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Session III - Competition Issues in the Groceries Sector: Focus on Conduct

-- Contribution from Taimoon Stewart --

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This paper by Taimoon Stewart (University of the West Indies) is circulated to the Latin American Competition Forum FOR DISCUSSION under Session III at its forthcoming meeting to be held on 23-24 September 2015 in Jamaica.

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LATIN AMERICAN COMPETITION FORUM



23-24 September 2015 • Montego Bay • Jamaica

Session III - Competition Issues in the Groceries Sector: Focus on Conduct

GROCERIES SECTOR IN BARBADOS AND JAMAICA: STUDIES CONDUCTED BY THE BARBADOS AND JAMAICAN FAIR TRADING COMMISSIONS

SUMMARY AND ANALYSIS

-- CONTRIBUTION FROM TAIMOON STEWART* --

Introduction

Purpose

1. The content of this paper is drawn upon the work of the Barbados and Jamaica Fair Trading Commissions, summarising their market studies in the grocery sector, and providing a cross analysis of the findings. As background to the summaries of these studies, an outline of the structure of these economies provides a grid against which to locate the findings of the two studies. Some reference is made to an earlier study which revealed both structure and conducts that define the competition landscape in these small economies.

Features of Small Economies

2. It should be made explicit here that Caribbean countries are micro economies, highly dependent on import of grocery supplies. Most are island states dependent on transportation by shipping rather than overland freight with the former incurring higher costs, particularly on routes that do not provide scale economies. Prices of imported goods are highly susceptible to fluctuations depending on shipping and insurance rates, changes in the exporter's prices [or local currency devaluation]. Compounded with this dependence on import, the economies are largely geared toward production for export. There is little hinterland for production of food at a subsistence level in the island states. Most of the economies are reliant on tourism, so, imports of food items cater for the needs of tourists as well. The larger islands are able to produce some agricultural products, but not sufficient to feed the population. Guyana and Belize

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have the land space to do so, and Belize is being largely self-reliant. But the rest are dependent micro island economies.

3. Because these markets are small, and purchasing supplies and shipping in bulk reduces cost, economies of scale are an important determinant of number of firms in the market and thus, market structure. Concentration of wealth in the hands of a few families (now conglomerates) and historic links dating back to colonial times to major importation houses, lead to oligopolistic market structure, with competitors who are well known to each other. High barriers to entry exist because of the power of the entrenched firms, the capital at their disposal, and the difficulties newcomers face in accessing capital because of the culture of banks. In addition, local manufacturing is also highly dependent on import of inputs to production, and exposed to changes in commodity prices. Moreover, capital goods used in production are imported. Finally, a number of large manufacturers are foreign direct investors; for example, the sole producer of flour in Barbados, and indeed, several other Caribbean states, is ADM (of the infamous lysine cartel case).¹

Introduction to the Market Studies

4. The Study done by the **Barbados Fair Trading Commission (BFTC)** sets out to find explanations for the high increases in food prices in the period January 2009 to July 2011. A basket of food classified by the Ministry of Commerce, Consumer Affairs and Business Development which monitored and published prices weekly in the newspaper over this period provide the data that were analysed. Results showed that prices increased over the 31-month period, and that there was synchrony in the movement in prices within a product category, inclusive of competing brands. Some explanatory power is provided by exogenous factors such as increase in value added tax, but in other instances, explanations were not found. The BFTC then explored structures within the sector that could explain the market power and use of market power in influencing pricing.

5. The study done by the **Jamaica Fair Trading Commission** focused more narrowly on one aspect of competition in the grocery sector: that of private branding by stores of selected products. It asks, to what extent is this used as a competitive strategy by stores in Jamaica, what influences decisions by stores to introduce their private brand, the category of goods that are targeted for branding, and how is shelf space allocated to gain competitive advantage.

¹ Stewart et al. 2004. Competition Issues in Selected CARICOM Countries: An Empirical Examination. IDRC website.

SECTION 1

Summary 1. “A Description of the Factors Contributing to High Food Prices in Barbados”. July 2013. Study conducted by the Barbados Fair Trading Commission.

1. Introduction

What follows is a summary of the BFTC study, and the research and findings are totally attributable to that institution.

6. The BFTC study focuses on the period from January 2009 to July 2011, and investigates price increases during that period. It was motivated by the public debate that ensued, with perceptions by consumers that distributors and retailers were price gouging. Data from the Barbados Statistical Service (BSS) indicate that there was a general increase in food prices each year from 1980 to 2009. The rate of increase was approximately 3.1% per year from 1980 - 1997; and 6.5% per year thereafter, until 2005 when prices increased on average by 8%, with the highest increase of 14% for 2007/2008 period. Notably, in 2009 there was an appreciably high increase in food prices from 1980 levels with inflation showing a cumulative rate of change of 11.1% over the period under study. There was also a general increase in the Retail Price Index (RPI). Food represents approximately 30% of the overall RPI, and is therefore assumed to significantly influence RPI. The objective of the study was to explore the movement of prices of a basket of goods, examine the possible causes for price changes by highlighting the horizontal and vertical relationships, analyse the impact these relationships have on competition, and explore the extent to which measures can be advanced that are more conducive to competition.

7. Indeed, the BFTC had already done some prior investigation of this sector in 2006, and the assessment confirmed a significant increase in food prices at that time. The findings of that study pointed to monopolistic competition within the distribution sector:

- There were strong links between some wholesalers and a number of retail outlets and this could contribute to manipulating the market;
- Wholesalers were exclusive suppliers of similar but differentiated brands, leading to limited inter-brand competition;
- There were indications of resale price maintenance in the locally produced product sector, and locally manufactured good recorded the highest price increases between September 2002 and September 2006.

2. Current Study: Structure of the Market

2.1 Identifying the players

8. The study begins with an exploration of the characteristics of the sector that would determine market definition. It was found that various types of stores make up the retail grocery sector, and that Barbadian consumers shop in multiple stores.

9. The sector can be sub-divided into 6 types of retailers: Supermarkets Majors (large retailers with more than two stores, offering one stop shopping), Groceries Multiples (larger groceries with two locations), Convenience Retailers (which operate on a significantly reduced scale than the previous two), Small Shops and Mini-marts (one door facilities, usually owner occupied), Warehouse Stores or buyer's clubs (bulk shopping), and Wholesalers/Distributors (relatively few and many have exclusive distributorships agreements with the manufacturers/international distributors of many popular house hold brands).

10. Consumer behaviour in shopping in multiple stores could be explained by several factors, such as geographic proximity (so convenience, not solely price, is a motivator); product range offered; product quality; product availability, and for price sensitive consumers, the lowest price available. But, consumers can also purchase in bulk directly from wholesalers/distributors, enjoying discounted prices. Indeed, the walk-in trade of wholesalers/distributors consists of approximately 5% of their total trade in 2009 and 2010. So, consumers consider the various outlets as substitutable. Given the overlapping characteristics of the various retail outlets, the market of interest for the study was defined as "the market for retail/distribution of grocery products.

2.2 *Level of Concentration in the Sector*

11. Contribution of the sector for retail/distribution of grocery products to Gross National Product (GDP) are shown in Table 1 below.

Table 1. Contribution to GDP of Retail/distribution of grocery products

Year	% GDP	Of which 5 major grocery retailers held	Of which largest retailer held
2005-2007	10%		
2008	9 %		
2009	8%	75%	43%
2010		83%	48%

12. And the market share of the largest retailer was three times that of its closest rival. The market is therefore classified as oligopolistic, in that although there are a large number of competitors in the market, the majority of competitors are relatively small in size. The market features a small number of relatively large firms, there are high barriers to entry, and the market is dominated by a few firms.

13. The BFTC's analysis was that small size could lead to bottlenecks in supply of products to the consumers within the defined market, that it was a concentrated market, with factors that insulate the dominant firms (e.g., exclusive rights) and this could impede competition.

3. *Empirical study of price changes*

14. Analysis of annual changes in prices was conducted using data produced by the Department of Commerce on a number of food items from 20 outlets, and the data were verified by supermarket managers and published weekly in the newspaper. Price levels at January 2009 were used as the referent. Price analysis for the following products was conducted: Cereals, flour, and bakery products; rice and pasta; meat and chicken; tinned meats; tinned fish; butter, cooking fat, and oil.

15. The findings of the 2006 study linked price increases to increases in costs of imports, transport and energy, raw materials, packing materials and value added taxes. The researchers in the 2013 study identified synchronicity in the movement of prices and uniformity of prices, and offered several explanations for these trends, such as, two product types belonging to the same brand, or price changes to inputs to production/import. Both studies point to the need to examine structural issues that were shaping conduct. One such anomaly identified was that while global wheat prices are affected by international oil prices, local flour prices do not appear to respond immediately to wheat prices. This point to a locally driven impetus to price changes in the case of flour.

16. The following conducts are offered by the BFTC and analysed as explaining the pricing conduct of firms:

1. Resale Price Maintenance;
2. Vertical integration of companies with the prevalence of interlocking directorships;
3. Retail prices are being determined by decisions made upstream;
4. Increase in the Value Added Tax in January 2011;
5. Price parallelism.

17. Details on each of the above are provided below.

4. Analysis of Findings

- **Resale Price Maintenance.** Several retailers provide suggested resale prices, and Purity Bakeries affixes a suggested resale price. The problem is that while it is a suggested resale price, it becomes the *de facto* price among many retailers. There is a perception among retailers that they are bound by the suggested resale price.
- **Interlocking Directorships.** There is prevalence of vertical (not horizontal) interlocking directorships² and cross ownership within the retail and distribution of grocery products. Interlocks were found between farms and processors, distribution and wholesalers, and holding companies. This could lead to manipulation of the relevant market and distortion of competition. Further study is needed in this area.
- **Impact of upstream factors on downstream prices.** Price increases are often linked backwards to import prices. For instance, the increased price of fresh whole chicken was directly linked to the increase of imported inputs to production of feed, which increased costs of the island's lone feed manufacturing plant, which in turn increased prices for chicken farmers and processors.

18. However, an anomaly was identified in regard to production of flour, in which it was shown that the price of wheat on the international market did not influence the price of flour on the local market. Indeed, between January 2009 and July 2009, the price of wheat fell by 34%, while during the same period, the price of flour rose by 27%. And, trends in the international price of wheat throughout the period

² An interlock is created when an individual assumes the role of director on the board of directors of two or more companies that are direct competitors. One of the noteworthy outcomes of the study was that interlocks were identified between the following relevant categories: Farms & Processors; Distributors & Wholesalers; Holding Companies (BFTC 2013, page 40-41).

studied fluctuated marginally. It is interesting to point out that the sole producer of flour in Barbados [and several other Caribbean islands: Haiti, Belize, Dominican Republic, Grenada, Jamaica, and Trinidad and Tobago] is Archer Daniels Midland (ADM).³

4.1 Value-Added Tax

19. Changes in government policies also led to price increases. In January 2011, the value-added tax rate increased by 2.5% to 17.5%.

4.2 Trends in retail prices: Price Parallelism?

20. The study revealed that price fluctuations were uniform across all retail outlets. Four possible explanatory factors were offered for uniformity of price fluctuations:

1. There could have been simultaneous occurrence of sales;
2. Price variations could have been influenced by variations in wholesale prices;
3. Trade/product promotions may have been initiated by the wholesaler and there would have been some measure of pass-through to consumers. However, retailers could enhance their profit by not allowing 100% pass through, thus reducing consumer welfare;
4. Retailers may be engaging in conscious parallelism, following the leader in the market by accepting his price as the benchmark and adjusting their price accordingly. Indeed, lags in the data supports this posit, as delays may be explained by the time it takes for the “price-follower” to be aware of price changes and respond by changing his list price. This is in keeping with the finding that the market is oligopolistic, and further, that in a small market, information on price changes is easily available.

21. Another puzzling trend observed by the BFTC was that different brands were being sold within unusually small price ranges, irrespective of differences in quality, despite different costs across brands and the fact that consumers were sensitive to brand differentiation. In other words, good quality brands were sold at a similar price as poor quality brands. This price equivalence is due to the oligopolistic nature of the market. The lack of competition in the market allows retailers to set prices without having to consider a competitor that sets significantly lower prices. This phenomenon may be also attributed to interlocking directorships even though interlocks were found to be in vertical markets and not horizontal. Even though vertical interlocks are not considered harmful to competition in the literature, the fact that the markets under consideration are highly concentrated and integrated may be the explanation for the similarities in products across brands.

5. Perceptions of the Market for the Wholesale Supply of Grocery Products

22. Methodology: The BFTC mailed a short confidential questionnaire and conducted interviews with key industry players in the retail and distribution sector. Responses were analysed and categorised into themes by the BFTC.

³ ADM led a cartel including four other companies to fix the price of Lysine. The cartel was successfully prosecuted by the US Department of Justice in 1996 and ADM was fined US\$70 million.

Perceptions on the State of Competition in the Wholesale/Retail

23. Wholesalers and retailers surveyed considered that competition was intense and effective, keeping prices down and margins reasonable among wholesalers. Retailers attributed healthy competition to a contracted market that was the result of amalgamation of wholesalers and distributors leading to a rationalisation of the market. Interviewees for the most part felt that there was no single dominant firm: that there were several small and medium sized firms and four large firms. A countering view, however, was that some firms were able to maintain dominance through vertical integration, and wholesalers were exerting control over a number of retailers. For instance, a special offer by one distributor on their brand of cereal was vetoed by another distributor who was affiliated to the retailer, to prevent competition with their own cereal.

24. Another factor that lends market power is that large wholesalers stock a greater variety of items, so retailers tend to use them. But some retailers stated that they have a policy of limiting their purchases from the large wholesalers and source products from other wholesalers.

5.1 Challenges to the Incumbents

25. Practices such as stock diversion and parallel importation have emerged that result in erosion of the power/control of the traditional importers. Some goods are being brought in through normal customs procedures and others are part of activities in the informal economy. It was felt that although a growing phenomenon, and a worrying one for the incumbents, as yet it is not sufficiently large to pose competitive restraint on the established wholesalers/distributors.

5.1.1 Stock Diversion

26. This practice involves supermarkets taking advantage of a very good [international] price for a product, but ordering in excess of its own requirement in order to achieve the bulk required to qualify for the discounted price. The importer then sells on the excess to other supermarkets at a wholesale price. The products therefore enter the market legitimately, but this practice makes it difficult for the legitimate wholesaler who would have paid market price for the product.

5.1.2 Parallel Importation by Retailers

27. Some brands are individually sourced by retailers, but, this is not a frequent occurrence, since others claimed that supermarkets do not have the liquid cash to import directly and do not have access to credit from the international manufacturers/distributors. Indeed, they are highly dependent on credit from local wholesalers. Further, they do not have independent access to well-known brands, at competitive prices. Therefore, this is not a big constraint on the dominant players, but in most cases, there are exclusive distributors for the brands and the 'illegal' importers can then free ride on the promotion of the product by the company that has the exclusive right. Further, services and guarantees may fall back to the exclusive distributor, but he has no control over the quality of the products that are being brought into the country.

5.1.3 The Underground or "Grey" Economy

28. This is a growing phenomenon in Barbados and manifests itself in several ways. The medium for importation is via the 'barrel' economy. This is a phenomenon that exists throughout the region, is an important tool for combating poverty and is reflective of remittances by migrants to relatives left behind; relatives or friends would fill a barrel (literally) with products and ship to the recipient, or an individual would travel to the US and make purchases at low cost retailers, and ship the items packaged in a barrel. The informal vendors target products that are high in value relative to volume, such as cosmetics, toiletries, soaps, laundry detergents and household cleaning agents. The charge at customs is a flat sum, irrespective of the value of the contents, that is, the tariff is levied on the bulk, not on the value of individual items.

Therefore, the rate of duty paid is less than that paid by the importers of the same items in the formal sector who pay a tariff per item. The vendors are usually itinerants, selling from home, or are vendors at the local markets, or the importer even sell on to groceries.

29. Wholesalers have pointed to several problems caused by this trade. Products are brought in close to expiry date as these are cheaper to buy, compromising product quality standards. Some products are imported from markets where labelling standards are not met. Problematic for those who have exclusive dealerships is that they could be held accountable for damages, returns, and other consumer concerns. Further, the illegal importers piggyback on the promotion of the product by the dealer. So, they doubly benefit by not paying the full customs duty and by not contributing to the promotion of the product.

5.2 Analysis of Research Findings

30. The findings by the BFTC are that vertical integration of companies gives dominance to the firms, and that this dominance has led to practices such as refusal to supply products or services, or preventing competitors from accessing distribution networks.

31. Given the findings of the research, and the conclusion that there were opportunities for manipulation of the market, four areas were highlighted: raising rival's costs; the effects of vertical integration; access to credit facilities; and international vertical integration.

5.2.1 Raising Rivals' Cost

32. Some independent retailers lack bargaining power and are unable to negotiate favourable prices with suppliers. The large importers have access to manufacturers and international distributors and are able to secure exclusive dealerships. There have been instances when a small independent wholesaler may lose a brand that is in demand because the larger wholesaler, with greater reach and power, convinces the manufacturer to switch dealership. With monopsony power, the large retailer could secure reduced prices, but the wholesaler could at the same time raise prices given to the small retailer. This diminishes consumer choice, reduces the viability of small firms, and distorts competition in the market, limiting investment and innovation.

5.2.2 Effects of Vertical Integration

33. Vertical integration has led to the blurring of the lines dividing manufacturer from wholesaler, distributor and retailer. Vertical integration spans distributor and retailer, and distributors and retailers are investing in manufacturing, and securing private labels for their retail outlet. Distributors are establishing vertical relationships with shipping lines, thereby reducing transport cost. The study by the BFTC argues that since exclusive distributorships affect the acquiring, storing, and supplying of products for retail trade, proponents have asserted that vertical integration is considered a strong signal of dominance. There is the example of the common ownership of Barbados grocery, Super Centre, and Barbados distributor of grocery supplies, SBI Distribution, placing both companies in strong positions within the grocery retail and distribution markets, respectively. And, Super Centre and SBI are part of the Barbados Shipping and Trading (BS&T) group which owns, among others, a shipping arm, an international distribution and a procurement company, marketing and advertising company, and a supermarket chain. ANSA McAl, another conglomerate in Barbados, operates in manufacturing, brewing, insurance and finance, shipping, and trading/distribution. The recent acquisition of the Barbadian Trimart Supermarket (formerly Julie'N) by ANSA McAL gives firms within the group access to capital/credit, economies of scale, and product differentiation/availability.

5.2.3 *Access to Credit*

34. The ability to provide credit on the part of the wholesaler, and the credibility of the retailer to secure good credit from wholesalers are crucial to the viability of the grocery sector, and the actors within this sector. Retailers are heavily reliant on credit from wholesalers with a 45-day payment cycle, and with over 80% of stock supplied on credit, and so wholesalers need to have substantial capital backing. Moreover, importers/wholesalers need to have credibility with international manufacturers/distributors, to secure credit from them. This poses substantial barriers to entry both in the wholesale and retail sectors. The contraction in the wholesale market has also rendered access to credit at a premium. Furthermore, because of vertical integration, and market power, dominant firms are in a position to abuse their power by denying some firms access to credit.

35. In the aftermath of the take over of Julie'Ns supermarket by Trimart, and the closure of at least six small retailers, public perception was that the fault lay with wholesalers who gave preferential credit facilities to larger supermarkets and those within their group. However, wholesalers who were interviewed claimed that there is no preferential treatment given other than on the basis of quantity purchased, and this is open to all retailers. This argument that wholesalers deliberately starve small retailers to flush them out of the business is counter-intuitive, given the level of credit owed to them, and the loss they would incur in the event of collapse. Moreover, they would also be shrinking their customer base, and that does not make good business sense.

5.2.4 *International Vertical Integration*

36. Concerns have been expressed that the vertical integration of importers/wholesalers with Miami based operations allows two levels of mark-ups, one from Miami to the wholesaler, and another from wholesaler/distributor to retailer, and consumers do not benefit from the cost savings. However, in favour of the benefits of this extended vertical integration, it is argued that the Miami based agent can secure better prices, arrange shipping, consolidate smaller shipments to achieve scale and reduce cost, and expedite the whole process of shipping. Further, and importantly, they gain creditability with manufacturers and large distributors and so can access better terms of payment, particularly from manufacturers that are unwilling to extend credit to the Caribbean-based purchasers. The BFTC proffered the view that since duties are payable on imports, it would not make sense for the Miami arm to charge high prices since it will increase the quantum of duty paid in Barbados, and that on the surface, it appears that the Miami operation is a rational business decision that may generate savings for the wholesaler/distributor.

5.3 *Other Contributing Factors to Price Increases*

5.3.1 *Competitive Food Prices*

37. It was claimed that prices across the Caribbean region may differ partially because some, mainly international, suppliers use per capita income to determine the prices that each island can afford and base their prices on such. A more important question, though, is whether the price differentials recorded in the local market are a true reflection of the recorded trends in global food prices. The example of a Barbadian joint venture with PriceSmart Inc.⁴ was used to demonstrate that even though its entry into the market was premised on high volume low pricing based on low cost, no frills, warehouse type environment, its prices

⁴ PriceSmart Inc. is the largest operator of membership warehouse clubs in Central America and the Caribbean, with over 770,000 membership accounts and 1 million cardholders. PriceSmart is headquartered in San Diego, California, and it owns and operates 36 warehouse clubs in 12 countries and one U.S. territory. It also offers online shopping in all countries where PriceSmart operates.

were comparable to those offered by retail outlets, and sometimes exceed those. And, they source some of their supplies from local wholesalers, and are therefore bound by their prices. The BFTC concluded that competitive prices are not fully realized because of the implications of collective dominance involving key players in the market, possibly through JVs, interlocking directorships, and/or cross-directorships. And, while there is no evidence that firms are colluding, it is probable, given the growing number of opportunities to do so.

5.3.2 *The Basket of Goods*

38. In regard to price caps for the basket of goods for some 27 essential products identified by the Ministry of Commerce, Consumer Affairs and Business Development, it was found that price caps were expressed in terms of percentage mark-up at the retail level, the price caps did not control the base price of the product, rather, it was the allowed markup by the wholesaler/retailer, and so did not prevent increases in prices even though the percentage markup was fixed. Brand strength was found to be a significant factor in consumer choice, and that each of the listed items was represented by at least 2 different suppliers of brands, thus giving consumers brand choice, and that consumers still purchased premium brands, irrespective of higher cost.

5.3.3 *Level of Service and Quality*

39. Consumers were found to choose retail outlets on factors other than price, that is, they were willing to pay extra for the benefits offered by the ‘upmarket’ higher priced retailers, that is, convenience, better brands, and more choice, at the sacrifice of higher prices. These outlets incur higher operating costs which are transferred to consumers, and are indicative of market power. It represents economic rent, that is, what consumers are willing to pay for non-price attributes of an outlet.

5.3.4 *Inconsistencies in Customs Procedures and Administration*

40. An additional cost faced by small island economies dependent on imports of groceries that are transported by sea is that the goods arrive at the port in containers that then have to be cleared by the importer through customs. Because products are coming from a foreign country, they have to be inspected to verify that they meet Sanitary and Phyto sanitary regulations and the standards applied by the National Standards Institute. A factor that contributes to higher food prices in Barbados is that it has become the norm for supermarket containers to be cleared by Customs after working hours, rather than during normal working hours, thus utilizing staff outside of working hours and incurring overtime charges from at least five government departments (Veterinary Services, Barbados National Standards Institute, Ministry of Health, Port staff, and Customs) In addition their own staff are also paid overtime salary. Additionally, there are increasing incidents of compensation charges when a ship is delayed beyond its scheduled time of departure, or exceeded the standard free time applicable both in import and export cycles (demurrage charges). The time period allowed before charges apply is not reasonable, it was claimed, because it includes non-working days.

41. Radical price increases have also occurred as a result of customs reclassification of an item, thereby increasing the custom tariff paid by importers in the formal sector in the case of one item from 20% to 140%.

42. Distributors have accused shipping agents of colluding, increasing charges over time. The BFTC as recognised this trend, and, following an investigation into the shipping industry, uncovered evidence of collusion among shipping agents in levying a Local Administrative Charge directed to importers.

5.3.5 *Entry of New Players in the Market*

43. Barriers to entry of new competitors in the wholesale market are high, in that newcomers would have to compete with established lines of procurement and shipping, with good credit terms, and exclusive dealerships. While new brands could be brought in, there would be considerable expense in marketing and advertising, and finding buyers/shelf space in an already well serviced market of an estimated 3,000 outlets. There would be the risk of flooding the market with similar products.

5.4 *The Barbados Fair Trade Commission's Conclusions*

44. The results of their study showed that food prices increased by 12.3%⁵ over the 31 month period; that there was synchrony in the movement of prices; and that prices of different brands within the same product category changed at roughly the same time. While this phenomenon can be partially explained by exogenous factors, in some instances, explanations for the synchrony were not forthcoming.

45. On one hand, it was seen that consumers use different criteria to distinguish between brands, and price competition is not as important as brand quality. Manufacturers are aware of this and price their products based on perceived brand strength. On the other hand, a contradictory finding was that good quality (or perceived quality) brands were sold at a similar price as poor quality brands, and this was a result of the oligopolistic structure of the relevant market.

46. Finally, the research identified possible vulnerabilities within the grocery retail sector in Barbados that may lead to anti-competitive conduct. The most common channel through which anticompetitive behaviour may be manifested is in the wholesaler-retailer nexus, where vertical restraints such as minimum resale price maintenance can facilitate cartel-like behaviour and abuse of dominance, thereby dampening competition. The import/wholesale sector was seen as oligopolistic, and the market power of these firms was further deepened through vertical integration upstream with shipping companies and international Miami-based branches for procurement and dispatch of products, and downstream with retailers. This vertical relationship upstream and downstream has led to increasing concentration and the foreclosure of smaller business that cannot meet the competition. Entry into the import/wholesale sector faces high barriers because of the advantage of the large powerful incumbents and the fact that retailers are dependent on up to 80% and more of credit and a 45-day payment cycle. One therefore cannot enter the wholesale sector unless flush with capital, and with good credit facilities with manufacturers. Finally, exclusive distributorship of branded products is hard to challenge. Even though a growing phenomenon of parallel importation was found, this is sporadic in the formal sector, is largely in the informal sector, and is limited in size.

⁵

The Retail Price Index (RPI) for food increased from 161.3 points in January 2009 to 181.1 points in July 2011 (Data from the Barbados Statistical Service, Base: July 2001 = 100).

SECTION 2

Summary of Study Conducted by the Jamaica Fair Trading Commission, ‘Competition Issues in the Grocery Sector in Jamaica’. (2015).

47. The study, still in progress, being carried out by the Jamaica Fair Trading Commission (JFTC), focuses on a growing phenomenon in the grocery sector, that is, retailers introducing private labels in their outlets (store brands), a phenomenon also observed in Barbados. The study’s objective is to assess the scope of private labels to improve the competitive dynamics in the retail sector. Questions asked were: what is the significance of store brands? How should shelf space be used by retailers in competing with national brands? What are the categories of goods that are likely to have a successful store brand?

48. An extensive review of the literature is done, and a qualitative research provides information on what is happening in the market regarding competition between private labels (brands) and national/international brands, or those brands accessible to all groceries (hereafter called *public brands*). Because of the dependence on imports, international brands have a large share of the public brands available in Jamaica, as it does in other Caribbean countries. It was found that food and alcohol constitute 37% of the basket of consumer goods, almost three times as much as the next significant component. This sector is important because of the high percent of the consumer’s budget is allocated to groceries, the high frequency of interaction with retailers, and the wide cross-section of individuals who consume grocery items.

1. Literature Review

49. “Store brand” is defined as all merchandise owned by and sold through a specific chain of stores, that is, a retailer’s brand [hereafter called *private brands*]. This includes the bakery sector of groceries. Such brands have a strong presence in supermarkets in developed countries, ranging between 15%-45 % of market share, but in the developing countries, its presence is quite small, constituting below 10% of market share.

50. The rivalry between public brands and private brands pivots on price and quality. Private brands generally target price conscious customers, generally offers cheaper alternatives in categories with high sales volumes. It was found that as spending power decrease, persons are more likely to substitute away from higher priced goods to cheaper goods. To counter this competition offered by private brands, manufacturers focus on the value-conscious consumers, and so public brands gain a reputation of being the best value for money, built over decades through advertising and delivery of consistent good quality. The downside of private brands is that their lower average prices cause such products to be regarded as less attractive as it signals inferior quality.

51. The literature suggests that because retailers control shelf space occupied by both brands, the private brand has an advantage over the public brand, in that store owners could allocate prime shelf space for his brand, at eye level, for instance. Another question explored in the literature is what are the characteristics for private brands to reap success? It was found that they should be in product lines where there is minimum differentiation, low brand quality, high price sensitivity, high purchase frequency, and low innovation rate. And, the conclusion was that if private brands meet these criteria, then the best option for the producers/wholesalers of public brands is to cooperate with the retailers to produce their private brands.

52. There were contrasting views on whether it is better or worse for store brands if there are many public brands in the category of good chosen for the private brand. One view was that Store brands thrive in markets that are well established so they can feed off the manufacturers’ advertising of their brands in these product markets. Another view posited is that the more public brands in existence in a category of good, the more difficult it will be for private brands to be successful due to the intensity of the competition.

Within this view, it is argued that the far reach of advertising of the public brands will lead to capture of market share. The advice given for retailers to counter negative attitudes towards their private brands is to ensure that the customer is provided with reliable information about the product in the packaging, and ensure that presentation is good.

2. Research Methodology

53. The goals of the research undertaken was to assess what competition exists between private and public brands, discern the complexities of relationships between retailers and merchandisers and gain insight into participants views of that relationship with each other. A qualitative methodology was considered the most appropriate for these purposes. Data collection was done through semi-structured personal interviews, and accuracy of reporting was ensured by recording of interviews and review of the report by the interviewee. Accuracy of data was checked by anonymous visits to the respective retail outlets. It was assumed that public brands represent a significant strategy for retailers to snatch market share. Finally, extensive use was made of secondary data for information on both public and private brands in Jamaica.

54. Questions focused on the historical context in which a private brand was introduced, the significance of shelf space, and the extent of interest of supermarkets to compete using private brands. Interviewees were all at senior decision making level in supermarkets; merchandising representatives were managers who were influential in dictating what goods were sent to a particular location and the terms of trade. Six leading supermarkets and four top merchandisers were targeted. Of these, four supermarkets and 3 merchandisers responded. And, only two of the four supermarkets interviewed had private brands.

3. Findings of the Research

1. Significance of Private Brands

It is interesting that while the definition of private brands includes bakery goods and other goods owned by the supermarket, these were not recognized by the store owners as brands. They cited consumer demand as the reason for introducing private brands, and this was the result of the growing sophistication of consumers, influenced by exposure to international supermarkets, but also, customers were demanding lower prices as the economy contracted and disposable expenditure shrunk (as revealed by a survey of customers done by one of the supermarkets surveyed). Retailers were also willing to introduce private brands because it increased their profit margin by 20%-30%. Interviewees stated that they would introduce a private brand if it would result in a significant reduction in the price of a good, as for instance, if the distributor was cut out. But many concerns were expressed about taking the step to introduce a private brand, since there were many drawbacks. They cited the large investment required, since minimum quantity was required, and given the size of market, often they cannot turn over the volume required for a brand to be created. Additional costs are incurred for storage and marketing the brand, while facing uncertainty as to how customers would respond. The point was made that while it is easier to test customers' response with produce that can be offered for tasting in the store, it is more difficult for other products.

2. Category of goods store brands tend to thrive in: Interviews revealed that the stores managers choose products that have a high volume of sales to target for private branding, such as tin food grocery items, and that they compete on price. Store managers and merchandisers maintain that they do not compromise on quality.

3. *Allocation of shelf space:* Surprisingly, the interviews revealed that store managers do not take advantage of their power to allocate prime space to their own brand. They maintained that they allocate space along traditional lines, and according to volume of sales, so that the fastest selling products are given prime space. Further, unlike their counterparts in the developed countries, supermarkets do not charge for access to prime shelf space. This is one area of continuing research that the JFTC is undertaking.

4. Some Concluding Comments

55. The Jamaica study, like the Barbados study, draws out the limitations imposed on economic actors by the small size of the economies in the Caribbean region. Achieving economies of scale is vital, and influences both decisions on whether to produce locally, and the number of firms that can economically engage in importation. This necessarily leads to market structures that are oligopolistic. Exclusive distributorships are also very prevalent, and that stems largely from the fact that manufacturers are more comfortable dealing with one importer who can be relied upon to order in bulk, and to properly advertise and service the product. Moreover, current trends are leading to growing concentration as firms integrate vertically both upstream (establishing agents/purchasing houses in Miami, buying into shipping companies) and downstream (being importer, wholesaler, distributor, and buying supermarkets as well). The phenomenon of vertical integration is also observed in Jamaica. This vertical integration provides companies with increased market power.

56. The Barbados study fleshed out the growing challenge to established import houses through parallel importation of brands, or imports via the informal economy, particularly the “barrel” trade, with the importers/vendors paying a fraction of the customs duties applicable to the products. These practices put the exclusive distributors at a disadvantage since their rivals free ride on the benefits derived from their advertising, and they may be held responsible for faulty products.

57. Several conducts arising out of market power were identified among the larger businesses in Barbados, such as wholesalers giving preferential prices to conglomerates, while independent retailers do not have bargaining power to negotiate better prices. Some small independent wholesalers may even lose brands to their larger counterparts. The issue of credit facilities also conferred market power to the large wholesalers, because of the dependence of retailers for credit facilities for over 80% of their purchases. The capital requirement to be able to give such credit facilities is a barrier to entry of new firms in the import/wholesale sector.

58. While some acumen in business is being displayed by business persons as they seize opportunities to expand and reduce costs, maximizing profits, the Jamaica study revealed a much more cautious approach to taking another step in gaining competitive advantage by having private labels. This strategy is therefore in its infancy and the constraints identified by the store managers lead them to be risk-averse. The issue of economies of scale also was raised in respect of private brands. The infancy of this practice is also revealed by the fact that stores do not strategically use their power over shelving to gain advantage over rival brands, nor do they charge for prime shelf space.

59. Interesting information was revealed about the behaviour of managers in regard to pricing. It was found, for instance, that even within a group, individual stores had a high level of autonomy in decision making. Nor was there pressure put on stores by public brand representatives to put up the price of their goods that were privately branded. Merchandisers stated that they priced their products individually, taking into account what the market can bear and the margin required by retailers. They complained, however, that retailers sometimes put a lot of pressure on them to reduce their price by asking for a reduction at source, and that this practice is growing, so much so that they feel unduly pressured.

60. The findings of the Barbados study can be applied across the region. In an earlier study (Stewart et al. 2004), similar market structure and practices were found in other CARICOM countries. The importer/wholesaler sector was found to be oligopolistic, and the derived market power made these economic actors more susceptible to engaging in exclusive dealing, tie-ins, loyalty discounts, and refusal to deal. This earlier study also found a prevalence of interlocking directorships in this region. Oligopolistic markets led to firms practicing price parallelism in other countries as well.

61. The 2004 study also found that importers in most cases are also distributors, and in many cases, are retailers as well. The very large importers tend to deal with wholesalers, but can also deal directly with retail outlets. So the lines of demarcation are much diffused. Additionally, competition occurs across lines, that is, supermarkets or large retail businesses are importing directly from the US and competing with agents. And, competition from the informal sector and from newly arrived ethnic groups such as Chinese, Vietnamese, and Indians who grouped together within their ethnic group to import in bulk and worked closely together in business. Similarly, the challenge of the informal sector to the formal sector in Jamaica has been explored elsewhere (Stewart 2009. OECD Global Forum on Competition).

62. The issue of sole distribution is a problematic one in all the territories. Because of the small size of the market, particularly in the micro-economies, exporters have a preference for dealing with a sole importer and distributor, so that container loads of goods can be sent, rather than small consignments. It was the norm in the region to have sole agents for products, but this is eroding in all the territories, primarily because competitors can go to large distribution houses in Miami and purchase a range of brands. With the trend now of direct buying by retailers at the large warehouses in Miami, sole agents are finding that retailers are importing their agency brands and free riding on their advertisements. This practice transcends the North South dimension, and regional distributors also refuse to deal with anyone but their agent in another CARICOM country.

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