of all market participants, irrespective of the position in the business chain or function.

Competition on the merits is the basis for a series of market processes which directly benefit the consumer and which cannot be achieved through state regulation or through direct state provision:

- Competition on the merits is the fundamental condition for appropriate prices, i.e. for products which represent value for money. Excessively high prices cannot be maintained in an environment characterised by competition.

- Competition on the merits is the basis for efficient use of resources. Only those who use the resources available to them economically and thriftily will be in a position to reduce production costs and to keep prices in line with international competition in a globalising world.

- Competition on the merits is the necessary condition for innovations. Only those who can offer the consumer new products in competition have the possibility to win market shares and gain access to new categories of buyers. This is the only way to generate the impetus to invest in research and development and hence also to make a contribution to the further development of society. State-run markets or markets closed off by monopolies are therefore hostile to innovations.

State merger and competition legislation is indispensable for functioning competition. Its objective is to put in place the same rules for all those involved in competition and to prevent market power becoming overly aggregated.

Risks to competition on the merits

Competition law addresses risks to competition on the merits in Germany from three angles:

- Merger control has the aim of preventing market abuse through a concentration of companies and hence the development of oligopolies and monopolies. However, the way competition law has developed at European level in particular has led to the thresholds for state intervention (market dominance) being reached on increasingly rare occasions which means that potential abuse of market power cannot be prevented effectively.

- The ban on cartels prevents concerted practices between otherwise autonomous competitors, hence reducing competition.

- Anti-abuse supervision sets limits on behaviour targeting prevention and discrimination.

At European level, practical significance attaches above all to merger control and the ban on cartels.

Competition on the merits also requires identification and elimination of market distortions, e.g. resulting from exploitation of market power. An essential aim of Markenverband is therefore effective enforcement of antitrust law.

a) Dangers of concentration

In a series of markets, concentration processes can be observed which are harmful to competition. For suppliers of branded goods and services, a concentration at the trade level is particularly relevant.

The concentration in German food retailing means that a few trading groups have developed a power over their suppliers which can have a negative impact on competition.

According to the Federal Cartels Office, the five largest German retail undertakings represent around 90% of the turnover in food retailing. Each one of these businesses provides a share of more than 10% of the needs of consumers in Germany.

The turnover significance of the top five trading groups is markedly higher as a rule for their suppliers in the branded goods and services industry than the significance of the trading groups on the consumer market. One of the reasons for this is that discount chains (with an own-brand share of 70% on average) sometimes carry fewer other brands. This means that the current market leader regularly accounts for 35 to 40% of the turnover of suppliers of branded goods.

b) Concentration, buyer power, dependence

A consequence of concentration in the German retail sector is the creation of "buyer power", the term used in antitrust law to designate the dependence of a supplier on its customer.

Even with a turnover share of 7.5 to 8%, there is already an economic dependence of a supplier on its customer, because a possible turnover reduction of this order or magnitude cannot easily be replaced. The European Commission regards a short-term turnover loss of 22% as immediately threatening the survival of the suppliers in question.

The producer dependence resulting from buyer power in the retail sector is often not balanced by "brand power" (the need for a retailer to carry a branded article in its assortment). A German retailer with a full range carries some 20,000 to 30,000 articles. The direct turnover significance of even heavily traded brand manufacturers will generally be well below 1% for this retailer. Furthermore, due to strong competition between brands, the retailer can manage without each individual brand in almost all categories – in the short term at least.

Lastly, the consumer goods industry cannot adjust its offer rapidly and without complications due to high specialisation and technical constraints, so that significant cuts in order volumes cannot be offset in the short term by the production of other products or by closing production lines to reduce costs.

c) Free choice for mature consumers?

Functioning competition in the retail sector requires consumers to be able to choose from wide assortments and hence play their role as "referee" steering demand in the market. The consumer's freedom of choice is hampered without assortment competition at the point of sale. The willingness of a retailer to include a product in the assortment is at the same time decisive for the sales success of a branded article. Inasmuch, retailers play a key role as gatekeepers between consumers and manufacturers.

From this position, a retailer with buyer power increasingly takes over this demand-steering function from the consumer. The result is that it is no longer the customer but the retailer who decides what is on the shelf. The customer no longer has a say:

Economies of scale arising from concentration increasingly allow entry into private label assortments which are in competition with established branded goods. It is difficult for the consumer to make price comparisons, because private labels are exclusive to the retailer. At the same time, they become the retailer's marketing focus, manufacturer brands are relegated to second place without relevance for choice. A retailer's private labels already represent more than 40% of turnover in the food retailing sector, and the turnover significance of such private labels is more than 70% in individual categories and distribution channels (discount).

With increasing buyer power, the consumer focus is also diminishing: higher competitive pressure on less concentrated sales markets means that the business interest of retailers concentrates more sharply on the procurement market, where listing and assortment decisions are reached on the basis of what can be "earned" from suppliers.

d) Anti-competitive behaviour through "supplier-exploitation"

Retailers with buyer power use dependence to squeeze ever more advantages from their suppliers, in particular improved conditions for which there is no objective justification.

Despite this, these suppliers must refrain from seeking avengement for anti-competitive behaviour or even from cooperating with the Federal Cartels Office, in order to avoid sanctions.

In particular, § 20 paragraph 3 of the Act against Restraints of Competition (GWB) and its ban on "supplier-exploitation" is a dead letter in many cases.

e) Innovation versus free-riding – retailers in dual role as sales channel and competitor

Due to the strategic development of their private label assortments, retailers sometimes are no longer only a sales channel and partner but also a competitor of their suppliers.
The difficulties that arise from this dual role of retailers for dependent suppliers are particularly clear on the introduction of new products and innovations. In practice, if a new product or other innovation is to be successful, it must be communicated to the retail partner sufficiently far in advance, presented and recommended for listing.

In practice, it is observed all too often that retail businesses use the knowledge acquired in this way to develop copies of the product even before the original is introduced, which is then offered alongside the supplier's original product as a private label. Even conscious delays to the marketing launch for the original product while the copy is developed are possible.

The manufacturer of branded goods has almost no promising possibilities adequately to amortise its innovation and development costs as an innovator and first mover due to the simultaneous market introduction of the private label me-too product. This form of free-riding can shut down the original manufacturer's innovation capacity and willingness – to the detriment of consumers.
Due to the overwhelming importance of the retailers in question as a sales channel, it is not possible for suppliers to protect the information properly against unreasonable exploitation by the retailer.

Perspectives for protection of competition

Modern antitrust law is "concentration-friendly" since it assumes that power agglomerations ultimately have a favourable effect for consumers by keeping prices low. Intensive price competition in the German retail sector seems to confirm this.

However, the situation in retail trade shows that high concentration restricts the demand-steering role of consumers, at least at stages in the business chain with a gatekeeper function as is the case for retail, and jeopardises optimal market outcomes at the level of suppliers of consumer goods.

Moreover, as a result of rigid application of merger control focused on sales markets and the liberalisation of purchasing syndicates, secret competition in the retail sector is restricted, which mainly benefits the retailers with the most buyer power.

For that reason, thought needs to be given to measures for protecting competition and an adjustment of the current framework conditions in this area.

Markenverband recommends the following approaches:

- **Stop concentration, prevent market power**

  Although the current antitrust law is supposed to prevent concentration on both sales and procurement markets, a traditional focus of its application lies in analysis of mergers on the relevant sales markets. This is partly because procurement markets are often markedly more complex in structure, and their delimitation and definition therefore is more unwieldy. But competition-distorting effects of mergers have a different impact on sales and procurement markets depending on the degree of concentration. An even-handed analysis of both sales and procurement market before a merger plan is approved is absolutely essential. It must be sufficient to block a plan if perceptible restraints of competition obtain even on just one of the two markets.

  The market share thresholds for the assumption of market dominance regularly differ from those for the dependence of companies in the market counterparty. It is therefore worth considering to take into account the value judgements in the area of control of abusive practices already at the stage of merger control. The particularities of the market stage must also be taken into consideration. In particular if companies decide about access to customer groups of their suppliers, the creation or strengthening of relative market power (dependence) must be sufficient to prevent a merger.

- **Solution of "naming and shaming" problem through introduction of a right to antitrust law information for associations**

  With a view to the division of power in the interplay between stages in the business chain, suppliers are regularly prevented from "naming and shaming" when antitrust law is infringed. Antitrust authorities suffer a lack of evidence. This so-called "naming and shaming" problem has constituted an obstacle to implementation of German antitrust law for many years.

  Markenverband has prepared a proposed solution which would grant associations protecting commercial interests a right to ask for preliminary injunctions and claim information as well as cease and desist orders in a way comparable to trademark law.

- **Define buyer power and abusive behaviour; establish a code of conduct**

  Antitrust authorities can ensure consistent and convincing application of antitrust rules to prevent abuse of power through the adoption of communications/guidelines. Such guidelines can typically name abusive behaviours, define market share thresholds for buyer power and substantiate transparency obligations for the grant of certain advantages. This, too, would help to solve the "naming and shaming" problem.

  Furthermore, such guidelines are the basis for self-regulatory measures by companies (code of conduct) including establishment of the corresponding settlement mechanisms (ombudsman).

- **Make it easier for dependent companies to defend themselves against illegal behaviour**

  Antitrust authorities have discretion to decide on application of a ban on cartels. In the framework of guidelines, antitrust authorities should make it clear to what extent an exchange of information or concerted behaviour among competitors seems worthy of investigation because it perceptibly distorts competition if it only serves for a general defence against clearly illegal demands. In this connection, Markenverband underlines that behaviours which target a defence against abusive behaviours should not be taken up by the antitrust authorities because effective and prompt legal protection is not available due to the unsolved "naming and shaming" problem.

- **Clarify antitrust listing right for suppliers vis-à-vis retailers with buyer power**

  Antitrust law already contains a ban on discrimination and restraints for companies with market dominance and market power. However, in practice this is only applied to manufacturing companies when the issue of a right to receive deliveries is involved. But the wording of the standard also comprises a right for suppliers to a "listing" with retailers with market power. Notwithstanding this, such a right is currently not granted by courts. The legislator needs to create clarity in the situation.

- **Remove the time limit on the ban of "supplier-exploitation" in § 20 paragraph 3 of the Act of Restraints of Competition (GWB)**

  The competition law ban of "supplier-exploitation" in § 20 paragraph 3 second sentence GWB (version in force since 1 January 2008) prohibits companies with buyer power from exploiting their market position to invite or cause dependent companies to grant them advantages without any objectively justified reason.

  The standard has had a so-called "sunset clause" since the last amendment which will expire on 31 December 2012. Starting on 1 January 2013, the version in force until 31 December 2007 once more becomes valid, whereby the ban of "supplier-exploitation" ban will be limited to dependent "small and medium-sized enterprises".

  In practice, the limitation to dependent SMEs leads to considerable delimitation and application difficulties. Furthermore, it is difficult to understand why the exploitation of market power to secure advantages which are not objectively justified from dependent companies should be deemed to be fair under competition law because these companies fall outside the narrow definition of an SME. The competition-distorting effect of "supplier-exploitation" would potentially be even greater.

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