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Gerlinde Metz

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For my parents and sisters.

Abriss

Die Arbeit setzt sich mit der Nachfragemacht und der generellen Position von Lebensmittelhändlern in Österreich auseinander. In den letzten Jahrzehnten hat sich eine deutliche Verschiebung der Macht von den Konsumenten zu den großen Lebensmittelhändlern, nicht nur auf dem österreichischen Lebensmittelmarkt abgezeichnet. Grund für diese Entwicklung sind neben Industrialisierung, Globalisierung und einer vermehrten M&A Aktivität auch ein wandelnder Lebensstil und die damit einhergehenden Veränderungen der alltäglichen Bedürfnisse. Durch zunehmenden Stress ist Zeitmangel ein gängiges Phänomen unserer Gesellschaft. Um diesem Problem entgegenzukommen entstehen Geschäfte mit immer größeren Verkaufsflächen um einem stetig wachsenden Produktsortiment Platz zu machen. Dies wiederum ermöglicht es dem Kunden an nur einem Ort fast sämtliche Einkäufe zu erledigen und somit an Zeit zu gewinnen.

Parallel dazu, reduzierte sich im Laufe der Jahre die Zahl der Lebensmittelhändler stark. Im Jahr 2005 hielten die Top-5-Unternehmen einen Marktanteil von mehr als 78%. Nur 3 Jahre später, im Jahr 2008 werden 78,5% von den Top-3; Rewe, Spar und Hofer gehalten. Im europaweiten Schnitt weist Österreich einen der höchsten Konzentrationsgrade im Lebensmittelhandel auf. Dies ist besonders kritisch zu sehen in Anbetracht der Tatsache, dass die Lebensmittelpreise in Österreich deutlich über denen Deutschlands liegen, die Begründung dafür jedoch unklar ist. Daher liegt die Vermutung über eine mögliche Preisabsprache und verminderter Konkurrenz zwischen Lebensmittelhändlern, sehr nahe.

Ziel der Arbeit ist es, sich ein klares Bild über den österreichischen Lebensmittelmarkt zu verschaffen und dessen Probleme aufzuzeigen. Zu Beginn werden die Auswirkungen von Nachfragemacht anhand von theoretischen Modellen veranschaulicht. Weiters werden Strategien beschrieben, die es Händlern ermöglicht eine bevorzugte Stellung innerhalb der Wertschöpfungskette zu erreichen. Anschließend werden Indikatoren beschrieben, anhand derer Nachfragemacht zu bestimmen ist. Den Schluss bildet der praxisrelevante Teil, der Einblick in die Geschehnisse des österreichischen Lebensmittelmarktes in den letzten Jahrzehnten gibt und die Funktion von Politik und Wettbewerbsbehörde kritisch untersucht.

Abstract

The thesis deals with the topic of buyer power in retailing in Austria. In recent years a power shift has occurred, with the emphasis toward the retailer. This was due to industrialization, globalization, and increased M&A activity among grocery retailers coupled with people's changing lifestyles. As a consequence customers now demand more and differentiated products and services, than a few decades ago. Nowadays it is important for customers to have a one-stop-shopping opportunity offering a broad product range, since their busy lifestyle does not allow lots of time for extensive grocery shopping. Specialist shops such as butcheries or greengrocers become end-of-range models.

At the same time the number of grocery retailers decreased significantly in Austria. In 2005 the five largest food retailers held a market share of more than 78%, whereas in 2008 only the top three namely, Rewe, Spar and Hofer held a common market share of 78.5%. In fact Austria has one of the highest concentration levels in grocery retailing across Europe. In addition, it is particularly noticeable that prices in Austria are significantly higher than in Germany. The difference in prices could not be justified by any serious or obvious argument. Consequently food retailers are suspected of price fixing and it assumed that competition is limited.

The following work gives the reader a clear picture of the Austrian market in food retailing, along with its problems and dynamics. By starting with a theoretical model, the reader should get an idea of the overall economic impact of buyer power in theory.

Furthermore, the strategic actions that retailers use to establish a powerful position within the supply chain are explained. After that the reader will learn about the different indicators of buyer power. Finally the focus lies on the development of the Austrian market and its retailers in recent years and what has been attempted by politicians and competition authorities to get things straight.

1.Introduction

1.1 Overview

The past few decades bore testament to a substantial change in retailing, not only within Europe, but more generally across the world. The supermarkets, as we know them today, evolved from the Co-operative movement in 19th century in Britain. The first step was initiated by local retailers who banded together to sell their products to working people at prices they could afford.[1]Furthermore, industrialisation and technological advancement heralded the beginning of a new era, one with an emerging demand for mass consumer goods and a decrease in agricultural production, as cheap food from other countries became available.[2]In 1948 following the second World War the Agricultural Act reinforced the “cheap food policy“[3] that dominates the current climate and this post war boom laid the foundations for an immense increase in production and the supermarket revolution. With the Resale Act, abolished in 1964, thus enabling manufacturers and suppliers to determine the price retailers sold their products for. From this point on retailers decided on prices and low price strategies evolved to attract customers.[4]

Along with the conventional supermarket new store formats also emerged. The superstore, often more than twice the size of the conventional supermarket, offers the possibility of one-stop-shopping. Quite often located out of town, this can be interpreted as a response to the new lifestyle people have adopted. Beyond this, hypermarkets with a size between 9.000 m² and 30.000 m² offer the largest range of food and non-food items and are always located out of town.[5] The typical convenience store is not a supermarket, as it has less floor space and consumers are top-up rather than one-trip shoppers. Convenience stores range from the private owned

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[1] Michaels (2002)p.3

[2] Seth and Randall (1999)p.8-9

[3] Michaels (2002)p.3

[4] Michaels (2002)p.3

[5] Zentes, Morschett and Schramm-Klein (2007)

corner shop next door to the symbol group retailers such as Spar, but their existence is evanescent. [6]

One should not underestimate the significance of retailers, as they represent the link between producers and consumers. Their power and influence in every respect for both consumers and producers is immense. Hence, the trend observed in recent years is towards larger retailers and highly concentrated markets across Europe. This has been a field of interest to economists and authorities, but it is controversial as to whether authorities pay due attention to this problem. Without doubt this offers consumers a broader range of products and an extensive variety adapted to their lifestyles; however, it may be argued this is at the expense of traditional and expert retailers.[7] Table (1) illustrates those European countries where the five largest grocery retailers controlled more than 70% of market share in 2005, with Austria being one. This is in contrast with Poland, the Czech Republic, Greece, and Italy, all of whom face a relatively low five-firm concentration level.[8]

Table1: EU States where the top 5 retailers made up more than 70% of the grocery market in 2005

Country	Market Share
Finland	90.02 %
Sweden	81.80 %
Ireland	81.40 %
Slovenia	81.60 %
Estonia	78.80 %
Austria	78.70 %
Germany	70.10 %
France	70.00 %

Source: author unknown (2007)
http://www.responsible-purchasing.org/assets/docs/EU%20MEP%20Retail%20Briefing.pdf

Given that we find eight countries with a concentration level of more than 70 % in 2005, it is not surprising to discover that among most EU states the five-firm concentration ratio increased from 1993 to 1996 to 1999, as Table (2) indicates. These developments were pivotal for the change in the relationship between suppliers and retailers. As the market share of retailers increased dramatically, the former supplier-driven market shifted to a market where retailers posses authority, thus permitting them buyer power over suppliers. Since retailers face fewer competitors, suppliers

[6] Michaels (2002)p.5

[7] Dobson (2002)p.1

[8] Perkins (2001)p.745

are forced to deal with them as they represent the link between consumers and suppliers. Their power is accumulated through: their high share of market, a declining number of retailers, and their pivotal role as a connector between producers and consumers, all of which combine to allow retailers to charge suppliers (e.g. slotting allowances) for direct access to their stores or offer exclusive contracts to specific suppliers.[9]

Table 2: Five-Firm Concentration (%) in Grocery and Daily Good Retailing for EU Member States

	1993	1996	1999
Austria	54.2	58.6	60.2
Belgium & Luxembourg	60.2	61.6	60.9
Denmark	54.2	59.5	56.4
Finland	93.5	89.1	68.4
France	47.5	50.6	56.3
Germany	45.1	45.4	44.1
Greece	10.9	25.8	26.8
Ireland	62.6	64.2	58.3
Italy	10.9	11.8	17.6
Netherlands	52.5	50.4	56.2
Portugal	36.5	55.7	63.2
Spain	21.6	32.1	40.3
Sweden	79.3	77.9	78.2
UK	50.2	56.2	63.0
EU 15 (weighted av)	**40.7**	**43.7**	**48.9**

Source: Dobson P. (2002)p.7

1.2 Retailers in Europe

In a global ranking by Deloitte (2009) the 250 largest retailers worldwide were assessed based on non-auto retail sales for the fiscal year 2007. The European Top 10 are illustrated in Table (3) and most striking is the fact that France, Germany and the UK dominate the market in terms of retail sales. ‘Ahold‘, a Dutch retailer, dropped in rank from 2002 and was replaced by the French ITM, but with this exception, the Top 9 remained unchanged from the 2006 survey. The European Top 10 are among the 25 largest retailers in the Global 250 ranking and all operate in food retailing.[10] In addition, the French and German retailers are leaders in global operations. On average the French retailers are active in 18.9 different countries and some 35.3% of their

[9] Dobson (2002)p.1

[10] Deloitte (2009)p.29

sales are foreign-derived. German retailers operate on average in 13.8 countries and make over 40% of their sales abroad.[11]

Table3: Top 10 European Retailers in 2007

Ranking	Top 250 Ranking	Company	Country of Origin	Retail Sales in US$ billions
1	2	Carrefour	France	112.6
2	3	Tesco	UK	94.7
3	4	Metro	Germany	87.6
4	7	Schwarz	Germany	69.3
5	10	Aldi	Germany	58.5
6	12	Rewe	Germany	51.9
7	14	Auchan	France	49.3
8	18	E. Leclerc	France	44.7
9	19	Edeka Zentrale	Germany	44.6
10	23	ITM (Intermarché)	France	40.7

Source: Deloitte(2009)p.30

Importantly, European retailers did not grow by merely internal expansion and incorporating overseas operations. Recent mergers and acquisitions of the major players in Europe have added to the increased concentration of retailers. In Finland the merger of Kesko and Tuko came under severe criticism. Finland had no domestic authorities charged with regulating mergers within its borders. Therefore, after it had been accomplished, the case was directed to the EC which rejected the acquisition on the grounds that Kesko would act as a gatekeeper in the acquisition of Tuko.[12] In Austria the takeover of the Julius Meinl AG by Rewe was rejected in 1999, as Rewe would have had a monopolistic position within the eastern part of Austria and a controlling position in the procurement market. But the commission agreed on the acquisition of 162 Meinl-stores without taking control over the entire Julius Meinl AG.[13] While the commission authorities within Europe are not entirely ineffective, they do face severe criticism regarding their lack of control over the emerging concentration among retailers and the subsequent detrimental effects on competition and welfare. In the French market, authorities seemed to be largely ignorant of the M&A activities within food retailing. In 1996 Auchan, a leading French grocery retailer, acquired Pão de Açúcar, a major player in Portugal. As well, Carrefour merged with Promodès in 1999 to become Europe's leading and the world's number two retailer, after

[11] Deloitte (2009)p.27

[12] Lehtinen (1997) http://www.mondaq.com/article.asp?articleid=5859

[13] see: http://europa.eu/rapid/pressReleasesAction.do?reference=IP/99/83

Wal-Mart.[14] As stated in recent news Germany‘s biggest retailer, Metro, is on the lookout for new growth opportunities together with Arcandor, the holding company of Karstadt and the biggest department store in Germany together with Metros Kaufhof. Since 2008, Metro has planned to sell Kaufhof,[15] so far without success, but it is rumoured by experts that Metro and Arcandor plan to merge Kaufhof and Karstadt by creating a joint venture, with Arcandor holding 51% and Metro 49%. Aside from various synergies this would result in a major decline in competition, beneficial to Metro and Arcandor, but hopefully alarming to the German and other European competition authorities.

In addition, collaboration and consolidation among retailers impedes one‘s ability to achieve a clear picture of the real levels of concentration. Retailers collaborate not only on a national level but equally across borders via buyer groups or alliances, such as EMD and AMS. The top seven European alliances, in combination with the top three retailers, are responsible for more than 50% of the food supplies within Europe. Furthermore, contracts between suppliers and retailers are no longer fixed on a long-term basis but rather determined through online exchanges and Internet-based auctions, where the contract is offered to those suppliers offering the lowest price. This can have major impacts upon suppliers‘ survival, as long-term contracts help to ensure that their investments are somewhat safe. This is in opposition to the current situation whereby producers compete for contracts on a short-term basis, and with an uncertain and potentially volatile future income, so too do they alter their investment decisions. In addition they may feel pressured to reduce prices to levels below the cost of production and if experienced over a longer period may result in insolvency. Alternatively, so as suppliers can remain within the market under such circumstances, they may elect to reduce the quality of products to a level below standards. While perhaps not noticed instantly by quality-control-agencies, this results in a degraded quality for consumers.[16]

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[14] see: http://www.carrefour.com/cdc/group/history/

[15] Seidel and Seidlitz (2008) http://www.welt.de/

[16] Dobson (2002)p.2-3

2. Theoretical background

The following section discusses the underpinning theory. I shall start by providing some basic definitions of the terms that will appear often within the thesis and give a brief introduction to some microeconomic theory, before examining the more detailed cases including monoponsy and others.

2.1 Scope of theory

Prior to dealing with buyer power it is paramount to determine the field of research and more broadly the branch of science within which it is imbedded. As a student of international business, the starting point of my thesis in science lies within the field of economics and management.

This is noteworthy as buyer power can be analysed within the field of social and political science or the jurisprudence and others. It does not entail that these sciences will be excluded, contrariwise they will have some impact on the topic, but the focus lies within the theory of economics and management, and more precisely on microeconomic theory.

2.2 Definition of Buyer Power

One definition of power is the “possession of control, authority or influence over others“.[17]

However buyer power is a broad term and therefore an ultimate definition is difficult to find. The following section should give the reader an insight into the problem of buyer power. Within this section I give an overview of what buyer power is referred to in general. Not only the definition of buyer power is important but also defining the different types and approaches of buyer power and other related terms. Elaborating this is essential, as it demonstrates at an early stage that buyer power has different facets.

Monopsony power is essential to analyse when searching for a definition of buyer power. A monopsony exists if one buyer faces several competitive suppliers.[18] Monopsony power is the reverse of monopolist power. As the monopolist is the only seller in a market, she increases the price of his good by selling a lower amount.

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[17] Könemann(1993) p.789

[18] Clarke et al.(2004) p.9

On the other side the monopsonist, the single buyer in a market, increases the price of the good he purchases by lowering the amount he buys. Both influence the price by varying the amount sold, or in the case of the monopsonist, purchased. It is noteworthy that within this approach the buyer does not discriminate among suppliers. Even if monopsony power is the determining factor for price reduction, it reduces the market price. Hence all sellers are affected not only certain.[19]

One definition is that:

> *"Monopsony power is understood to mean those instances where a price decrease is such that it falls below competitive levels and there is a corresponding reduction in the input supplied or a corresponding diminishment in any other dimension of competition."*[20]

Another approach to buyer power focuses rather on bargaining power or, in other words, countervailing power. This approach is concerned with whether the buyer in relation to his competitors receives a better price through bargaining power, which is "the power to obtain a concession from another party by threatening to impose a cost, or withdraw a benefit, if the party does not grant the concession."[21] Bargaining power has to be distinguished from monopsony power. It is noteworthy that the former reduces the price by threatening to lower the amount to be purchased, while the latter reduces the price by actually lowering the amount to be purchased.[22]

It is assumed that competitive suppliers set their price equal to the marginal cost, therefore only suppliers under imperfect conditions can reduce their price when threatened by a buyer, as they set their price above the marginal cost curve. For that reason bargaining power equals countervailing power, and more precisely bargaining power is the compensative power against market power on the supply-side.[23] Another definition depicts countervailing power as "[a] situation which predominates when the excessive market power of firms is counterbalanced by opposing market powers possessed by traders who sell to or buy from the former."[24]

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[19] Kirkwood(2004) p.36

[20] Competition Bureau Canada (2008) http://www.cb-bc.gc.ca/eic/site/cb-bc.nsf/eng/home

[21] Kirkwood cited by Chen(2008) p.244

[22] Chen(2008) p.244

[23] Chen(2008) p.244-245

[24] Goede(1997) p.302

Another approach incorporates monopsony power as well as bargaining power. Considering this approach, the factors determining buyer power are not competitive prices or conditions suppliers face, but rather conditions other buyers receive or would receive in a competitive market. As competitive conditions suppliers face may be imperfect and prices other buyers receive are uncertain to lie above or under the suppliers marginal costs, this approach combines bargaining power with monopsony power.[25]

Finally the following definition arises:

> *"Buyer power is the ability of a buyer to reduce price profitably below a supplier's normal selling price, or more generally the ability to obtain terms of supply more favourable than a supplier's normal terms. The normal selling price, in turn, is defined as the supplier's profit-maximising price in the absence of buyer power. In the case where there is perfect competition among suppliers, the normal selling price of a supplier is the competitive price, and buyer power is monopsony power. On the other hand, in the case where competition among suppliers is imperfect, the normal selling price is above the competitive price, and the buyer power is countervailing power."*[26]

2.3 Economic Theory

Most microeconomic textbooks focus on perfect competition, oligopoly and monopoly. What these three market structures have in common, is that they all face numerous participants on the demand side, but they differ from each other by the number of suppliers, as illustrated in Figure (1). But for further investigation of buyer power it is essential to study market structures where only few participants or even only one dominates the demand side. Therefore the following section will focus on those market structures, which are relevant when analysing the underlying theory of buyer power.

But before going into detail on market structures it is crucial to note that Figure (1) only observes face-to-face market power, therefore it is assumed that suppliers do not have buying power and the demand side has no power in selling. But a firm can actually have a superior position in buying and selling, which can have major implications for competition.[27]

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[25] Chen(2008) p.245

[26] Chen(2008) p.247

[27] Dobson, Waterson and Chu (1998)p.8-9

Figure 1: The structure of markets

		SUPPLY SIDE FORM		
		MANY	FEW	ONE
DEMAND SIDE FORM	MANY	Perfect Competition	Oligopoly	Monopoly
	FEW	Oligoponsy	Bilateral oligopoly	Monopoly oligopsony
	ONE	Monopsony	Oligopoly-monopsony	Bilateral monopoly

Source: Dobson P., M. Waterson and A. Chu (1998) p. 8

In order to measure real life markets it is fundamental to have an ideal model as a benchmark. This ideal model within economic theory is the model of perfect competition, which allows economists to demonstrate that generally society is worse off when markets are imperfect.[28]

In a perfect competitive market both suppliers and buyers are price takers. They sell and buy at the equilibrium price. If a supplier raises his price above the equilibrium, a buyer would switch to one of his competitors, hence suppliers have to stay within the equilibrium price. Vice versa, if the buyer tries to negotiate on obtaining a lower price, the supplier will sell his product to other customers, as there are sufficient willing to buy at the equilibrium price. Thus a perfect competitive market is characterised by a multitude of suppliers and buyers. In addition products need to be homogeneous. If a supplier raises the price above the equilibrium, buyers are only able to switch to competitors given that there exists a perfect substitute to this product. Therefore a perfectly competitive market needs homogeneous goods. Another characteristic in an efficient market is that there are no entry or exit barriers. Given that a new firm can exit and enter the market with no extra costs, it is ensured that the perfectly competitive market can be sustained by the multitude of buyers and sellers.[29]

[28] Perloff (2004) p.232

[29] Pindyck and Rubinfeld (2009) p.272-273

2.3.1 Monopsony

The model of perfect competition rarely holds within reality, but it is crucial to consider before investigating the theory of monopsony, which is most adequate when investigating buyer power.

As already mentioned, monopsony power is the opposite to monopoly power. The distinction between monopoly and monopsony power is that monopoly power is due to market power on the supply side and monopsony power due to market power on the demand side. However both do have comparable implications on social welfare.[30]

2.3.1.1 Model of Monopsony[31]

To demonstrate the implications of monopsony power, I utilise the model of monopsony by Blair R.D. and Harrison J.L.(1993):

A firm based in a small town produces textiles (X) by hiring labour (W) and machines (A).

It has the following production function:

$$X=X(W,A) \tag{1.1}$$

According to the insulated area in which the firm is based, it holds a monopsony position when employing labour. Therefore the wage *(y)* paid by the firm depends on the number of people employed within the firm, which leads to the following function of labour supply:

$$y=y(W) \tag{1.2}$$

It is assumed that the slope of this function is greater than zero.

The firm buys its machines at the market price and is a competitor within this market. The number of machines the firm acquires is fixed in the short-run, given that the firm already determined its size. Therefore the firm can maximise its profits *(p)* by varying the labour it employs. It is assumed that the firm sells its textiles in a competitive market, therefore the following profit function arises:

$$p = P \cdot X - y(W)W - m\bar{A} \tag{1.3}$$

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[30] Blair and Harrison (1993)p.36

[31] Blair and Harrison (1993)p. 36-37

In this equation P is the price per textile, m the price per machine and $\bar{A}$ the fixed amount of machines the firm acquires.

In order to maximise profits the firm will increase the number of employees as long as the marginal effect on p is zero. This is the case when the first partial derivative of the profit function W is equal to zero:

$$\partial p / \partial W = P \cdot \partial X / \partial W - (y(W) + W\, dy(W) / dW) = 0 \qquad (1.4)$$

When examining this equation in detail, $\partial X / \partial W$ demonstrates the change in output when increasing labour by one unit, which is defined as the marginal product of labour (MP_L). Since P is the price for textiles, P multiplied by $\partial X / \partial W$ is the value of the additional output given to the change in labour, which is defined as the value of the marginal product of labour (VMP_L).

As noted before, the slope of the supply of labour $y(W)$ is positive. In the event that the firm hires one additional employee, it must pay a higher wage. It is noteworthy that the firm has to pay this higher wage not only to the additional worker, but also to all other employees. Hence hiring one more employee has two effects. First, the new employee receives $y(W)$, the wage equal to what the others receive. It does not consider the increase in wage yet. Second, the income (W) that the other employees receive is increased by $dy(W) / dW$, which accounts for the increase in wage due to the additional worker.

Therefore the last part of equation (1.4), $(y(W) + W\, dy(W) / dW)$ demonstrates the costs caused by one additional worker and is therefore called the marginal factor cost of labour (MFC_L). Thus the equation (1.4) can be rewritten as the following:

$$\partial p / \partial W = VMP_L - MFC_L = 0 \qquad (1.5)$$

In order to maximise its profits the firm increases the number of employees until VMP_L equals MFC_L.

2.3.1.2 Implications on welfare and price trough monopsony power[32]

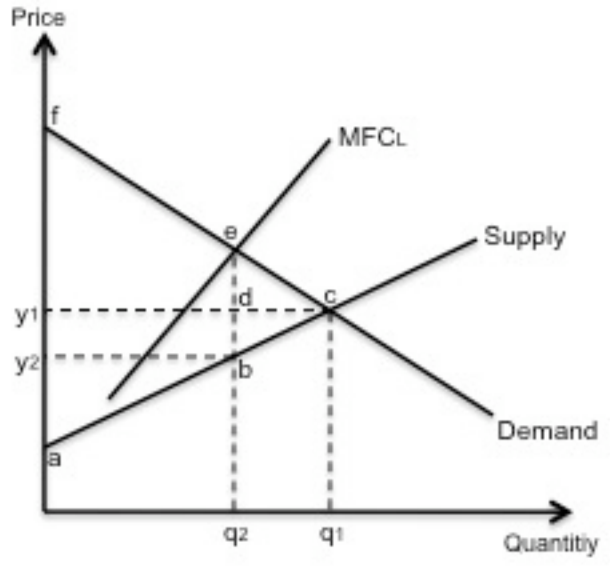
Assuming the firm would act like a competitor and hire employees at the equilibrium it would hire q_1 employees and pay a wage of y_1 as demonstrated in Figure (2). Consumer surplus is equal to the area fcy_1, producer surplus equal to acy_1. However the

[32] Blair and Harrison (1993)p. 37-39

firm does not act like a competitor in the labour market, therefore stops hiring employees at the point where MFC_L exceeds VMP_L, as the firm maximises profits when MFC_L is equal to VMP_L, as illustrated in Figure (2). VMP_L is equal to the demand curve within the equilibrium. So the firm is maximising profit when it employs labour at q_2, which is at the intersection of MFC_L and the demand curve. Hiring labour at q_2 is optimal for the firm, but decreases social welfare.

Therefore as demonstrated in Figure (2), producer surplus decreases by y_1cby_2, but the firm attains an additional surplus equal to the difference between the area y_1dby_2 and ecd. Furthermore a dead-weight loss equal to the area *ecb* evolves. Hence, if a firm has monopsony power, too few resources are applied, which entails a general loss in social welfare and second, part of the lost producer surplus is passed on to the firm‘s (consumer) surplus.

Figure 2: Monopolistic welfare losses



Source: Blair, R.D. and Harrison J.L.(1993)p.38

2.3.1.3 Can monopsony power be beneficial to final consumers?[33]

The above model on monopsony by Blair R.D. and Harrison J.L.(1993) reveals that monopsony power of buyers in a market has negative effects on suppliers and on social welfare. Nevertheless it is often argued that exempt from buyers, final con-

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33 Blair and Harrison (1993)p. 39-41

sumers do benefit likewise. Because the price savings a monopsonist obtains, are passed on. This implicates lower prices to final consumers. This assumption seems reasonable at first sight, but in fact is refused as shown by Blair R.D. and Harrison J.L.(1993) in the following section, when comparing a monopsonist in contrast to a firm under competitive circumstances.[34]

As illustrated in equation (1.5) a monopsonist‘s ideal level of hiring employees is where the marginal factor cost of labour (MFC_L) is equal to the value of the marginal product of labour (VMP_L). Given that MFC_L is the product of price (P) times the marginal product of labour (MP_L) the following equation results:

$$P * MP_L = MFC_L \tag{1.6}$$

By rearranging this equation the following arises:

$$P = MFC_L / MP_L \tag{1.7}$$

Basic economic theory demonstrates that in a competitive market a firm‘s output level is set where output price (P) equals marginal cost of production. Therefore the monopsonist‘s marginal cost of production is equal to MFC_L / MP_L as illustrated in equation (1.7).

A firm acting not only in a competitive output market but also in a competitive input (labour) market faces in contrast to the monopsonist, a fixed wage rate irrespective of the number of people hired. Therefore the MFC is ceaseless and equal to the wage rate (y). Further $P * MP_L = y$, which denotes that the firm is hiring employees as long as the additional market value of output due to increased labour is higher than the wage rate (y). By remodelling this, the following equation results:

$$P = y / MP_L \tag{1.8}$$

As illustrated in Figure (2), MFC_L is greater than the input (labour) price a monopsonist faces, namely MFC_L is larger than y. Thus the marginal cost of a firm with monopsony power is higher than that of a firm without, therefore:

$$MFC_L / MP_L > w / MP_L \tag{1.9}$$

Whereby the left-hand side represents the marginal cost of the monopsonist, the right-hand side the marginal cost of a firm without monopsony power.

[34] Blair and Harrison (1993)p. 39-41

Due to the fact that marginal costs are crucial to determine a firm‘s output level, the monopsonist will reduce its output level, relative to the firm without monopsony power. But the reduction in output level of this one monopsonistic firm will have no effect on overall competition in the output market. Therefore the monopsonist will set his output price equal to that of a firm without monopsony power, namely at the market price. According to this, price savings due to monopsony power are not relayed to consumers. [35]

The above model of monopsony is very useful to best describe the implications of monopsony power and even though it is exemplified on the labour market, the model is applicable on the product market, which is more appropriate when analysing buyer power in retailing. Therefore the model will be continued with regard to the product market, namely where the input market consists of products instead of labour. This means that from now on the firm has monopsony power in buying units of input, instead of hiring employees.

2.3.2 The Monemporist

The term "monemporist"[36] is used to describe a firm who is a monopsonist in the input market and a monopolist in the output market.

One assumption, made due to the fact of dealing with products in the input market, is that the firm uses the input product in final stages of production to accomplish the product. Hence demand is referred to as ‘derived demand‘ (dD) or average (net) value (revenue) product of the factor (AVP) as illustrated in Figure (3).[37]

Due to the additional monopoly position of the monopsonist in the output market, the derived demand curve (dD) is downward sloping which leads to the marginal revenue product (MRP) of input. The monemporist maximises his profit at the intersection of MFC and MRP, which lies below the competitive equilibrium, whereby price is equal to y_3 and quantitiy reduces to q_3. The grey-shaded area in Figure (3) illustrates the dead-weight loss resulting from an additional monopoly postition in the output market. This reveals that besides a firm‘s monopsony power in the input market, a mo-

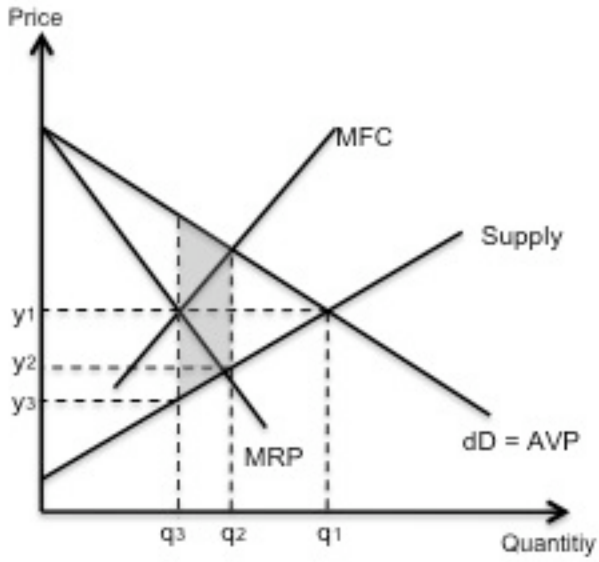
[35] Blair and Harrison (1993)p. 39-41

[36] Nichol (1943) cited by Dobson, Waterson and Chu (1998)p.12

[37] Dobson, Waterson and Chu (1998)p.11

nopoly position in the output market reinforces its position within the market which leads to an additional loss in social welfare.[38]

Figure 3: Additional Welfare Losses from an Monemporist



Source: Dobson P., M. Waterson and A. Chu (1998)p.12

To summarise, a monopsony is characterised by a buyer‘s ability to reduce input prices below the competitive equilibrium, by lowering the overall quantity demanded, whereas a monopoly is defined by a seller‘s ability to increase prices by restricting quantity supplied. In both cases the market is losing in total quantity traded in relation to the competitive market, therefore the market is no longer allocatively efficient. Unlike often assumed, lower input prices obtained through monopsony power do not result in lower prices in the output market. As a matter of fact if a buyer, besides being a monopsonist, has monopoly power in the output market, lower input prices turn into higher output prices.[39]

But a monopsony can have natural reasons as well. In some industries it may be most functional to allow only one buyer within the market, by reason that resources are best employed, even though welfare and dead-weight losses arise. As well, buyer cartels are founded due to cost-efficiency. Especially in retailing, where buyer groups are not rare, competition authorities view them critically. Moreover, so far the discus-

[38] Dobson, Waterson and Chu (1998)p.12-13

[39] Blair and Harrison (1993)p. 42

sion was mainly concerned with static welfare, so the question arises, to what extent will buyer power have an effect in the long run? As producers feel impelled to lower prices to further compete within the market, their profit decreases. Thus it is more difficult for suppliers to undertake new investments, which in turn results in lower quality and decreased consumer variety as less money is spent on product engineering and innovation.[40] Having a market where one part is totally dependent on one single buyer is always problematic.[41]

2.3.3 Oligopoly & Oligopsony

So far we were primarily dealing with monopsony. However as Figure (1) suggests, there are apart from monopsony, other market structures to consider important in terms of buyer power, for instance oligopsony. The difference between the two lies in the number of firms acting on the demand side. Oligopsony is characterised by many suppliers, like monopsony, but more than one buyer on the demand side.

In order to exert buyer power under oligopsony the following three criteria are essential:[42]

I. The buyers‘ purchase volume is significant in the market
II. Entering the market on the demand side is difficult
III. The slope of the supply curve is positive

If these conditions are fulfilled, the theory of oligopoly is applied to examine oligopsony, as well as the theory of monopoly is adapted to assess monopsony, as per statement above. Under an oligopsony the deviation from the competitive equilibrium in terms of price and quantity is highest, when the number of buyers involved in the market is lowest. As it is the case in a market characterised by dominant buyers, the more powerful one single buyer is in terms of market share and control, the greater his potential to push prices below the market equilibrium.[43]

In an oligopoly, firms are interested in their rivals‘ actions and choose their strategies accordingly, because the strategy one firm pursues, affects the success of the other

[40] Dobson (2002)p.4

[41] Clarke, Davies, Dobson and Waterson (2002)p.14

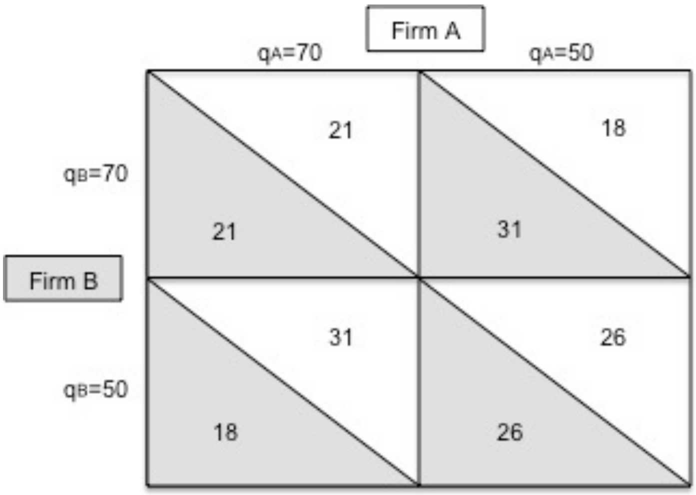
[42] Clarke, Davies, Dobson and Waterson (2002)p.12

[43] Clarke, Davies, Dobson and Waterson (2002)p.12

and vice versa. In this context a strategy is referred to the output or the price set by a firm. Under perfect competition things are different as the market price is assumed to be exogenously determined, therefore the strategy of an individual firm can be ignored.[44]

Game theory helps to explain the way decisions are taken by oligopolistic firms. For this reason, the basics will be explained by taking the example of a duopoly (an oligopoly consisting of two firms) and giving the profit matrix for these two rival firms A and B for one period as illustrated in Figure (4).[45]

Figure 4: Profit Matrix (given in € millions)



based on: Perloff, J. M. (2007), Microecnomics p.423

Both firms try to maximise their profits, but as their strategic decisions influence each other, one firm can only be better off if the other firm is worse off. Firms A and B can choose between an output level of 70 or 50 units. Each firm who decides to produce the higher output level can either earn a profit of € 21 million or € 31 million, as well as with the lower output level either € 18 million or € 26 million, depending on the other firm's output strategy. Neither firm A nor firm B knows of the other firm's strategy, because both firms make their decisions simultaneously. The situation both firms are faced with is referred to a "noncooperative game of imperfect information."[46]

[44] Perloff (2007)p.421

[45] Perloff (2007)p.422-424

[46] Perloff (2007)p.423

Even though the firms don‘t know about the other firm‘s output decision, both firms will choose an output level where output equals 70, as profits are relatively higher, regardless of the other firm‘s output strategy. Furthermore $q_A=q_B=70$ presents a Nash equilibrium, given that both firms would not change their strategies, even if they would know of the other firm‘s output decision beforehand as their profit does not increase by changing to the lower output level .[47]

The most efficient strategy for both firms is to produce an output level of 50 ($q_A=q_B=50$), as both firms would earn a profit equal to € 26 million. In order to achieve that both firms follow this strategy, firms A and B have to co-operate and therefore trust each other. But both firms face a *prisoners‘ dilemma*, whereby each firm has an incentive to cheat on the other as profits would increase to € 31 million by doing so. None of the two firms can be sure that the other will adhere to the contract, therefore they only collude if they have the possibility to punish the other firm in case of deception. However, in a single-period game that is not the case. Therefore firms collude in a multi-period game where the end can‘t be predicted as the following example shows.[48]

Let us assume firms A and B are in a multi-period game where the end of the game is unknown. Both firms agree to co-operate and produce 50 units of output and consequently both firms earn € 26 million each period. In case firm A cheats on firm B (or vice versa) and produces 70 units instead, firm B will punish firm A by producing 70 units in all of the following periods, which decreases the profit from € 26 million to € 21 million. In case the end of the game is known, the situation in the last period is the same as in the single-period game, as the incentive to cheat is high since the fraudulent firm can‘t be punished thereafter.[49] The above examples show to some extent why firms collude and form cartels.

2.3.4 Bilateral market power

If we take another look at Figure (1) we find that market power can be present on both sides of the market, therefore we call them bilateral. The most significant case is bilateral monopoly, where one buyer, who is a monopolist in his output market, is

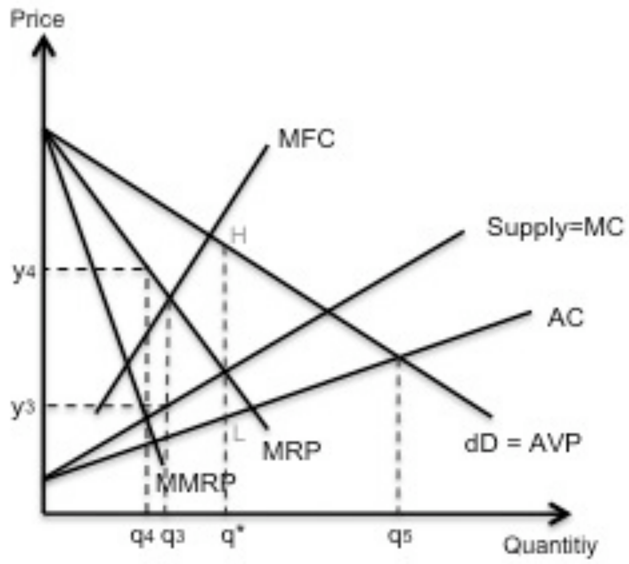
[47] Perloff (2007)p.422-424

[48] Perloff (2007)p.424

[49] Perloff (2007)p.424-425

faced by a monopolist in his input market. This case is examined by extending Figure (3). Previously we saw that the competitive equilibrium is where derived demand (AVP) and the supply curve intersect, whereby the supply curve is equal to marginal costs (MC). Furthermore we defined MFC and MRP, the former being the upward sloping supply, the latter the downward sloping demand curve. Now two more curves arise in our graph in Figure (5), namely the average cost curve (AC) and MMRP, which is marginal to MRP. MRP arises due to the monopsonist‘s additional monopoly in selling his output (monempory), whereas MMRP demonstrates the situation of a bilateral monopoly. The difference between the two is that in a bilateral monopoly, the single buyer has no monopsony power, as the seller holds a monopoly position, everything else being equal.[50]

Figure 5: Bilateral Market power



Source: Clarke, R., S. Davies, P. Dobson and M. Waterson (2002)p. 16

Now the market is characterised by a powerful supply and demand side. At first we will consider the situation where both sides do not act in conjunction. Hence either the buyer dominates and establishes the price first and the seller ascertains the quantity thereupon (monopsony outcome), or the seller dominates and sets price first and the buyer acts as in a competitive market (monopoly outcome) where MC is

[50]Clarke, Davies, Dobson and Waterson (2002)p.15

equal to MMRP. Therefore the seller sets the price at q_4 and quantity equals y_4 as illustrated in Figure (5).[51]

Thus one part defines the price the other has to comply with. Now we assume that buyer and supplier are conscious of their interrelation and co-operate, therefore they first set quantity before they determine the price together. The optimal quantity for the single buyer and the single supplier is at the intersection of MC and MRP, given as q*. However the price lies in between H and L as illustrated in Figure (5). This implies that the price has to be above the supplier‘s average costs (AC) and beneath the buyer‘s average value product (AVP), as H represents the price the buyer and L the price the seller just breaks even. Hence the price is an outcome of the two parties‘ bargaining.[52]

The output q* is Pareto efficient for the two monopolists, but although it is higher than q_3 and q_4, it is not necessarily better in terms of social welfare. It is important to notice that on the one hand a monopolist buyer reduces quantity beneath the competitive level to maximise profits, but on the other hand he can still realise profits when output equals q_5 where AVP and AC meet, given in Figure (5).[53]

After analysing the different structures of markets, it seems obvious that none of them has beneficial effects on welfare, contrariwise we could only find detrimental effects. As well, the argument that monopsony power can be beneficial to final consumers was rejected as the lower prices received by intermediate buyers are not passed on to final consumers.[54] In oligopolistic and bilateral markets there is a high incentive to co-operate even if collusion is complex as the involved firms have to be prevented from cheating on each other and anti-competitive laws and governments prohibit cartels.

So far we considered only market structures when analysing buyer power. The number of participants acting in a market is crucial for the emergence of buyer power, but there exist other sources of buyer power, which we referred to as bargaining power

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[51]Clarke, Davies, Dobson and Waterson (2002)p.15

[52]Clarke, Davies, Dobson and Waterson (2002)p.15-16

[53]Clarke, Davies, Dobson and Waterson (2002)p.16-17

[54] Blair and Harrison (1993)p. 42

before. In the following the emphasis lies on strategic actions, taken by powerful buyers to exert power.

3. Strategic Buyer Behaviour

There exist different practices taken by buyers to exert power. These are divided into the following ten categories. The practices are concerned with various sources of bargaining power, whether it be anti-competitive by squeezing competition out of The market, areal in terms of land use planning and concentration, monetary by charging illegitimate fees or shifting rents, among others. The practices described in the following are rather representative than complete. [55]

Category 1: Slotting allowances

Slotting allowances represent fees paid by suppliers to have their product placed in the store shelves. But not all suppliers are asked for slotting allowances. As some products are indispensable for supermarkets to store, only certain suppliers have to pay in order to have their products placed. The amount depends on various factors and is usually based on an agreement between the supplier and retailer. Suppliers introducing new products are very likely to pay slotting allowances. It is argued by retailers that the success of the product is uncertain as well as products placed at eye level or on special display are charged in exchange. There seem to be no clear rules why some suppliers are charged with slotting allowances and others are not. Even though slotting allowances are not generally illegal, their existence is controversial.[56]

Category 2: Exclusive Distribution

By closing a sole or exclusive distribution contract, retailers are provided with special distribution rights. This practice is related to conditional purchase, described within the next category.[57]

[55] Dobson, Waterson and Chu (1998)p.22

[56] see:FMI Food Marketing Institute http://www.fmi.org/media/bg/slottingfees2002.pdf

[57] Dobson, Waterson and Chu (1998)p.22

Category 3:Conditional purchase behaviour

Retailers using this strategy purchase only if a supplier guarantees substantial concessions to them. This can be devastating to suppliers‘ viability, especially if the retailer accounts for a significant proportion of their sales. Therefore they often have to lower the prices in order to comply with retailers‘ conditions, since their alternatives are limited. Frequently retailers induce this exclusive position by imposing conditions on suppliers, which prevent them from selling to others. Food manufacturers reported on cases in which supermarkets conditioned their purchase on the fact that manufacturers would not supply discounters with their products. Retailers deny these incidents. However, it is noteworthy since not only suppliers but also discounters are affected.[58]

Category 4: Exclusivity contracts

The question arises why suppliers engage in exclusive contracts with buyers, as described in Category 2 and 3. One reason can be taken from literature, whereby manufacturers induce exclusive terms in order to restrict competition which allows higher downstream prices, beneficial to both parties. Another reason may be due to vertical externalities, occurring from extensive autonomous behaviour. Therefore, suppliers may accept exclusive contracts for their own advantages. Furthermore, retailers lure suppliers by offering exclusive contracts under good conditions at first but alter conditions to their advantage within time.[59]

Category 5: Cloning behaviour

In general, trademarks are legally protected from being copied by others. However, this protection is not sufficient from keeping others, especially retailers, to clone or copy products. In recent years the number of own-labelled products by retailers increased, as well as the retailers‘ capability to design products very close to the original.[60] Consequently, the retailer is becoming a direct competitor to the manufacturer of the original product, which is either positive or negative for consumers.

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[58] Dobson, Waterson and Chu (1998)p.22-23

[59] Dobson, Waterson and Chu (1998)p.23

[60] Dobson, Waterson and Chu (1998)p.23-24

On the one hand, store-brands alternatively offer to consumers a supplement at lower prices. On the other hand manufacturers‘ incentive to invest in product development and innovations is reduced as retailers are likely to copy them soon after. Therefore consumers may face less product innovations in the future. Retailers have major advantages in competing with other manufacturers, since they benefit from a double role: being a supplier and selling to final consumers. In contrast to sole manufacturers, they have additional access to valuable information. In their role as retailer they are provided with facts about consumers‘ habits and preferences by means of loyalty cards and other marketing tools, plus their role as buyer keeps them updated on product innovations. Besides price and information advantages, retailers can favour own-labelled products by supporting them with better shelf-placement.[61]

Category 6: Joint marketing

A retailer and manufacturer may engage in joint marketing to improve their sales, which may be beneficial for them individually, but not in general terms. Within a joint marketing program, as for instance commodity bundling, joint promotion, special discounting or a special joint advertising campaign, a manufacturer presumably provides the retailer with unique privileges which are not offered to others. This gives the retailer a certain advantage against others, since retailers compete with heterogeneous products.[62]

Category 7: Predatory buying of inputs

Sellers may attempt to lower prices to push rivals out of the market, since they fail to compete in the long-run. Analogously buyers, such as retailers, may follow a cost-raising strategy. Thereby a retailer extends her purchase-level significantly, whereupon competitors drop out of the market, since they can not compete in this market anymore. Their costs would rise to an exorbitant dimension and become unbearable. This strategy has most impact on markets where scarce resources such as skilled labour or quality raw materials are utilised, as alternative or substitute inputs for production are limited. But the signal, this strategy entails appears even more effective

[61] Bundeswettbewerbsbehörde Republik Österreich (2007)p.11

[62] Dobson, Waterson and Chu (1998)p.24

than the strategy itself. It does not only result in fewer market participants but also alienates potential market entrants.[63]

Category 8: Strategic purchasing of facilities

A supermarket or store in general represents the key facility of distribution in retailing. Therefore the fragmentation and density of stores among retailers within an area is an important factor for a supplier‘s success, since manufacturers face limited alternatives to switch to another retailer when the market is dominated by only one or a few retailers. Nowadays the hypermarket is the dominant store format, hence it is the main key facility of distribution to sell products to the end consumer, and the epitome of concentration. This affects not only manufacturers as they may see themselves captured by a single retailer, but also competition among retailers. In this context the role of the first-mover becomes vitally important, as planning controls often restrict the construction of new stores for environmental reasons. Hence, being the first to open up a market within an area or discovering well-situated sites for new stores entails a major advantage and a certain source of power to retailers.[64]

Category 9: Reciprocal dealing

Reciprocal dealing is based on an agreement between a seller and a monopsonistic buyer, whereby the seller undertakes to purchase again from the buyer. This may entail economies of scale as the buyer engages in the input market of his own seller. For instance, the wholesale department of a conglomerate firm purchases from a processed food factory, which in turn buys its inputs from the conglomerate firm.[65]This leads to an increased interdependence within a market and more room for imperfect market conditions.

Category 10: Terms of business

Most of the terms and conditions between a buyer and seller are agreed on in a contract. However, in most industries some unwritten rules and norms exist, which are adopted and become generally accepted in the course of time. These so called

[63] Dobson, Waterson and Chu (1998)p.24

[64] Dobson, Waterson and Chu (1998)p.24-25

[65] Dobson, Waterson and Chu (1998)p.25

‘standard terms of business‘[66] for instance, are generally applied methods of payment or the sharing of promotional expenses between the two parties. Depending on their relevance and acceptance within the industry, these terms can either be positive or negative for the involved.[67]

Whether these practices are harmful or not to consumers depends mostly on factors such as competition in the down-stream market and concentration among retailers. In a competitive down-stream market, retailers are likely to pass cost advantages on to final consumers in spite of strategic practices, whereas in a market with a limited number of retailers, strategic actions may add to reduced competition, create barriers to entry and facilitate collaboration among retailers. On the other side the practices may lead to increased efficiency by means of lower costs to consumers and higher service and product quality. Therefore it varies from case to case whether the practices are considered harmful or beneficial to consumers.[68]

An investigation of the UK grocery market in 2000 by the Competition Commission[69] (CC) gives some insights into the impact of practices on the relationship between suppliers and retailers. Suppliers were asked to report on practices retailers employed and, despite of multiple accusations from the suppliers‘ side, it was challenging to get more detailed information, as suppliers feared to be punished by retailers if they disclosed too much information. Hence, the CC sent a list, including 52 practices[70] suppliers had complained about to retailers. These in turn were asked to state whether they engaged in those practices within the past five years or not. The first 24 practices were random and the others divided into groups like contractual arrangements, delistings, intermediaries, prices, product specifications, and suppliers‘ contributions to marketing/promotional activities. Retailers were asked, for instance, if they demanded payments or price reductions from suppliers which were not cost-related; made alterations of terms of contracts without adequate notification in advance, re-

[66] Dobson, Waterson and Chu(1998)p.25

[67] Dobson, Waterson and Chu(1998)p.25

[68] Dobson, Waterson and Chu(1998)p.25-26

[69] see: http://www.competition-commission.org.uk/rep_pub/reports/2000/446super.htm#

[70] see: http://www.competition-commission.org.uk/rep_pub/reports/2000/446super.htm# Appendix 11.3

sulting in additional costs for suppliers; charged suppliers for displaying or placing their product at all; conditioned their purchase on the duration of the credit period suppliers agreed on or accomplished delistings in favour of own-label products.

The CC found that the utilisation of 27 of these practices by retailers holding a market share of more than 8 percent of grocery resale has detrimental effects on competition and holds potential for another way of constituting to a monopoly. Hence, they suggested that an obligatory Code of Practice for the major retailers would be most adequate to get things under control.[71] However, the success of the Code has been controversial.

4. Indicators of buyer power

4.1 Buyer Concentration

As mentioned before, buyer power mostly occurs in markets in which a few buyers dominate the demand side. Therefore, buyer concentration is an indicator of buyer power. But a high buyer concentration does not entail that buyers actually exert power, even though chances are high that they do so.[72]

There are several indicators of buyer concentration, hence it can be ambiguous to which we refer. In the glossary of statistical terms by the OECD we find that 'Concentration refers to the extent to which a small number of firms or enterprises account for a large proportion of economic activity such as total sales, assets or employment.'[73]

Buyer concentration can be measured by relating the number of buyers with the percentage of sales of a good, they are responsible for. For instance, 5 buyers buy 50 percent of the total amount of a good. Since this indicator is not hard to calculate and of informative nature, it has practical relevance. However, it is not always one-to-one comparable as the percentage accounting for the sale of a product is chosen randomly.[74]

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[71] see: http://www.competition-commission.org.uk/rep_pub/reports/2000/446super.htm# Chapter1,p.6-7

[72] Clarke, Davies, Dobson and Waterson (2002)p.28-29

[73] Khemani and Shapiro (1993) see: http://stats.oecd.org/glossary/detail.asp?ID=3165

[74] Clarke, Davies, Dobson and Waterson (2002)p.29

For instance, in general 10 buyers accounting for 50 percent of purchases is not alarming, whereas 5 buyers could indicate a high buyer concentration. Furthermore, it is essential to consider the percentage each firm accounts for individually, since 10 firms may account for 50 percent of purchases all together, but the leading firm may be in charge of 40 percent and the remaining nine firms share the residual 10 percent of purchase. Hence, size inequalities among firms are worth of attention, but there is no rule of how to combine both measures.[75]

Another well known indicator of buyer concentration is the five-firm buyer concentration ratio, which summarises the market share of the five largest firms on the buying side of a market. That is not to say that a number other than five firms is unconceivable, but it is rather unusual as the five-firm buyer concentration (BCR5) is most applicable. Thus, for instance, if the largest five firms each account for 22 percent, 15 percent, 9 percent, 6 and 4 percent, then the BCR5 is equal to 56 percent. As the former indicator, the BCR5 does not involve complex calculations and is of a visceral nature.[76]

Other indicators of buyer concentration include the Herfindahl index, which is defined as ‘A measure of industry concentration. The value of the index is the sum of the squares of the market shares of all firms in an industry. Higher values indicate greater concentration.‘[77] It is generally applied to measure concentration on the supply side, but can be applied within this context as well. However, it is more elaborate to calculate and less intuitive than other measures.[78]

4.2 Elasticity of supply

It is argued that within a monopsony, buyer power, given as the difference a buyer is inclined to pay for a product and the price he actually pays, is the inverse of the elasticity of supply. In turn, the inverse of the elasticity of supply is referred to as the BPI or the buying power index. The distinction from other indicators is that the index measures to which extent buyers influence the market, whereas size is subordinate.

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[75] Clarke, Davies, Dobson and Waterson (2002)p.29

[76] Clarke, Davies, Dobson and Waterson (2002)p.29

[77] OECD (2004) see http://stats.oecd.org/glossary/detail.asp?ID=6205

[78] Clarke, Davies, Dobson and Waterson (2002)p.29

It may be not clear at first sight that the inverse elasticity of supply is a measure for buyer power. However, it is argued that in a market with a perfectly elastic supply, even a sole buyer with a dominant position facing no competitors is incapable of exercising power due to limited supply. Alternatively, the more imperfect elastic supply is within a market, the greater the monopsonist‘s ability to exert buying power. Since the monopsonist is able to lower purchase prices by restricting demand, he can obtain overstated earnings.[79]

However, the BPI faces several drawbacks. Unlike the BCR, it is challenging to calculate the elasticity of supply for a real market, therefore the BPI is less applicable in reality. Another disadvantage is its appropriability, as it is mainly adequate in monopolistic-like markets and becomes more complex and restricted in its utilisation within other market structures. Nevertheless, it can provide pivotal information on buyer power, therefore it should not be underestimated.[80]

4.3 Performance Measures

Another approach to buyer power is by investigating performance-related indicators, such as price-cost margins. Even though they are no determinants for buyer power, they may assist to indicate buyer power and lead to further investigations.[81]

The price-cost margin, the difference between the price a buyer is willing to pay and the price he actually pays, is important since in a monopsonistic model it can be indicative of a monopsonist‘s buyer power. It is assumed that the higher the price-cost margin a monopsonist earns, the more buyer power he exerts. Therefore, price-cost margins can be indicative for buyer power as they may reveal some information on the extent of discounts or the value of other terms buyers receive from suppliers.

However, the drawbacks of price-cost margins as indicators for buyer power are that, first of all, it is difficult to obtain the relevant information to calculate them. Second, their implications can be interpreted in various ways. On the one hand, it is argued that buyers increase price-cost margins by lowering prices by means of buyer power, but on the other hand high price-cost margins may indicate lower costs due to effi-

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[79] Clarke, Davies, Dobson and Waterson (2002)p.30

[80] Clarke, Davies, Dobson and Waterson (2002)p.30-31

[81] Clarke, Davies, Dobson and Waterson (2002)p.31

ciency reasons such as buying in bulk. Thus, high price-cost margins are not a priori undesirable. However, buyers or retailers exerting power on both sides of the market, namely as buyers and resellers, may exert buyer power to lower prices on the one side, but do not pass these cost advantages on to final consumers. Consequently high price-cost margins can be good indicators for buyer power, but their sources may be diverse.[82]

4.4 Market definition

The previous indicators assist competition authorities, researchers and others to measure buyer power. However, another important factor is to define the market upon which the indicators should be applied. Therefore, we deal with market definition in the following:

A market can be defined by various factors depending on the purpose of its definition. In our context, two factors are essential to determine a market: the geographical scope the market is located in and the existence of substitutes. Additionally, the definition varies depending on the selling or buying side of the market. On the selling side, typically, several stores are located within an area that is within easy reach for consumers; the market is therefore sub-state. On the buying side the market definition can be extended towards a more national or international market. However, specific brands or products demanded by consumers may delimit the market. Furthermore, local suppliers may depend on regional retailers, particularly if long-term agreements are a common practice.[83]

To define a market one can adhere to the following definition in which the majority of '*... customers would switch to readily available substitutes or to suppliers located elsewhere in response to a hypothetical small permanent relative price increase to the products and areas being considered*.'[84] Since customers would buy in other areas or switch to other products, the price increase is ineffective, even detrimental to the seller (retailer). However, the market definition is complete when the previous definition is inverted. Namely, when the majority of customers remains with the seller

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[82] Clarke, Davies, Dobson and Waterson (2002)p.30

[83] Clarke, Davies, Dobson and Waterson (2002)p.32

[84] European Commission (1997b) cited by Clarke, Davies, Dobson and Waterson (2002)p.32

despite a price increase, which leads to higher profits for the seller. An example would be if all retailers for electronic products within a sub-area increase prices by one-fifth to one-tenth, but customers still adhere to those sellers and do not seek to find others at lower prices. Then the market is defined. However, in case the majority of customers seeks to find lower prices in other sub-areas, the definition of the market has to be extended until the increase in prices would become profitable for retailers.[85]

Defining a market by a hypothetical price increase, as the previous example demonstrates, is also known as the SSNIP (Small but Significant Non-transitory Increase in Prices) Test or Hypothetical monopolist test. The test was adopted by the US department of Justice and became internationally accepted.[86]

The OFT states:

> *'In essence the test seeks to establish the smallest product group (and geographical area) such that a hypothetical monopolist controlling that product group (in that area) could profitably sustain 'supra competitive' prices, i.e. prices that are at least a small but significant amount above competitive levels. That product group (and area) is usually the relevant market.'*[87]

Beside the geographical and substitute component, consumer habits are also essential to define a market. In the food sector, European countries mostly differ from each other in terms of consumer habits and preferences. Therefore, the markets are more national than international. However, national markets are probably oversized if we refer to the market definition of the OFT. Hence, it would be more adequate to divide them into sub-regional markets. But national data are easier to access than sub-regional data. Thus, national markets are practically more relevant, even though results may be distorted and buyer concentration undervalued.[88]

Another important factor is whether discount and convenience stores are included in the definition or left out. In several European countries, discount stores developed within recent years towards the more traditional supermarket, hence, discount stores are included. Convenience stores, on the other hand, are left out as they rather serve

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[85] Clarke, Davies, Dobson and Waterson (2002)p.32-33

[86] Motta (2004)

[87] OFT see: http://www.oft.gov.uk/shared_oft/business_leaflets/ca98_guidelines/oft403.pdf p.4

[88] Clarke, Davies, Dobson and Waterson (2002)p.33

for top-up than one-stop shopping and their customers seem to be less sensitive to price changes.[89]

So far we considered the market definition on the selling side. The market definition on the buying side differs by the parties directly involved, since suppliers‘ actions are relevant instead of consumers‘. However, needless to say that consumers‘ actions are always essential. Now let us assume that a buyer who is active as reseller decreases purchase prices of his suppliers by one-fifth to one-tenth. If sufficient suppliers subsequently stop providing the buyer with their products, his product range will be significantly reduced. Consequently, the buyer‘s profits decrease as fewer consumers seek to buy at his stores. Instead of increased profits, the buyer incurs losses from decreasing suppliers‘ prices. In this case the market definition has to be extended and similar buyers have to be included, until suppliers sell their products despite a decrease in prices.

It is remarkable that final consumers again take a major part in defining the market. Retail buyers are affected the most by suppliers‘ delivery stop, when they fail to store those products heavily demanded by consumers. An example for the market definition on the buying side would be an Italian retailer for designer clothes who demands a price reduction from its suppliers within a special region. Due to the price reduction, a majority of suppliers stop providing this retailer with the clothing they manufacture. This in turn makes the price reduction unprofitable for the retailer, since his product range is significantly reduced and less consumers seek to buy in his stores. In this case the market definition has to be extended and similar clothing retailers have to be included. Consequently if the Italian retailer then retains sufficient suppliers despite cutting prices, the definition of the market is accomplished.[90]

However, theory and practice differ from each other. In the food industry for instance, the bigger manufacturers operate across borders. Still, retailers mostly negotiate with national affiliates and the geographic market is therefore assumed to be national across Europe. Although under certain circumstances it is rather adequate to take the European market as benchmark. Another important factor to consider is which prod-

[89] Clarke, Davies, Dobson and Waterson (2002)p.33

[90] Clarke, Davies, Dobson and Waterson (2002)p.34-35

ucts to exclude or include in the market definition. A retailer has to store a number of products in order to be considered well-assorted. Whether products such as fresh food, detergents, cosmetics, alcohol etc, are included or excluded from the market definition varies across nations.[91]

In conclusion it is assumed that in the food industry the market definition on the selling side as well as on the buying side is rather national with some exceptions. Convenience stores are left out, but traditional supermarkets, hypermarkets and discounters are included on the selling side. Furthermore the definition implies household goods and beverages.[92]

5.The real world

So far we were concerned with the principles of buyer power. The theory of microeconomics demonstrated its impact on welfare with regard to different market structures. We investigated strategic practices, utilised by retailers to extend their market power or even establish a dominant position in the market. Moreover, we identified the indicators of buyer power and demonstrated how a market is defined in theory.

The theoretical concept of buyer power may not be fully applicable in practice, since the overall picture of an economy or a market is difficult to investigate in theory. Therefore, the following section provides essential information on real markets and whether the theoretical concept of buyer power holds in practice. Hence, we will investigate decisions by the European Commission (EC) on mergers in recent years. This should be a key moment while reading the thesis, as it reveals background details on markets, after a detailed discussion on theoretical principles. Furthermore a discussion on recent food price developments in Austria indicates how buyer power or a highly concentrated market can possibly influence a market.

5.1 European Commission in Merger Cases

Before going into detail on decisions made by the EC, it is essential to clarify the role of mergers in terms of competition and the competencies of the EC in this respect.

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[91] Clarke, Davies, Dobson and Waterson (2002)p.35

[92] Clarke, Davies, Dobson and Waterson (2002)p.35

When two or more firms merge, the effects on the economy vary depending on the case. On the one hand a merger may enhance economic efficiency by reducing costs through economies of scale or by the development of new products. However, on the other side a merger can have detrimental effects on competition. By combining resources, firms may reinforce their market power and obtain a dominant position in the market. Consequently, consumers may face higher prices, lower quality and reduced choice, since competitors, unable to compete in such a market, were driven out.[93]

Therefore, in general competition authorities have to approve a merger prior to being accomplished. In case more than one EU member is involved or the firms‘ consolidated annual sales revenue is above a certain limit, the case is directed to the EC. Furthermore, it is verified whether the merger can be permitted or not. However, in case the annual sales revenue does not exceed the limit, national competition authorities investigate the relevant cases. Some mergers, however, may be investigated by the EC even though national authorities are responsible for them.[94]

5.2 The decision on Rewe/Meinl

The following case is based on numbers and information related to the EC decision on Febuary 3, 1999.[95] The information given in the following is not up to date, since we refer to the time before the merger in the late nineties. Therefore, by writing in the present tense we are referring to the pre-merger period. Nevertheless, the purpose is to evaluate the merger decision of the EC in order to obtain information about the Austrian market. The Rewe/Meinl case was and still is of major importance not only for competition authorities but also in the food retailing industry. It sets an example in the history of food retailing and is often referred to in similar cases. The investigation of this case therefore gives us valuable insights into the Austrian market and its dynamics.

5.2.1 Rewe/Meinl

In August 1998 the German group Rewe announces its intention to acquire 100% shares of the Austrian retailer Julius Meinl AG. In 1996 Rewe, a major retailer and

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[93] EC see: http://ec.europa.eu/competition/mergers/overview_en.html

[94] EC see: http://ec.europa.eu/competition/mergers/overview_en.html

[95] EC (1999) see: http://ec.europa.eu/competition/mergers/cases/decisions/m1221_19990203_600_en.pdf

wholesaler in the food industry, entered the Austrian market by the acquisition of BML (consistent of *Billa*, *Merkur*, *Emma*, and *Mondo* operating in food-retailing and drugstore-chain *Bipa*). The Julius Meinl AG (consistent of PamPam, Julius Meinl, Julius Meinl Gourmet and Jééé), a retailer of everyday consumer durables, does its operations in Austria and to a small extent in Italy. It owns 341 stores, which are all intended to be purchased by Rewe.[96]

Since the combined turnover of the two firms was above the threshold and the acquisition of 100% Meinl shares was supposed to contribute significantly to the concentration of the market, the EC was responsible for the investigation of the merger according to Article 2 of the Merger Regulation.[97]

5.2.2 The Evaluation under the Merger Regulation

The EC investigated the case on two different levels: the supply side (distribution market) and the demand side (procurement market) of the food retailers' market. On the supply side Rewe/Meinl acts as seller to the final consumer, whereas on the demand side it purchases goods from manufacturers and producers. In the following, the market definition of the two firms involved in the merger will be identified.[98]

5.2.3 The Distribution Market

5.2.3.1 Relevant Product Market

There is a distinct market in food-retailing, which includes all retailers stocking food and non-food items in super- and hypermarkets in particular. Specialised shops such as bakeries or butchers, however, are excluded from this market definition. Even though Rewe and Meinl suggested to include them together with farmer's markets and petrol-stations, the EC refused to do so. It found that those specialist shops could not be appropriate substitutes, as they do not satisfy the principle of one-stop-shopping. Plus, the EC argued that 98% of customers of specialised shops equally buy at supermarkets. Petrol-stations were also not included, since customers' intentions to shop at a petrol station are different from shopping at a supermarket, because prices are significantly higher and the product range is substantially smaller.

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[96] European Commission(1999)Commission Decision Case NoIV/M.1221p.1-2

[97] European Commission(1999)Commission Decision Case NoIV/M.1221p.2-3

[98] European Commission(1999)Commission Decision Case NoIV/M.1221p.3

The remaining question is whether discount stores are included in the market definition. The EC states that discount stores carry mostly unbranded products and offer reduced service, compared to the traditional retailers. Hence, it was controversial whether discounters are direct competitors and should be included in the market. By all means, the EC argued that decisions would not be affected thereby.[99]

5.2.3.2 Relevant geographic market

The relevant market of Rewe, Meinl and also of competitors Spar, Löwa and ADEG is national. All retailers operate all over Austria, even though their prevalence varies across regions. Spar is better established in the western part of Austria, whereas Rewe (Billa) is more prevalent in the eastern part. Since the product range and prices do not vary significantly across the country, the market is assumed to be national.[100]

5.2.3.3 Market shares

In Austria the two major retailers, Rewe and Spar hold together a market share of more than 60%. Table (4) illustrates the market shares of each retailer in Austria. The numbers indicate that a merger with Meinl would even increase Rewe's market share and leave competitors behind.[101]

Table4: Market Shares in Austrian Food-Retailing

Firm	Market share with discount stores	Market share without discount stores
Rewe/Billa	[27-33] %	[33-38] %
Meinl	[5-10] %	[5-10] %
Spar	[23-28] %	[27-32] %
ADEG	[8-13] %	[10-15] %
Hofer	[<15] %	
Löwa	[<10] %	[<10] %
Others	[<10] %	[<10] %

Source: European Commission(1999)Commission Decision p.7

5.2.3.4 Strengths

As mentioned above, Rewe holds a strong position in the eastern part of Austria, as does Meinl. Therefore, a merger between the two parties would not only increase

99 European Commission(1999)Commission Decision Case NoIV/M.1221p.3-5

100 European Commission(1999)Commission Decision Case NoIV/M.1221p.5-6

101 European Commission(1999)Commission Decision Case NoIV/M.1221p.6-7

Rewe‘s market share across the country but also reinforce its strong position in Vienna, Lower Austria and the northern Burgenland in particular. However, those parts are of major importance, since a majority of the country‘s purchasing power rests within these regions, as Table (5) demonstrates.[102]

Table5: Austria in 1999

Provinces	Population density (per sq km)	Surface (sq km)	Population
Burgenland	70	3 962	276 486
Vorarlberg	134	2 601	347 443
Salzburg	72	7 156	512 049
Carinthia	59	9 538	560 821
Tirol	53	12 640	665 773
Styria	72	16 401	1 183 146
Upper Austria	114	11 980	1 368 299
Lower Austria	80	19 186	1 532 920
Vienna	3 724	415	1 545 386
Austria TOTAL	95	83 879	7 992 323

Source: Statistik Austria, Interaktive Datenbank http://www.statistik.at/web_de/statistiken/index.html (accessed August 2009)

Prior to the merger application in 1999, Austria has an average population density of 95 people (per sq km). However, Vienna, Lower Austria and Burgenland together have an average population density of 143 (per sq km). This indicates that the purchase power is higher within these regions than in the rest of Austria. Although the East covers only 30% of the total surface, still more than 41% of the total population lives within this region. These numbers do not include commuters, who are estimated to 1.2 million collectively in Vienna, Lower Austria and Burgenland in 1991 and even increased until 2001.[103]

The merger would lead to a market share of Rewe/Meinl in East-Austria, four times larger than its largest competitor Spar. Plus, Rewe/Meinl would run more than twice as many stores within this area. Furthermore, the combined firm could increase its market share above 80% in Vienna, which may affect the entire market in Austria. Since a large proportion of the total turnover is effected in Vienna, a retailer holding a

[102] European Commission(1999)Commission Decision Case NoIV/M.1221p.8

[103]Statistik Austria (2007)Tagespendler/-innen 1971 bis 2001 nach Verkehrsmittel und Bundesländern

dominant position in this area could benefit in various ways. First, by exerting market power in the Viennese market, and second, by establishing a dominant position in other parts of Austria by means of resources acquired through its prevalent position in Vienna. However, Rewe and Meinl argue that Spar has a leading position in five of Austria‘s provinces. This is better on paper than in reality. Spar has a leading position mainly in rural areas, which are less populated. Therefore, the turnover in populous regions, such as Vienna is much higher due to a greater purchase power.[104]

In food retailing, large store formats are essential for a retailer‘s success. A combined firm of Rewe and Meinl would run the majority of large outlets such as supermarkets and in particular hypermarkets. Consumers favour these store formats since they respond to their busy lifestyles. Large outlets offer greater convenience to customers through a one-stop-shopping opportunity, compared to smaller stores. Rewe already owns 66 hypermarkets (Merkur) in Austria. By acquiring Meinl, another 40 (PamPam) would be added, while competitors Spar and Löwa operate 44 (Interspar) and 17 (Magnet) hypermarkets. Therefore, Rewe/Meinl would own nearly three times as many hypermarkets as its largest competitor Spar. Furthermore, Rewe is the leading retailer in terms of average sales per square metre. Its Merkur hypermarkets effectuate nearly twice the number per square metre than Interspar. However, Rewe/Meinl argued that Interspar would be larger in size, therefore they could offer a wider product range which gives them a major competitive advantage. Nonetheless, the EC could not find any evidence for this argument. On the contrary the numbers indicate the reverse.[105]

In food-retailing the location of a shop is not only crucial for consumers‘ convenience, hence retailers‘ turnover, but also for logistic handling. Consequently, the key locations are around urban centres, in shopping streets within city-centres, as well as in shopping centres and specialised supermarket centres. In urban areas, logistics may be impeded by high road traffic loads and restricted delivery periods. However, the

[104] European Commission(1999)Commission Decision Case NoIV/M.1221p.9-10

[105] European Commission(1999)Commission Decision Case NoIV/M.1221p.10-11

costs of logistics in rural regions may outweigh, since the points of delivery are scattered and some alpine valleys are hard to access.[106]

Rewe already operates 66 stores in these key regions. By the acquisition of Meinl the number would rise to 106, whereas Spar operates 62, Hofer 47, Löwa 20 and ADEG 5 stores in these key areas. Once again Rewe/Meinl would have a major advantage compared to its rivals, as it would occupy 40% of the vantaged locations. Besides, it may not be efficient to continue proceedings of all 341 Meinl shops and after a merger Rewe/Meinl would therefore convert some Meinl shops into its Bipa drugstores. Hence, competitors awaiting a share of the pie may be disappointed, since Rewe/Meinl would probably divest only a few shops.[107]

Rewe and Meinl have another corporate advantage compared to Spar: their organisational structure. Rewe and Meinl are chain store companies, therefore their shops are centrally organised. This gives them the power to decide on important issues (e.g. advertising, product policy, prices) for their shops. However, only 30% of Spar‘s stores are centrally organised, the remaining 70% are mostly operated by independent traders. This may be an advantage for the trader as it provides him with a greater freedom of decision. Nevertheless, centrally organised retailers such as Rewe or Meinl face several advantages. First, they are more flexible, since they are better able to respond to changes by implementing regulations on a central level. Second, they are best qualified to introduce their own-labelled product range due to their great authority to issue orders. A retailer stocking his own-labelled products faces a competitive advantage. Consumers use prices of branded-products to compare the price-quality ratio between stores. Hence, in order to attract customers, branded products are priced sharply. However this cuts profits from retailers, since the margin on these products is rather small. Consequently the advantage of own-labelled products is that customers do not have a one-to-one comparable product, since they are only available at this particular retailer. Therefore, consumers are less price-sensitive when it

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[106] European Commission(1999)Commission Decision Case NoIV/M.1221p.11

[107] European Commission(1999)Commission Decision Case NoIV/M.1221p.11-12

comes to own-labelled products. In Austria, so far only Rewe could introduce its own-labelled product range at an upper price level.[108]

According to the previous investigation of the distribution market, the merger assists the involved parties to obtain a dominant position in the market. There is a strong interdependency between the supply side and the demand side of the market. The retailer acts as intermediary between the final consumer and the manufacturer. Therefore, it seems natural that a firm with a dominant position in selling goods could possibly reinforce its position in buying these goods and vice versa. However, the demand side of the market will be investigated later on.[109]

5.2.3.5 Future Outlook

An important determinant of the degree of competition in a market is barriers to entry. If newcomers can access a market without major obstacles, the market has no or very low barriers to entry. Thus, it is implied to be of competitive nature, since the prevailing firms may never obtain a monopolistic-like position as firms will always seek to enter the market. However, in Austria the food-retailing industry is already highly concentrated and attempts of foreign firms to enter the market failed so far.

Therefore, it is supposed that a merger between Rewe and Meinl would rather reduce than tighten competition among firms. Nevertheless, Rewe argues that there are still potential growth opportunities in the Austrian market, as their own example shows: in recent years Rewe could set up 50 new stores and increase its market share from 5% to a total of 30%. However, none of its competitors could establish new stores or increase their market share equally. Therefore it may be traced back to Rewe‘s already existing market power.

In addition, building authorities restrict the construction of new outlets based on land-use planning laws.

5.2.3.6 Causality

The Commission conveyed its objections to the merger to the two firms involved. Their arguments thereupon were certainly not satisfying as the following demonstrates.

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[108] European Commission(1999)Commission Decision Case NoIV/M.1221p.13

[109] European Commission(1999)Commission Decision Case NoIV/M.1221p.14

One of the objectives of the EC is to maintain fairness and equality within a market. Especially in markets with high barriers to enter, smaller firms may suffer under powerful competitors, since those may seek to drive them out of the market by taking advantage of their position. However, it is in the EC‘s interest to support efficient firms and will not support smaller firms only for the sake of their survival.[110]One argument brought forward by the two parties is that Meinl would be too small to further compete in the market. Without the merger it would therefore drop out of the market. Moreover, in case of a public sale, Rewe would acquire most of Meinl‘s stores. They argue that Rewe would be most adequate because of their common history and the geographic location of their shops. Additionally, according to Rewe, a merger with Rewe would have the least anti-competitive effect on the market.[111]

The EC considers the above arguments only if Rewe can prove the following:

I. without the merger Meinl has to file for bankruptcy
II. without the merger Rewe would acquire Meinl anyway
III. a merger between Rewe and Meinl has the least anti-competitive effect on the market

The onus of proof rests with the involved parties.

Meinl is not solely active in retailing, hence the EC assumes that the decision to divest its food-retailing division is rather a management decision. The firm may seek to focus on other lines of business, which seem more promising. Therefore, the EC could not support argument number one. The other two arguments could neither be testified. There is no evidence that, among all retailers, Rewe would be best qualified to acquire Meinl. Moreover, the argument that Rewe would be the best candidate for anti-competitive reasons is contrary to the EC‘s findings.[112]

Nevertheless, Rewe and Meinl could not supply evidence for any of the three arguments. Therefore, in summary the EC believes that a merged firm would have a dominant position in the Austrian market of food-retailing.[113]

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[110] Motta (2004)p.24-26

[111] European Commission(1999)Commission Decision Case NoIV/M.1221p.15

[112] European Commission(1999)Commission Decision Case NoIV/M.1221p.16-17

[113] European Commission(1999)Commission Decision Case NoIV/M.1221p.17-18

5.2.4 The Procurement Market

Buyer Power can also have beneficial effects on welfare. If both the supply and demand side of a market are in strong positions, it may compensate for seller power. This is referred to as countervailing power.[114] In this case it is assumed that benefits buyers receive are more likely to be passed on to final consumers.

In retailing, the distribution market is strongly related to the procurement market. If a retailer holds a big share as seller on the supply side of the market, he will probably have a big share on the demand side of the market, since he procures the goods final consumers ask for. Furthermore, a big share of the procurement market may enable the retailer to obtain exclusive conditions (e.g: exclusive contracts or conditional purchase arrangements) from suppliers. If the retailer seeks to drive competitors out of the market by employing these conditions, the benefits for final consumers are limited. They only profit until competitors are driven out of the market and the retailer holds a dominant position.[115] This effect is also known as the waterbed effect[116].

5.2.4.1 Relevant product markets

The following deals with the product markets on the demand side. In order to define the relevant product market, it is important to examine producers‘ flexibility. In general, a manufacturer in the food industry produces only a specific range of products. For example: bakers, confectioners or butchers do not produce the full range of products available at the supermarket. Hence, it is essential to investigate whether a manufacturer could alter production without major obstacles in order to produce a diverse product.

For instance, a butcher willing to make bread first needs some investment and special knowledge in order to alter production and bake bread professionally. However, since a producer‘s capability to switch production from one product to another is limited, the procurement market is divided into nineteen different product categories such as: fresh fruit and vegetables; meat and sausages; poultry and eggs; frozen foods; baby foods; pet foods; detergents, polishes, cleaning products; body care

[114] Kokkoris (2006)p.140

[115] European Commission(1999)Commission Decision Case NoIV/M.1221p.18

[116] Dobson and Inderst (2007)p.393

products, etc. Within these product categories a clear market structure can be derived. However, manufacturers of different product categories vary from one another. In particular, manufacturers of food and non-food items differ from each other in terms of firm size and number of competitors. Manufacturers of non-food items such as body-care products or detergents are often large international corporations, whereas suppliers of fresh-food such as fruits, vegetables, bread and meat are rather small to medium-sized firms.[117]

Furthermore, to define the relevant product market, it is essential to examine the alternative channels of distribution such as cash-and-carry, wholesale or delicatessen. Retailers are not the only buyers on the market but they certainly take the majority of goods into charge. Besides, it is difficult for the supplier to switch between different channels of distribution, since products have to be customised. For instance, a trader specialised in delicate food may ask for different marketing and packaging than a wholesaler. Therefore, a supplier may be forced to overhaul its machinery completely, in order to live up to the expectations of new customers. Hence, the EC assumes that it takes major investments and modifications to switch to another channel of distribution, and so it is not seen as a good alternative for substitution.[118]

5.2.4.2 Relevant geographic markets

The European Union facilitates to merchandise goods across Europe. Therefore it is assumed that retailers now can choose between suppliers from all over Europe. However, most of the products sold by Austrian retailers are made in Austria. Although prices in Austria are, compared to the German neighbour, about 20% higher, retailers still purchase on average 80% of their goods at national suppliers. This is mostly due to consumers‘ preferences, since Austrian products are considered to be of high quality. In fact, even goods produced by international corporations are sold via their national offices to guarantee services such as shelf maintenance and market research. These services can be best realised by national subsidiaries since they possess the relevant cultural knowledge. Besides, consumers‘ preferences vary significantly across Europe. Even products designed for the German market have to be

[117] European Commission(1999)Commission Decision Case NoIV/M.1221p.18-20

[118] European Commission(1999)Commission Decision Case NoIV/M.1221p.20-21

altered for the Austrian market, since consumers‘ tastes and preferences differ. Therefore, the geographic market is national.[119]

5.2.4.3 Competitive assessment

After determining the relevant product markets on a geographic level, the following provides some practical information on the markets.

On average each product market (product category) consists of 22 producers. However, product markets covering non-food items are higher concentrated than others. Hence, the average number of producers of basic foods, dairy goods, meat and sausage products lies above the average at 40-50 producers within each category. Furthermore, the concentration among firms in the distribution market is higher than in the procurement market. Less than 10 food retailers control the market, five of whom operate their business all over Austria, namely Rewe, Meinl, Spar, ADEG and Löwa. The others are small specialised traders, and Metro, a cash-and-carry wholesaler holding a market share of about one-tenth.[120]

This indicates that food retailers are indispensable for producers‘ survival for several reasons. First, a large proportion of a producer‘s turnover is effectuated by food-retailing chains. In all product markets, except for baby foods, body care and cosmetics, and bread and pastries, retailers account for more than 50% of producers‘ turnover. Second, according to suppliers, losing a food-retailer undertaking a share of more than 20% has major implications for their economic activity. Other retailers may be unable to take on the lost business, and changing to other channels of distribution is for most producers out of the question, since costs for altering production outweigh profits. Another alternative is to carry on an export trade. However, it takes about five years until an adequate level of products can be exported and the business becomes profitable. Furthermore, Austrian producers export only a very small proportion of their production.

Consequently, a producer is, compared to a retailer rather limited in choosing his trading partners. In addition, Rewe already accounts for a big proportion of producers‘ total turnover on average. Therefore, a combined firm with Meinl would lead to a

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[119] European Commission(1999)Commission Decision Case NoIV/M.1221p.21-22

[120] European Commission(1999)Commission Decision Case NoIV/M.1221p.23

level close to 40%. This is alarming, since producers mentioned in a survey that losing a retailer accounting for more than 22% of their turnover would be hard to replace. Consequently a producer is rather limited in comparison to a retailer.[121]

On the other side, the largest supplier retailers face in Austria is the Nestlé group. However, the proportion of its trade volume is far from being dominant. Nevertheless, Rewe and Meinl argue that there is a major dependency on suppliers, especially for branded food and Austrian products. The latter can certainly be denied. In fact, consumers demand products made in Austria, but there are sufficient suppliers, especially in the fresh food sector. Hence, a relationship of dependence could not be verified. The truth of the argument that retailers depend on suppliers of branded products, is subject to consumers‘ reactions after a delisting of such a must-store product. Thus, the worst reaction would be that consumers do their entire shopping elsewhere, since this product is no longer available at this store. However, this is rather unlikely as in most cases consumers find a substitute product they can buy instead of the branded one. Hence, it is assumed that consumers rather emphasise shopping convenience rather than product brands. Therefore, they will be more likely to switch to substitute products than do their entire shopping at another retailer. Hence, the EC could not find any evidence in favour of retailers‘ dependence on suppliers.[122]

5.2.4.4 Rewe/Meinl‘s Strengths

As mentioned before, Rewe‘s centralised organisation is not only beneficial for the distribution but also for the procurement market. It takes Rewe about 2 weeks to introduce a new product to all of its Billa stores. This is out of reach for its biggest competitor Spar. Furthermore, a producer willing to sell his products all over Austria has to contract most certainly with Rewe. Due to the fact that a major part of the total turnover in food-retailing is effectuated in the eastern part, it is needless to say that it is rather impossible as a producer to circumvent Rewe, since it dominates the market in the East.[123]

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[121] European Commission(1999)Commission Decision Case NoIV/M.1221p.24-27

[122] European Commission(1999)Commission Decision Case NoIV/M.1221p.27-28

[123] European Commission(1999)Commission Decision Case NoIV/M.1221p.28-29

Another strength is Rewe‘s own-branded product range. A strong own-branded product line enables a retailer to exert power over its suppliers. Manufacturers of products other than must-store are especially affected, since a retailer can replace those easily with his own-branded products. Therefore, no-name products face a higher risk of being delisted.[124]

In summary, the EC assumes that a merger between the two parties involved would lead to a dominant position in the procurement market, since it would even increase Rewe‘s already high volume of purchase.[125]

5.2.5 Findings

Given that under these conditions the EC would reject the merger, the involved parties suggested the following:[126]

- Rewe will purchase only 162 out of a total of 341 Meinl stores
- 45 out of these 162 stores are converted into Bipa drugstores
- Rewe will not acquire stores within the eastern part of Austria
- Meinl will continue its operation in food-retailing with 179 shops independent from Rewe, mainly in East-Austria

Under these conditions the EC is permitting the merger. Given that Rewe would not acquire any stores in the eastern part of Austria, one of the key arguments against the merger could be rejected. Furthermore, the EC‘s concern that a combined firm would own the majority of large-format outlets could be denied, since Rewe acquires only 16 out of the 40 PamPam stores. Besides, Rewe originally intended to acquire twice as many stores at key locations. Moreover, it can not be assumed that the acquisition of 162 stores will affect the procurement market significantly, since Meinl remains an active player in food retailing. More precisely, 41% of Meinl‘s volume on the procurement market will be transferred to Rewe. However, this reinforces Rewe‘s position in non-food markets by 1 to 1.5 %, which is even beneficial, given that the concentration of suppliers in the non-food section is rather high.[127] In summary Rewe

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[124] European Commission(1999)Commission Decision Case NoIV/M.1221p.29-30

[125] European Commission(1999)Commission Decision Case NoIV/M.1221p.30-31

[126] European Commission(1999)Commission Decision Case NoIV/M.1221p.31-32

[127] European Commission(1999)Commission Decision Case NoIV/M.1221p.31-33

acquires 34% of Meinl, and thereby increasing its market share by 2.5% to a total of 32.5%.[128]

5.2.6 Conclusion

The findings and the decision of the EC indicate that Rewe has a lot of potential to dominate the Austrian market in various ways. Therefore, the acquisition could not be accepted implicitly. The merger could only be permitted under certain conditions and those cannot be rejected as irrelevant. Of the 341 stores Rewe intended to acquire, only 117 are pursued as grocery stores. The decision set an example in the Austrian and even European history of food retailing. However, the decision occurred a decade ago and the market probably changed ever since. Therefore, we will continue to investigate the recent events, which marked the development of the Austrian market. On April 23rd, 2008 Rewe announces its intention to become ADEG‘s controlling shareholder with a share of 75%.[129] This case reveals interesting details on the Austrian food retailing industry. Although the case is different from the Rewe/Meinl decision, it is a good way to gain insight into recent developments. Therefore, in the following the EC‘s decision on the case Rewe/ADEG is examined.[130]

5.3 The Case Rewe/ ADEG

The following evaluation of Rewe/ADEG is based on the official release of the European Commission on June 23rd, 2008 (Case Nr. COMP/M.5047- REWE/ ADEG).

Rewe intends to become ADEG‘s controlling shareholder by acquiring 75% of ADEG‘s shares. The other 25% should remain with ADEG‘s independent traders (ADEG Österreich Grosseinkauf - AÖGen). Prior to the merger the largest shareholders include ADEG‘s independent traders (AÖGen) with a share of 37.6% followed by Edeka Chiemgau with 37.5% and finally Rewe with a share of 24.9%. Since Rewe and ADEG‘s individual turnover at the EU-level exceeds 250 million and at least two member states are involved, the EC was found responsible to investigate this case.[131]

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[128] EUROPA (1999) http://europa.eu/rapid/pressReleasesAction.do?reference=IP/99/83

[129] Kommission der Europäischen Gemeinschaften(2008)FallNr.COMP/M.5047- REWE/ ADEG p.2

[130] Kommission der Europäischen Gemeinschaften(2008)FallNr.COMP/M.5047- REWE/ ADEG p.2

[131] Kommission der Europäischen Gemeinschaften(2008)FallNr.COMP/M.5047- REWE/ ADEG p.2-3

The following case bears resemblance with the Rewe/Meinl case. One argument in favour of the takeover is ADEG's exit from the market. However the onus of proof rests within the involved parties.[132]

5.3.1 ADEG

The Austrian company ADEG acts not only as retailer, but also as wholesaler in the food industry. It operates three wholesale distribution centres, 19 cash-and-carry markets and 83 retail stores, whereas 15 are operated as hypermarkets (Magnet) and 11 as ADEG convenience stores. In addition, ADEG supplies 582 independent shops, which include 472 convenience stores with a size below 400 m².[133]

5.3.2 The Wholesale Market

Given that ADEG operates as wholesaler in the food industry, the EC has to investigate the relevant market. However, Rewe only operates to a very small extent in wholesaling. Therefore, it can be assumed that a merger between Rewe and ADEG does not affect the wholesaling market significantly, and a detailed investigation of the relevant market can be neglected.[134]

5.3.3 The Distribution Market

In general the relevant market remains identical as in the Rewe/Meinl case. The market thus includes supermarkets, hypermarkets, and discounters. While in the Rewe/Meinl case it was questioned whether to include discounters, they are certainly included in this case, as the following demonstrates.[135]

Even though the main discounters (Hofer and Lidl) offer a narrower product range than the full-range-retailers, consumers still find a sufficient range of convenience goods, including fresh food. Moreover, Hofer and Lidl more than doubled their market share between 1997 and 2007 up to 24%. Hence, it is assumed that discounters have to be considered as competitors in the market. In addition the major retailers, Spar and Rewe, claim that discounters impose competitive restrictions on them. They argue that price reductions by discounters directly affect them insofar as they are

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[132] Angelo, S., H. Gahleitner, U. Ginner and M. Landsmann (2008) p.156

[133] Kommission der Europäischen Gemeinschaften(2008)FallNr.COMP/M.5047- REWE/ ADEG p.2

[134] Kommission der Europäischen Gemeinschaften(2008)FallNr.COMP/M.5047- REWE/ ADEG p.7

[135] Kommission der Europäischen Gemeinschaften(2008)FallNr.COMP/M.5047- REWE/ ADEG p.3

forced to adapt prices of own-branded products and key value items in order to remain competitive. Moreover, prices of branded products are affected likewise, since in the long run the price gap of branded and unbranded products becomes wider. High prices of branded products may not be justified any longer and therefore have to be adapted equally. As a consequence, the EC found strong evidence to include discounters in the relevant market.[136]

The relevant geographic market is national. Retailers stated that prices are established for a national market and do not vary significantly across Austria, although advertising differs in various regions. This corresponds to the findings of the Rewe/Meinl case.[137]

5.3.4 The Procurement Market

The upstream market involves those transactions in which products are sold from the manufacturer or producer to the retailer, but excludes those to the final consumer. In the Rewe/Meinl case the relevant product markets involved nineteen different product categories. The market definition of the current case is adopted from the Rewe/Meinl case. However, it is extended by one product category, since suppliers thought to seperate the market for poultry and eggs.[138]

On the geographic level the market definition deflects from the Rewe/Meinl case. While in the Rewe/Meinl case the EC was convinced that the market is national due to consumers‘ preference for Austrian products and the difficulty to switch to other distribution channels or export products, the situation now is slightly different. A market survey revealed that export levels differ significantly among product categories. In any case the definition of the relevant market can be neglected. It is assumed that a merger would not have any anti-competitive effects on the upstream market, therefore its market definition is negligible.[139]

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[136] Kommission der Europäischen Gemeinschaften(2008)FallNr.COMP/M.5047- REWE/ ADEG p.4-6

[137] Kommission der Europäischen Gemeinschaften(2008)FallNr.COMP/M.5047- REWE/ ADEG p.6-7

[138] Kommission der Europäischen Gemeinschaften(2008)FallNr.COMP/M.5047- REWE/ ADEG p.7-8

[139] Kommission der Europäischen Gemeinschaften(2008)FallNr.COMP/M.5047- REWE/ ADEG p.9

5.3.5 The competitive assessment of the distribution market

A combined market share of REWE and ADEG would account for 35.4% in 2008. In Table (6) the market shares of the major retailers are illustrated, together with the number of stores and the store formats they operate. Number one in terms of market share is Rewe, followed by Spar and Hofer. All of the other competitors have a market share below 6%.

Table6: The major retailers in Austria in 2008

Retailers	Number of stores	Hypermarkets	Supermarkets	Independent Retailers	Discounters	Market share
REWE International AG	1388	MERKUR	BILLA	SUTTERLÜTTY	PENNY	30.3%
SPAR	1421	INTERSPAR EUROSPAR MAXIMAKRT	EUROSPAR SPAR	SPAR		28.3%
Hofer	410				HOFER	19.9%
ADEG	966	MAGNET	ADEG Aktiv ADEG	ADEG Aktiv ADEG		5.1%
ZEV MARKANT	693	TABOR, PRO Kaufland WELAS	NAH&FRISCH UNIMARKT	NAH&FRISCH + Kaufleute		4.5%
ZIELPUNKT	365		ZIELPUNKT		PLUS	4.3%
LIDL	168				LIDL	3.4%
MPREIS	146		M-PREIS			

Source: AC Nielsen, Handel in Österreich Basisdaten 2007 und 2008 http://google.acnielsen.com/search?site=at_nielsen_com&client=at_nielsen&proxystylesheet=at_nielsen&output=xml_no_dtd&q=basisdaten+handel (accessed August 2009)

It is not the increased market share which poses a major problem in this case. In the Rewe/Meinl case the large market share together with the powerful position in the eastern part of Austria was alarming, since there was only one adequate competitor, namely SPAR, with a market share of more than 20%. However, in recent years discounters evolved more into full range retailers. Even though their product range is still narrower, they are certainly strong competitors in the market. As illustrated in Table (6) Hofer has a market share close to 20%. Hence, it is assumed that a merger of Rewe and ADEG would not harm competition on a national level. However, the EC is rather concerned that local markets are affected. The focus of the EC therefore, lies on the assessment of anti-competitive effects in local markets.[140]

[140] Kommission der Europäischen Gemeinschaften(2008)FallNr.COMP/M.5047- REWE/ ADEG p.9-10

Rewe argues that ADEG‘s independent traders (AÖGen) should not be included in the market since they are autonomous. However, according to the EC‘s investigations these traders are indeed dependent on ADEG and can in no way be seen as ADEG‘s competitors. They adhere to price suggestions made by ADEG, since prices are memorised in the cash register system and alterations have to be done manually by each individual trader. Besides, they often agree on purchase commitments to obtain favourable conditions from ADEG, such as lower store rents. In many cases ADEG owns the premise but rents it out to independent traders. Moreover, 85% to 95% of independent traders participate in collective campaigns initiated by ADEG. In addition the AÖGen holds a share of 37.6% of ADEG and is supposed to hold a share of 25% after the acquisition by Rewe. Hence, the EC could not find any evidence to exclude the AÖGen from the market.[141]

The EC stated that the competitive pressure on the market through ADEG is rather low. According to a survey in April 2007, ADEG was the most expensive supermarket in Austria, followed by Billa and Spar. Therefore, it is assumed that after a merger with Rewe, ADEG‘s prices would rather fall than rise, which is in consumers‘ interests. Besides, in the last decade ADEG‘s market share decreased by nearly 50%, since it had to close down several shops. Furthermore, except for its MAGNET hypermarkets, ADEG operates mostly in rural areas as regional supplier. Therefore, it rarely encounters the rather urban Billa. Hence, the EC estimates ADEG‘s competitive pressure on Rewe or the market of food retailing in general as rather low or even absent.[142]

However, Rewe‘s largest competitor Spar argued they would be adversely affected by an acquisition of ADEG, since Rewe could increase its purchase power. Nevertheless, it is not assumed that Spar would be significantly affected. In Austria retailers of different size compete successfully in the same market. Hence, it is surprising that Rewe‘s largest competitor complains about the merger, whereas the other smaller

[141] Kommission der Europäischen Gemeinschaften(2008)FallNr.COMP/M.5047- REWE/ ADEG p.10-11

[142] Kommission der Europäischen Gemeinschaften(2008)FallNr.COMP/M.5047- REWE/ ADEG p.11-13

competitors deny that an acquisition would create a serious threat to exit the market, as indicated in a market survey.[143]

Furthermore the EC conducted a study to investigate the local markets. Even though prices are set on a national level, it is assumed that competition on a local level influences prices. Therefore the applied data was edited according to the 121 districts in Austria, since this seemed most adequate to investigate local markets. The objective was to examine the concentration of Rewe/ADEG in those districts. This may be an important indicator, in addition to national market shares, to examine the markets. Hence, a district was considered critical if one of the two following criteria was met:[144]

- The turnover of the combined firms exceeds 45%, plus there is an increase in turnover
- The turnover of the combined firms lies between 35% and 45%, plus the increase in turnover exceeds 5%

According to these criteria the EC identified 24 critical districts. It is assumed that Rewe/ADEG could possibly influence national pricing, since those districts account for 20% of the total population in Austria and are dominated by Rewe/ADEG in terms of turnover. Therefore, the EC found that the acquisition could not be permitted, unless conditions are altered.[145]

5.3.5.1 Modifications

Given these concerns, in order to complete the merger the involved parties suggested the following:

I. Shops owned by ADEG within the critical districts will be sold to independent buyers
II. Independent traders of the AÖGen can choose freely any wholesaler

The second condition was fulfilled when the following could be verified:

a) The independent trader is not obliged to comply with a period of notice longer than 3 months

[143] Kommission der Europäischen Gemeinschaften(2008)FallNr.COMP/M.5047- REWE/ ADEG p.13-14

[144] Kommission der Europäischen Gemeinschaften(2008)FallNr.COMP/M.5047- REWE/ ADEG p.16

[145] Kommission der Europäischen Gemeinschaften(2008)FallNr.COMP/M.5047- REWE/ ADEG p.17

b) Upon completion of business relations the independent trader is not charged a lump-sum exceeding € 50, 000

In addition, ADEG is obliged to offer those traders willing to terminate their contract a tenancy agreement at current market prices with a contract duration of at least five years, in case ADEG is the lessor of the store. Plus, ADEG is obligated to assist traders in critical districts to leave the company within the next 5 to 10 years. However, they do not have to force independent traders unwilling to leave ADEG.[146]

Consequently, a district is no longer considered critical if one of the following conditions applies:

- The combined turnover of Rewe and ADEG does not exceed 35%
- The combined turnover of Rewe and ADEG lies between 35% and 45%, but the increase in turnover is below 5%
- There is no increase in turnover due to the merger

In case the involved parties do not meet the requirements within the period stipulated, Rewe has to sell an adequate number of its own stores (BILLA, MERKUR, PENNY) in those critical districts. This is known as the '*Kronjuwelen-Regelung.*'[147] Hence, in such a case Rewe is obligated to sell as many of its own shops, equal to at least 65% of the turnover, independent traders effectuate within these districts.[148]

Since the involved parties agreed to adhere to these terms, the EC could reject the concerns regarding the merger. Therefore, the EC concluded that a merger between Rewe and ADEG would not have any significant effects on prices.[149]

5.3.6 Competitive Assessment of the Procurement Market

As mentioned above, it is not assumed that a merger would lead to an increase of Rewe's power in the procurement market. In 13 out of the 20 product markets a combined firm would have a market share bigger than 15%. In the Rewe/Meinl case the critical threshold was at 22%, due to the fact that a manufacturer's economic

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[146] Kommission der Europäischen Gemeinschaften(2008)FallNr.COMP/M.5047- REWE/ ADEG p.18

[147] Kommission der Europäischen Gemeinschaften(2008)FallNr.COMP/M.5047- REWE/ ADEG p.19

[148] Kommission der Europäischen Gemeinschaften(2008)FallNr.COMP/M.5047- REWE/ ADEG p.18-19

[149] Kommission der Europäischen Gemeinschaften(2008)FallNr.COMP/M.5047- REWE/ ADEG p.20

situation would be significantly affected by losing a customer with a market share of more than 22%.[150]

In this case four product markets, namely poultry, diary products, beer, and wine and alcohols, have a market share above 22%. This implies that Rewe/ADEG would have buyer power in these markets. In fact, as indicated by suppliers in a market survey conducted by the EC, Rewe already has buyer power in the procurement market. Consequently, Rewe‘s buyer power is not new to suppliers. Still they object that the acquisition of ADEG could possibly strengthen Rewe‘s power significantly. In addition, due to the modifications in the local distribution markets, the EC denies that the acquisition would have any detrimental effects on the procurement market.[151]

5.3.7 Conclusion

The EC decided to permit the acquisition of 75% of ADEG‘s shares, since Rewe accepted the conditions imposed.

The process to sell shops according to the terms imposed by the EC passed through 3 different stages. The second was accomplished in December 2008, which included the disposal of 62 shops willing to be sold. Thus, 31 shops were acquired by ZEV MARKANT (Nah&Frisch) and the others by Spar and Unimarkt. The last stage should be completed in June 2009 and all requirements should be met by that time. M-Preis acquired 20 shops in Salzburg and Carinthia. None of the critical districts were located in Tyrol and Vorarlberg, hence, no shops had to be sold there.[152]

The official representation of employees, the AK (Arbeiterkammer), is nevertheless sceptical about the the takeover. Although hundreds of jobs can be be guaranteed, the acquisition of 75% of ADEG‘s shares is considered critical in terms of market concentration. The AK criticises that the EC did not scrutinise the market as scheduled. They set the concentration level to consider a market as critical in terms of competition at 45%. This is overestimated considering the small size of Austria. In

[150] Kommission der Europäischen Gemeinschaften(2008)FallNr.COMP/M.5047- REWE/ ADEG p.21-22

[151] Kommission der Europäischen Gemeinschaften(2008)FallNr.COMP/M.5047- REWE/ ADEG p.22

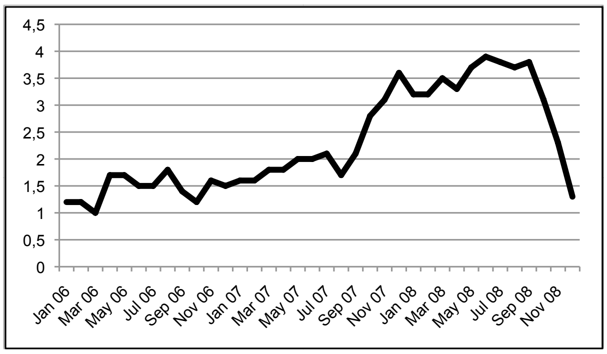
[152] KEY ACCOUNT Edition 5/09 p.3-4

addition, the decision of the EC sets a signal. Other retailers active in Austria may be induced to increase their market share, due to the EC‘s indulgence.[153]

5.4 The Inflation Rate and Price Developments in Austria from 2007-2008

Since September 2007 the inflation rate increased steadily as demonstrated in Figure (6) by the consumer price index (VPI: Verbraucherpreisindex). The VPI is an indicator for the inflation and price development in Austria. In December 2007 the VPI amounted to 3.6%, however in June 2008 it reached its peak with 3.9%.

Figure 6: Inflation in % in Austria from 2006 to 2008



Source: Statistik Austria: VPI Inflationsraten 1998 bis 2008 http://www.statistik.at/web_de/statistiken/preise/verbraucherpreisindex_vpi_hvpi/index.html (accessed November 2009)

In particular, prices for food, energy, housing and transport increased in Austria, which raised a significant political discussion.[154] In 2007 prices for consumer goods increased by 2.2% whereas food prices increased by 4.1%. This is particularly alarming since it mostly affects people with low incomes, as products such as bread, butter, eggs, milk and vegetables experienced the highest price increases.

There can be several reasons for a high inflation rate, such as global development, increasing oil prices, rising demand for food from Asia, as well as speculation on the world market. In addition, politics are of major importance, since the already scarce resources like crop and oil seed are being used for the production of agrofuel, for instance biodiesel and ethanol. The production is boosted by subventions and tax abatements by the U.S. and European governments; this in turn increases food prices.[155]

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[153] Angelo, S., H. Gahleitner, U. Ginner, M. Landsmann and S. Nikocevic (2009) p.158

[154] Angelo, S., H. Gahleitner, U. Ginner and M. Landsmann (2008) p.8

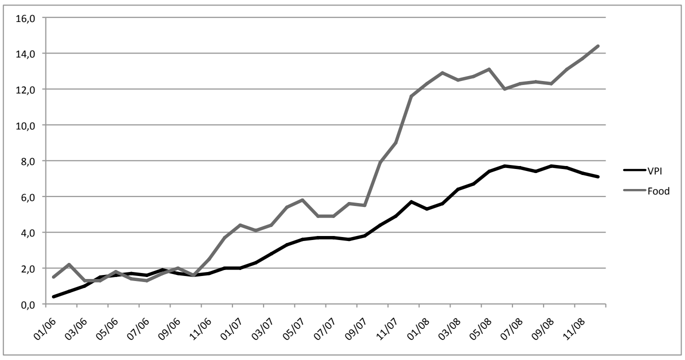
[155] Angelo, S., H. Gahleitner, U. Ginner and M. Landsmann (2008) p.8

However, it is argued that besides international and political factors the inflation in the Austrian food market is largely ‘homemade‘.[156]Hence, in each product category a distinction is made between international and country-specific factors influencing the inflation rate. It is particularly important to find out to which extent the high inflation rate can be traced back to domestic factors.[157]Critics believe that the already bad situation on the world markets has been used in Austria to raise prices within the supply chain without an actual reason. As a consequence the big three retailers: Hofer, Spar and Rewe came under suspicion of price fixing.[158]

5.4.1 The Austrian inflation rate by comparison

Since September 2007 food prices increased at a level above the inflation rate, which is demonstrated in more detail in Figure (7).

Figure 7: Price development in % of Food compared to the Consumer Price Index (VPI) in Austria from 2006-2008



Data Source: Statistik Austria: Sonderauswertungen: Ernährung VPI 2005 http://www.statistik.at/web_de/statistiken/index.html (accessed November 2009)

It shows the differences in price development between the consumer price index (VPI) and the Food Index. The consumer price index consists of a certain consumer basket, including essential goods and services. The consumer basket is divided into 12 categories such as food, clothing, habitation, household goods, transport, education, culture, tourism, etc. The Food Index includes aliments and non-alcoholic drinks.[159]In January 2008 it reached its peak. The inflation rate increased by 5.6%,

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[156] Angelo, S., H. Gahleitner, U. Ginner and M. Landsmann (2008) p.8

[157] Wettbewerbskommission (2008) p.14

[158] Angelo, S., H. Gahleitner, U. Ginner and M. Landsmann (2008) p.8

[159] Statistik Austria (2009) http://www.statistik.at/web_de/statistiken/index.html

however food prices increased by 12.9%. Hence there was a difference of 7.3% in price development.

5.4.2 Comparision in the euro zone

According to a report by the AK in August 2008, prices in Austria were on average 24.4% higher than in neighbouring Germany. They compared prices of 72 identical products such as oil, butter, margarine, mozzarella, cream cheese, Camembert, Gouda cheese, Emmentaler, whole milk, spaghetti, mini-baguette, and wholemeal bread in Vienna and Passau (Germany). Including: Billa, Hofer, Interspar, Lidl, Merkur, Penny Markt, Spar, Zielpunkt, Adeg and Magnet in Vienna, Aldi, Netto, Kaufland, DEZ E-Center, Real, E-Aktiv-Markt Schwaiberger, Lidl, Penny, Norma, Plus nahkauf frisch+schnell and Rewe in Passau. Not only do prices in Vienna generally exceed those in Passau, but identical products from the same retailer are also more expensive in Austria. For instance, Lidl in Vienna charges on average 20.1% more for 19 identical products than Lidl in Passau. Zielpunkt even surcharges consumers in Vienna on average by 30.4% for 18 identical products than its German sister Plus. In the case of Penny, four identical products were found to be on average 20.6% more expensive than in Germany and at Hofer in Vienna one product was priced 16.2% more than at Aldi in Passau.[160]

Additionally, a report of the Austrian Competition Commission revealed the following:

In 2006 bread and cereal products were, after Finnland, most expensive in Austria and on average 18% higher than in the euro zone. In 2007 prices continued to increase even more than in the euro zone.[161]

In 2006 Austria was ranked number four in terms of best prices for the product category milk, cheese and eggs, only Germany, the Netherlands and Spain being less expensive. But in 2007 the inflation rate increased and it is assumed that country-specific coefficients are responsible for more than half of this increase. In total, the price increase within this product category was significantly above the trend of the euro zone.[162]

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[160] Delapina M. (2008) p.1-5

[161] Wettbewerbskommission (2008) p.16

[162] Wettbewerbskommission (2008)p.16-17

In the product category of soda, lemonade and juice the country-specific coefficients contributed to a large proportion of the ascending inflation. It is even assumed that the reason for the high inflation in 2006 and 2007 can be attributed mostly to country-specific factors.[163]

Given that the inflation rate and the increase in food prices in Austria was higher than in other countries, there is a rebuttable presumption that there have to be other country-specific factors influencing the inflation in Austria.[164] Therefore the AK attempted to illuminate the reasons for the high inflation rate and further made suggestions to improve the situation in Austria.

5.4.3 In search of an offender

High food prices were triggered by high prices of agricultural commodities (crop, sugar and oil seed) on the world market. In short, this was due to a high demand of food from Asia, shortfalls in important areas of cultivation, and speculations on the world market. In addition the soaring food prices in 2007 can be explained by a supplemental competitor on the food market. Since the production of agrofuels became heavily supported by governments in the EU and USA, producers of agrofuels became big players in the food market. In 2007 the USA produced ethanol out of 85 million tons of corn, which accounts for one quarter of the American corn harvest. This represents an increase of 30 million tons compared to the previous year. Despite the enhanced food production this led to a shortage of resources and, as a consequence, higher food prices on the world market. Nevertheless these global developments do not fully explain the heavy increase of food prices in Austria. Therefore the AK concludes that an already high inflation has been used by market participants to increase margins within the supply chain. The National Bank of Austria supports this argument. The market participants certainly denied this reproach. However, it is hard to deny since the increase of food prices from 2006 to 2007 in Austria is on average much higher than in the euro zone. Food prices increased on average by 66.7%, bread and cereal products by 28.7%, vegetables by 72.7%, soda and lemonades by

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[163] Wettbewerbskommission (2008)p.17-18

[164] Angelo, S., H. Gahleitner, U. Ginner and M. Landsmann (2008) p.18

71.4%, fish and sea food by 100% and milk, cheese and eggs by 144% in Austria compared to the average country of the euro zone.[165]

Experts see the lack of competition in the Austrian food market as one of the main reasons for these price developments, not only in the concentration among retailers but also among producers. This is especially so in in fields such as dairy products, gristmills, sugar and slaughterhouses.[166]In addition the Austrian Competition Authority (Bundes-wettbewerbs-behörde:BWB) is accused of being inactive. For instance, in February 2008 the brewing industry in Austria announced in the media that it would increase prices. This should be alarming to Competition Authorities. In Germany a similar case was investigated immediately by the Competition Authority. However, the Austrian Competition Authority did not see any need for action. It is argued that a powerful Competition Authority could alleviate problems. If firms are forced to publicise their activities, an investigation of the entire supply chain could be guaranteed, which gives some indication of the guilty party. This is hard to accomplish if the involved parties do not have to disclose their activities.[167]

5.4.4 The response to the price developments

The development of prices raised a big public discussion and politicians came under pressure to take action. As a consequence, the former minister for economic affairs, Martin Bartenstein prompted the Austrian Competition Commission (Wettbewerbskommission) to investigate the recent events. This was surprising since the Austrian Competition Commission is only the advisory board of the ministry and the Competition Authority (BWB). It has no rights to inspection, hence its competences are rather limited. The Competition Authority, on the other hand, is more powerful and better qualified for these studies. It is capable to initiate a house search or ask the involved parties to reveal important information. As a consequence it was nearly impossible for the Competition Commission to obtain first hand information. None of the accused parties was willing to provide key figures, some not even annual accounts.[168] There-

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165 Angelo, S., H. Gahleitner, U. Ginner and M. Landsmann (2008) p.18-19

166 Angelo, S., H. Gahleitner, U. Ginner and M. Landsmann (2008) p.21-22

167 Angelo, S., H. Gahleitner, U. Ginner and M. Landsmann (2008) p.20

168 Angelo, S., H. Gahleitner, U. Ginner, M. Landsmann and S. Nikocevic (2009) p.133-134

fore, the Competition Commission was required to do its research based on a report by the economic research institute (WIFO). They concluded that the price increase in 2007 was mostly due to country-specific factors, especially for cheese, eggs and diary products. In the euro zone, prices in the product category of fats and oils even decreased the first half year in 2007, whereas in Austria prices increased. However, these findings are not surprising.[169]

In its 2008 report the AK made three important suggestions to improve the situation:

I. Monitoring

   In Austria no public institution collects data or calculates economic key figures in order to monitor competition on a regular basis, only some private market research institutions do so eratically. However, in order to prevent fraudulent use, it is important to establish an early-warning system. Transparency is in particular important in those markets where all signs point to market abuse. Especially on the producer level, data is rare, and the knowledge limited. This opacity enables market participants to enforce price increases more easily, since it is hard to prove them guilty. In order to prevent market abuse the Competition Authority (BWB) should be provided with sufficient funds to implement a monitoring system.

II. Earlier interventions in market developments

   The market for agrofuels competes directly with the food market. Therefore, it would have been important to interfere immediately in these developments, since this contributed largely to the global increase of food prices.

III. Immediate investigations in case price increases get publicly announced

The AK was not the only institution exerting pressure on the government. The fact that the Austrian food market was malfunctioning was also based on findings by the National Bank of Austria, the WIFO and IHS (Institute of Advanced Studies). Even the study initiated by Mr. Bartenstein clearly indicated a need for action. Nevertheless the government remained inactive. In consequence, in June 2008 the AK decided to file a petition according to the Austrian Price Law. More precisely they demanded that the Ministry of Economy investigates whether REWE, Spar, Hofer, Lidl and Zielpunkt

[169] Angelo, S., H. Gahleitner, U. Ginner and M. Landsmann (2008) p.22

are in direct proportion to the price developments in Austria. Since knowledge on the entire supply chain is scarce, the AK adheres to its findings about retailers. This does not entail that they consider them as the only guilty ones within the supply chain.[170]

After the petition by the AK, the Ministry of Economy appointed a price committee. Representatives of the Austrian Federal Economic Chamber (WKÖ), the AK, the Agricultural Chambers (Landwirtschaftskammern), the Ministry of Finance, the Ministry for Social Affairs and Consumer Protection and the Ministry of Agriculture had to join this committee, chaired by the Ministry of Economy. However, after six sessions the proposal to audit the Austrian retailers in detail was rejected. To the regret of the AK, the majority of representatives found that prices in Austria did not increase significantly in recent time, even though numbers and reports indicate the reverse.[171] Therefore we have to assume that the decision-making was not based on facts.

6.Conclusion

Each and every one of us is inevitably a customer of food-retailers. The days are over where people acted as self-supporters and lived from their home-grown fruits and vegetables and the few things they bought at the corner shop next door. As a consequence retailers have taken a powerful position in our everyday life. Everyone can form her own opinion about these developments.

However, we and especially authorities should become suspicious if food prices in Austria are for no reason significantly higher than in Germany. The two countries are directly comparable as the major retailers act in both countries and the inflation rate could not made responsible for the high differences in prices. Therefore the increase in Austrian food prices has to be driven by the retailers and can not be blamed on global developments, since these affect both countries equally. Assuming that the onus of proof would rest with retailers, it is hard to think of any arguments to prove them innocent.

Furthermore competition among Austrian food retailers did certainly not increase. High barriers to entry make it almost impossible for newcomers to enter the Austrian market. Plus, the five-firm buyer concentration in Austria increased from 1999 to

[170] Angelo, S., H. Gahleitner, U. Ginner, M. Landsmann and S. Nikocevic (2009) p.133-135

[171] Angelo, S., H. Gahleitner, U. Ginner, M. Landsmann and S. Nikocevic (2009) p.135-136

2008 from 60.2% to 88.1% and is all along one of the highest across Europe.[172] Although the decision on the Rewe/Meinl case in 1999 clarified that a further concentration of Austrian retailers could be devastating, the concentration level increased onwards. Therefore the acquisition of ADEG by Rewe is not seen as creating further harm, since it is only the icing on the cake.

All indications are that the Austrian market in food retailing has its independent existence due to high or even adamant barriers to entry, low competition, a high concentration level, idle politicians and an inattentive competition authority. Although there is strong evidence for retailers‘ power in the Austrian food market, all attempts for further detailed investigations failed. The Austrian Competition Authority seems unwilling to face this problem. Similar in-depth investigations of various institutions in Austria came to the same result: The Austrian food retailing market clearly lacks transparency. This is not solely a problem in food retailing, however this would go beyond the scope of this discussion.

In order to get a clear picture, retailers have to reveal more information and data. So far it has been impossible to have a full understanding of the situation due to insufficient evidence. With more information available, it would be possible to make major investigations on the food market and its supply chain. However, this rests on politicians and the Austrian Competition Authority to rectify this in the future.

The lesson is clear: There is an urgent need of action from authorities and politicians, if we want to preserve the quality of food and the fairness towards consumers. In my opinion from all the consumer products food is most valuable, since YOU ARE WHAT YOU EAT.

[172] see Table (2) and Table (8)

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8.Tables

9.Figures

Ich habe mich bemüht, sämtliche Inhaber der Bildrechte ausfinding zu machen und ihre Zustimmung zur Verwendung der Bilder in dieser Arbeit eingeholt. Sollte dennoch eine Urheberrechtsverletzung bekannt werden, ersuche ich um Meldung bei mir.

10.Curriculum Vitae

EDUCATION

Oct 2004 - Jan 2010	**University Vienna:** **Master in International Business Administration** <u>Major Subjects:</u> Corporate Finance (Prof. Josef Zechner) International Management (Prof. Josef Windsperger)
Aug 08 - Dec 08	**Lund University (Sweden): Reassume** School of Economics and Management
1995 - 2003	**Secondary School** Kreuzschwestern Orth (in 4810 Gmunden – Austria)

PROFESSIONAL EXPERIENCE during my Studies

2009	Human Resource Management Divisions - Volksbank in Vienna
since Oct 09	Contract design, Correspondence, Communication and assistance of HR Business Partners
2009	The Economist Group GmbH (Vienna)
3 months	Receptionist: Customer care, Correspondence, Communication and assistance in daily affairs
2008	Holiday replacement at Leasing company “VB-Leasing“ in Vienna
1 month	(holiday replacement of secretary):Customer care, Correspondence, Communication and assistance in daily affairs
2007	Internship at “Volksbank Invest“ (Fund of Funds Management) in Vienna
1 month	Detailed fund-analysis via Zephyr Style Advisor, Work flow automating of program features and training of management, Assistance of management in its daily affairs
10/07-07/08	Working student at Micromed Mittermayer Service and Consulting
10 months	Data processing of medical statements via WHONET Software and general data base management
2006	Internship at “Volksbank Invest“ (Fund of Funds Management) in Vienna
2 months	*<u>Zephyr Style Advisor:</u>* Test run of software package *Zephyr Style Advisor,* Evaluation and implementation of software tools for fund management, Analysis of strengths and weaknesses with further presentation of findings and instruction of management to the program *<u>Furthermore:</u>* Processing of information material, Quantitative and qualitative fund analysis (Precise selection of fund universes, Reduction of raw data, Market observation an assistance in various analysing operations)

PROFESSIONAL EXPERIENCE before my studies

2004	Tourist Guide at the “Schloss Orth“ in Gmunden - Austria
1 month	Guided tours in German, English and French
2003-2004	Aupair in Geneva - Switzerland
14 month	Childcare and housekeeping, Intensive french language course and language practice based on everyday use of language
2002	Caregiver at the Nursing Home in Gmunden - Austria
1 month	Care and fosterage of elderly challenged persons, Arrangement of acitivies and excursions
2001	Internship at the Agency for cultural affairs in Gmunden - Austria
1 month	Assistance in the organisation of the yearly pottery market (with Spain as host country)

OHTHER SKILLS

Langues	German: fluent (mother tongue) English: fluent (TOEFL Test of English as a foreign language - 2007) French: fluent (Alliance française Diplôme de Langue Française - 2004) Swedish : basics
IT	MS-Office, ECDL (2002), Lotus Notes, Zephyr Style Advisor