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Session I - Structural Issues in the Groceries Sector: Merger and Regulatory Issues

-- Contribution from United States --

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The attached document from United States is circulated to the Latin American Competition Forum FOR DISCUSSION under Session I at its forthcoming meeting to be held on 23-24 September 2015 in Jamaica.

Contact: Ania Thiemann, Global Relations Manager, OECD Competition Division
[Tel: +33 1 45 24 98 87, Email: Ania.Thiemann@oecd.org].

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Session I - Structural Issues in the Groceries Sector: Merger and Regulatory Issues

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COMPETITION ISSUES IN THE RETAIL GROCERY SECTOR IN LATIN AMERICA AND THE CARIBBEAN

-- CONTRIBUTION FROM UNITED STATES --

1. Introduction

1. In the United States, the Federal Trade Commission (FTC) normally handles issues of competition in the supermarket industry. Over the course of its history, the supermarket industry has faced a number of mergers of large grocery store chains including, most recently, the acquisition of Safeway by Albertson's parent company, Cerberus. An important consideration of the antitrust authorities is whether a supermarket merger will result in a loss of competition.

2. In the sections below, we describe our analysis of competitive issues in the supermarket industry. Most of our discussion focuses on supermarket merger review. The goal of supermarket merger review is to assess whether the merger will change the merged firm's incentives and ability to increase prices or decrease quality. Whether it can do so often depends on the degree of substitutability between the products or services of the merging parties. The 2010 Horizontal Merger Guidelines provide the framework for assessing whether a merger is likely to raise anticompetitive concerns.[1] We discuss how the FTC has applied Merger Guidelines analysis to supermarket merger review.

3. Below, we also discuss the relationship between merger review and potential monopsony power. In principle, supermarket mergers could increase monopsony (buyer) power and lead to lower prices paid to food suppliers. As lower food prices are generally beneficial to consumers, this should not ordinarily be a source of concern in antitrust analysis unless the monopsony power provides additional incentives to

1 U.S. DEPT. OF JUSTICE & FEDERAL TRADE COMMISSION, HORIZONTAL MERGER GUIDELINES (2010), available at https://www.ftc.gov/sites/default/files/attachments/merger-review/100819hmg.pdf [hereinafter "2010 HORIZONTAL MERGER GUIDELINES"].

diminish output and increase prices to consumers. The FTC has not brought an enforcement action based on monopsony power in recent years.

2. Product Market

4. The characteristics of a store affect whether consumers would switch to a store with other characteristics in the face of an anticompetitive price increase, which is central to a product market definition. One of the most important pieces of qualitative evidence that the FTC relies on to define a product market is the format of a retail grocery store. The store format is easily observable through store features, such as: variety and number of product offerings, service offerings, and store size. The FTC has often concluded from this evidence that similar store formats should be included in the same relevant product market.

5. The FTC normally alleges a relevant product market that is defined by a store format or a collection of store formats. Indeed, for many years, the FTC alleged a product market for supermarkets that included only stores that were traditional supermarkets.[2] However, product markets have changed as the industry has evolved. Since the *Kroger/Winn-Dixie* merger in June 2000, the Commission has consistently included supercenters (*e.g.*, Wal-mart Supercenter) as market participants in supermarket mergers.[3] While the FTC has considered whether other grocery retail formats – limited assortment, hard discounters, club stores, or ethnic specialty stores, for example – should be included in the supermarket product market, the FTC has not included those formats in the supermarket definition.

6. One exception involved a case from Puerto Rico, in which the FTC included club stores in the same product market as supermarkets because club stores in Puerto Rico fulfill substantially all of a retail purchaser's weekly food and grocery shopping requirements in one visit.[4] The Commission emphasized that while it found that supercenters and club stores competed with supermarkets, this first-time inclusion of club stores was case specific and did not indicate a change in policy.

7. In the 2006 *Whole Foods/ Wild Oats* case, the FTC alleged, and a federal court of appeals ultimately agreed, that the parties participated in a premium, natural, and organic supermarkets ("PNOS") market, a product market distinct from traditional supermarkets.[5] The economic expert for the FTC presented quantitative and qualitative evidence that PNOS grocers were meaningfully differentiated from traditional supermarkets. He concluded that the evidence implied that PNOS constituted a separate product market.

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2 *See e.g.*, Complaint ¶¶ 1, 15 – 18, In the Matter of Albertson's, Inc., Docket C-3838 (Dec. 8, 1998) (defining "supermarket" and explaining that grocery retail stores with a different format are not supermarkets) available at https://www.ftc.gov/sites/default/files/documents/cases/1998/12/9810134cmp.htm.

3 *FTC v. The Kroger Co.*, Preliminary Injunction Brief ("PI Brief") 7 n.11 (June 2, 2000) ("Some mass merchants such [as] Wal-Mart have opened new "supercenters" that combine a mass merchandise store and a supermarket under one roof. The FTC includes the supermarket portion of these supercenters in the supermarket category.") available at https://www.ftc.gov/sites/default/files/documents/cases/2000/06/krogerbrief.pdf.

4 *See* Complaint ¶¶ 8 – 11, In the Matter of Wal-Mart Stores, Inc. and Supermercados Amigo, Inc., Docket C-4066 (Nov. 20, 2002), available at https://www.ftc.gov/sites/default/files/documents/cases/2002/11/walmartamigocmp.pdf.

5 Amended Complaint ¶ 35, In the Matter of Whole Foods Market, Inc., Docket No. 9324 (Sept. 8, 2008). In a preliminary injunction action, the FTC failed to persuade the district court that PNOS was a relevant product market. On appeal, however, the D.C. Circuit reversed the lower court and determined (in a divided opinion) that the FTC might have been able to prove a PNOS submarket. *FTC v. Whole Foods Mkt., Inc.*, 502 F.Supp.2d 1 (D.D.C. 2007), *rev'd* , 548 F.3d 1028, 1041 (D.C. Cir. 2008).

8. Because of the importance of format in defining the relevant product market, the FTC collects substantial information from a variety of industry participants during a merger investigation. In past investigations, the FTC has used evidence from internal company documents, interviews of store operators, websites, advertisements, and other information about the stores.

9. Although store format is an important consideration in determining the relevant product market, other types of qualitative and quantitative information about the industry can be informative to product market definition. For example, information about the merging companies' and their customers' perceptions of substitutes to the merging parties' stores is instructive on product market definition. The parties to a merger usually submit company documents and data across a broad range of topics, each of which provides insight into the product market definition. A company's pricing practices – specifically full-book price-checking, pricing guardrails, and price zones – often focus on a few store operators that the company views as primary competition.[6] Real estate committee documents assessing the viability of a new location for a store often analyze the competitive significance of the other grocery retailers near the potential new location. Customer surveys and cross-shopping studies may provide insight into which alternatives customers use.[7] Entry and exit event tracking, done by the merging companies in their ordinary course of business, show the effects of various entries and exits of different kinds of store formats on revenue. This type of information about competition and substitutability often demonstrates that when two companies' stores are similar on numerous dimensions, such as product offerings, services, and size, those companies almost always see their stores as providing a greater degree of competition and substitutability than stores with different mixes of products, services, and size.

10. The FTC has alleged product markets consisting of supermarkets (including supercenters) and premium, natural, and organic supermarkets. In doing so, it has excluded other formats from the product market. For example:

- Ethnic specialty stores offer a selection of products and services tailored to a specific customer group, distinct from the typical supermarket customer.
- Limited assortment stores do not offer a "one-stop" shopping experience because they provide no service counters and have mostly own-label products. Evidence in past investigations suggests that customers use these stores for a different type of service than traditional grocery stores.
- Many hard discounters purchase distressed/damaged/surplus grocery items at low prices, and do not keep a consistent or complete inventory selection.
- Convenience stores offer a relatively limited selection of high volume items and target the convenience shopper who is willing to pay more than the supermarket price. Specialty food stores – like gourmet stores – do not offer one-stop shopping (particularly because they typically lack non-food grocery items) and rarely price compete against supermarkets.

6 Full-book pricing is the practice of comparing prices to a competitor store's comprehensive list of products. Pricing guardrails are internal commitments to maintain prices within a certain range based on competitors' prices (*e.g.*, a store may commit to be 5% above club store prices and 5% below other conventional supermarket competitors). Price zones are internal commitments to offer identical prices at multiple stores within a "zone."

7 Cross-shopping studies, usually based on customer surveys, show where a customer regularly shops for groceries in addition to the survey-giving company's store. This may provide information as to which supermarkets customers view as close alternatives.

- Club stores' grocery items are limited to a few brands per grocery product and come in bulk packaging unsuitable for many grocery consumers.[8]

  All of these formats offer a limited range of products and services compared to supermarkets.[9] Supermarket shoppers typically do not view these other formats as adequate substitutes for supermarkets.[10] Further, although these other types of retailers offer some competition, they do not provide as significant or close competition as traditional supermarkets.[11]

11. Market participants included in the supermarket product market definition (*i.e.*, conventional chain supermarkets, independent grocery stores, and supercenters) are differentiated along several dimensions (*e.g.*, size, product assortment, price, service, etc.). For example, supercenters and independent grocers are on opposite ends of a spectrum within the supermarket product definition. Supercenters are very large stores. They often have large parking lots, score low in service and fresh food quality rankings, and offer low prices. Independent supermarkets are typically smaller stores than conventional chain stores and score high on service, but they may lack scale to competitively price against national grocery retailers. In a relevant geographic area where the only two chain supermarkets are merging and there is one supercenter and one independent grocer – for example – the analysis should include the local population's willingness to substitute the supercenter or the independent grocer for the chain supermarket.

12. In our experience, store format is often among the most important determinants of a relevant product market when evaluating retail grocery store mergers. Past investigations have found a strong correlation between store formats and other evidence of competitive interaction, on the one hand, and customer substitution on the other hand. Because retail grocers continue to experiment with different formats, however, the product market definition is a case-by-case determination and may differ among different geographic markets even in the same matter. As the discussion above describes, new store formats and local conditions can affect the product market analysis.

3. Geographic Market

13. To identify relevant geographic markets, the FTC currently begins the analysis by considering merging stores within a distance that is likely close enough to suggest they could have overlapping customer bases.[12] Convenience motivates supermarket customers' choices; consequently, consumers

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8 Staff has observed that some formats typically excluded from the supermarket product market can be included in the definition based on local conditions. As noted above, in *Wal-Mart/Supermercados*, the Commission defined a product market in Puerto Rico that consisted of supermarkets, supercenters, and retail sale of supermarket-type items at club stores or similar stores that allow consumers to complete substantially all of their weekly food shopping in one visit. To date, that is the only matter in which the Commission has included club stores in the relevant product market definition for a grocery retail merger.

9 The evidence gathered in merger investigations suggests that stock keeping unit (SKU) counts in these store formats are significantly lower than at conventional grocery stores.

10 Supermarket shoppers would be unlikely to switch to one of these other types of retailers in response to a small but significant increase in price or "SSNIP" by a hypothetical supermarket monopolist. *See* 2010 Horizontal Merger Guidelines § 4.1.1 (2010).

11 Note, that the FTC has alleged a product market for the sale of discounted general merchandise in retail stores that sometimes includes supermarkets, but not the converse – general merchandise stores, such as dollar stores, have not been included in the relevant product market in supermarket mergers. *See* Complaint ¶ 6, In the Matter of Dollar Tree, Inc., Docket C-4530 (July 2, 2015) available at https://www.ftc.gov/system/files/documents/cases/150702dollartreecmpt.pdf.

12 In the absence of price discrimination based on customer location, the Agencies normally define geographic markets based on the locations of suppliers. Geographic markets based on the locations of suppliers encompass the region from which sales are made. Geographic markets of this type often apply

predominantly shop very close to home. However, the distance a consumer is willing to travel for groceries varies by local conditions and store type. For example, grocery consumers are often more willing to travel farther in rural or suburban areas than in dense urban areas. Moreover, geographic features of an area, such as valleys, parks, waterways, highways, railroad tracks, and bridges (or the lack thereof) can affect a customer's willingness to travel. Similarly, consumers are generally willing to travel farther for supercenters than they are for conventional supermarkets.

14. Over the years, the FTC's definition of the relevant geographic market in supermarket merger cases has evolved. Through the early 2000s, FTC complaints alleged large areas such as metropolitan statistical areas ("MSAs"), counties, and cities.[13] In *Kroger/Winn-Dixie* in 2000, the FTC's brief in support of a preliminary injunction against the merger suggests the existence of local markets as small as 2-3 miles (3 – 5 kilometers), but the geographic market alleged in the complaint is the area in and around Ft. Worth (as opposed to the Dallas /Ft. Worth metro area).[14] Then in *Whole Foods/Wild Oats* in 2007, the FTC alleged "an area as small as approximately five or six miles [eight or ten kilometers] in radius from [PNOSs] or as large as a metropolitan area," marking the first time the FTC specifically alleged markets based on radius areas immediately surrounding stores.[15] In *Ahold/Safeway* (2012), the Commission defined each of its geographic markets using a mileage radius around each store.[16] Since then, all of the FTC's supermarket consent decrees have alleged highly localized areas based on a range of overlap distances.[17] For example, the *Albertsons/Safeway* complaint (2015) specifically alleges that within each localized market, the merging parties had stores within two-tenths to ten miles (three-tenths to sixteen kilometers) of each other and have overlapping trade areas. The Commission did not allege metropolitan areas such as Los Angeles, Las Vegas, and Seattle as relevant geographic markets, but instead alleged that each MSA contains many local relevant geographic markets. Defining highly localized markets has been driven by an increasing availability of customer information and sophistication of data analysis.

15. The boundaries of each relevant geographic market can be determined using documents and data produced by the merging parties and third parties, interviews of local market participants, and publicly

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when customers receive goods or services at suppliers' locations. Competitors in the market are firms with relevant production, sales, or service facilities in that region. 2010 Horizontal Merger Guidelines § 4.2 (2010).

13 *See e.g.*, Complaint ¶ 9, In the Matter of Koninklijke Ahold NV, Docket No. C-3687 (Sep. 30, 1996) (alleging relevant geographic markets such as "'the greater Hartford, Connecticut, area'" and "'the greater Providence, Rhode Island, area,'" – large metropolitan areas with many townships within.) available at https://www.ftc.gov/sites/default/files/documents/cases/1996/10/c3687cmp.pdf.

14 *FTC v. The Kroger Co.*, Plaintiff's PI Brief, June 2, 2000, p. 10 ("Consumers generally do not travel more than two to three miles to do their grocery shopping.") available at https://www.ftc.gov/sites/default/files/documents/cases/2000/06/krogerbrief.pdf. See also *FTC v. The Kroger Co.*, Complaint for Preliminary Injunction Pursuant to Section 13(b) of the Federal Trade Commission Act, June 2, 2000, at para. 12.b.(1) available at https://www.ftc.gov/sites/default/files/documents/cases/2000/06/krogercomp.htm.

15 Amended Complaint ¶ 36, In the Matter of Whole Foods Market, Inc., Docket No. 9324 (Sept. 8, 2008), *available at* https://www.ftc.gov/sites/default/files/documents/cases/2008/09/080908wfamendedcmpt.pdf.

16 Complaint ¶ 16, In the Matter of Koninklijke Ahold N.V., Docket No. C-4367 (Aug. 16, 2012) ("The relevant geographic market in which to assess the competitive effects of the acquisition is a roughly three to three-and-a half mile area surrounding Newtown[.]") available at https://www.ftc.gov/sites/default/files/documents/cases/2012/08/120817konkinlijkecmpt.pdf.

17 *See, e.g.*, Complaint ¶¶ 14-16, In the Matter of AB Acquisition, LLC, Docket C-4424 (Dec. 23, 2013); Complaint ¶¶ 15-17, In the Matter of Lone Star Fund V (U.S.), L.P., Docket C-4440 (Feb. 24, 2014); Complaint ¶¶ 14-16, In the Matter of Cerberus Institutional Partners V, L.P., Docket C-4504 (Jan. 27, 2015).

available information. Analysis of loyalty membership data has allowed for very precise drawing of overlapping trade areas. Entry/exit studies show the effect of entry/exit events on an incumbent's revenue, and provide further evidence about the contours of the relevant geographic market. Real Estate committee documents, pricing practices, and interviews of local store operators provide additional perspectives on local customer travel patterns. An analysis based on these sources provides a highly nuanced and supportable local geographic market definition.

4. Competitive Effects

16. The ultimate question of interest in any merger of differentiated products, including supermarket merger analysis, is whether the merger eliminates meaningful competition between sufficiently close substitutes that the merging parties can profitably impose a post-merger price increase.[18] The degree of substitutability between the merging parties and whether they could profitably impose a price increase will depend on a number of factors, including the number and type of other competing firms that are present. The focus of merger investigations is often to determine the degree of substitution between the merging firms and whether there are other adequate substitutes in the market.

17. If the merging grocery chains are close substitutes, then a merger may change the unilateral incentives of the combined firm. Prior to a merger, if either of the merging firms were to raise price, the customers lost to the other merging firm would represent a loss to the firm electing to raise prices. Post-merger, however, customers who switch between the parties' stores would no longer represent a loss to the firm since the acquiring firm would recapture these sales. The merged firm would have a greater incentive to raise prices or lower quality once the merger removes the competitive constraint that the merging parties had imposed upon each other. If there are several other close substitutes to the merging parties, however, the merged firm may not be able to profitably increase prices unilaterally because too large a fraction of sales would be lost to these other substitute supermarkets.

18. The incentive to raise price after the merger is based on the amount of sales the merged firm is likely to recapture and the margins earned on the recaptured sales. Economists often measure substitution in terms of the "diversion ratio," which is defined as the proportion of the unit sales that would be lost by one of the merging parties if it increased price, that are diverted to the other party. The diversion ratio is an important input into formal merger simulations and upward pricing pressure indices.[19]

19. A grocery store merger might also increase the probability of coordination between industry participants. An increase in market concentration may make it easier for competing firms (*i.e.*, firms that sell economic substitutes) to coordinate behavior and thus raise prices or lower quality. There are market conditions specific to the supermarket industry that may facilitate coordination, while others may actually serve as barriers to coordination. For example, competitor prices are relatively transparent, which tends to facilitate coordination. However, monitoring and enforcing agreements are costly activities due to the large number of product offerings and frequent supplier-specific promotions. The cost of monitoring tends to make coordination more difficult.

20. In addition to relying on documentary and interview evidence, as described in proceeding sections, the FTC employs quantitative analyses to estimate substitution patterns and the likely competitive effects of the transaction. The methods employed depend upon data availability and institutional details of the transaction under investigation.

18 A decrease in quality is conceptually similar. We use "price increase" as a short hand for either.

19 For a discussion of upward pricing pressure, see Joseph Farrell & Carl Shapiro, Farrell, J. and Shapiro, C (2010) "Upward Pricing Pressure and Critical Loss Analysis: Response, *The CPI Antitrust Journal, February 2010*. https://www.competitionpolicyinternational.com/assets/Free/Shapiro-FarrellFEB10.pdf.

21. We provide a brief description of three of these methods: market share analysis, loyalty card studies, and event studies. See Hosken and Tenn (2014) for a more detailed description of each of these methods and their application to retail merger review.[20]

4.1 Market Share Analysis

22. In the early stages of many U.S. supermarket merger investigations, the merging companies provide the FTC with data acquired from a third-party vendor about competitor grocery stores' annual sales. The FTC uses these data to construct market shares within defined markets. Market shares are used to identify areas where a merger could potentially be anticompetitive. The consideration of market shares implicitly assumes that substitution is proportional to share. In other words, substitution is greater to market participants with large shares than to participants with small shares.

23. Although market shares provide useful screens, they require definitions of product and geographic markets that include or exclude firms rather than allowing for a continuous measure of the extent of substitutability between firms. The decision to include or exclude a competitor that is only arguably part of the market from the market share calculation may have a dramatic impact on the resulting market shares and market concentration indices. We expect that measures of competition that account for varying levels of substitution between firms, such as those discussed below, may more accurately capture the nature of substitution between the firms.

4.2 Loyalty Card Studies

24. Many supermarket chains maintain loyalty card programs that track store purchases of individual consumers. Using methods described in Hosken and Tenn, the FTC has used loyalty card data to estimate more refined diversion ratios.[21] Loyalty card data typically includes store-level sales data for each customer and includes the residential address of those customers. Using residential address, the FTC has estimated market shares for individual Census block groups, which are geographic areas that usually contain about 1500 residents. By estimating block group-level market shares and then aggregating to the store-level, the analysis effectively controls for important consumer characteristics because the Census block group controls for average demographic information such as population density, wealth (*e.g.*, home value), income, age, education, ethnicity, and household size.

25. Calculation of the relevant block group-level shares also requires the total grocery expenditures of all residents in the block group. This information is unlikely to be included in any of the parties' data submissions, but can be estimated using demographic characteristics of the block group and public sources that report total household grocery expenditures.[22] Diversion ratios between the merging parties' stores can be calculated using weighted averages of block-group level shares that give more weight to block groups that contribute more sales to the relevant store.

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20 Daniel S. Hosken & Steven Tenn, *Horizontal Merger Analysis in Retail Markets*, Social Science Research Network (January 19, 2015), *available at*http://ssrn.com/abstract=2552548 *or* http://dx.doi.org/10.2139/ssrn.2552548.

21 *See* 2010 Horizontal Merger Guidelines and Farrell, J. and Joseph Farrell & Carl Shapiro, *Upward Pricing Pressure and Critical Loss Analysis: Response*, The CPI Antitrust Journal (February 2010), https://www.competitionpolicyinternational.com/assets/Free/Shapiro-FarrellFEB10.pdf.

22 The American Community Survey (https://www.census.gov/programs-surveys/acs/) conducted by the US Census provides household demographic information at the block group-level. The Consumer Expenditure Survey (http://www.bls.gov/cex/) conducted by the Bureau of Labor Statistics reports household-level grocery expenditures.

4.3 Event Studies

26. Another approach to estimating competitive effects relies upon event study approaches to analyze changes in the competitive environment, such as the effect of entry and exit by competitors. For example, the FTC's economic expert for the *Whole Foods/Wild Oats* case used event studies to conclude that entry by Whole Foods into areas with incumbent Wild Oats stores resulted in lost sales and lower prices for the Wild Oats stores. [23] The magnitude of the lost sales provided information about the diversion ratio between the two parties. The price results provided direct information about the potential effects of the merger.

27. Event studies frequently use "control group" stores that are unaffected by the event to control for market characteristics that could bias estimates of the effects. Control group stores could be other conventional supermarkets with similar sales revenues in geographic areas that are unaffected by the event. The validity of event studies, and the ability to draw inferences from them, depends on the similarity of the affected stores and the control group stores. For instance, whether the control group stores face similar cost fluctuations as the affected stores is an important consideration in choosing a control group.

28. Numerous academic papers have examined the effects of events on retail supermarket competition. These studies consider a wide range of events and control groups. For example, Basker and Noel (2009) and Hausman and Liebtag (2007) estimate that Wal-Mart's entry into food markets lowers food prices by about 1% and 3%, respectively.[24] Hosken, Olson, and Smith (2012) consider the effects of mergers on grocery prices.[25] They find that mergers in concentrated markets are often associated with price increases, while mergers in less concentrated markets are often associated with price decreases.[26]

5. Entry and Repositioning

29. The extent of barriers to entry will depend on the specific geographic market at issue. On the one hand, supermarkets have few proprietary assets or technological barriers. As a result, de novo store entry does occur.[27] On the other hand, entry barriers include the time and costs associated with conducting necessary market research, selecting an appropriate location for a supermarket, obtaining necessary permits and approvals, constructing a new supermarket or converting an existing structure to a supermarket, and generating sufficient sales to have a meaningful impact on the market. Thus, it is a fact-specific inquiry to determine whether entry would be timely, likely and sufficient.

23 *See* Expert Report of Kevin M. Murphy, Ph.D., *FTC v. Whole Foods Mkt., Inc.*, No. 1:07-CV-01021 (D.D.C. July 9, 2007) available at https://www.ftc.gov/sites/default/files/documents/cases/2007/08/070823murphy.pdf.

24 Emek Basker & Michael D. Noel, The Evolving Food Chain: Competitive Effects of Wal-Mart's Entry into the Supermarket Industry, *Journal of Economics and Management Strategy* 18:4, 2009, at 977-1009; Jerry Hausman & Leibtag Ephraim, *Consumer benefits from increased competition in shopping outlets: Measuring the effect of Wal-Mart*, 22 Journal of Applied Econometrics 1157-77(2007).

25 Daniel S. Hosken, Luke Olson & Loren Smith, *Do Retail Mergers Affect Competition? Evidence from Grocery Retailing*, Federal Trade Commission, Bureau of Economics, Working Paper No. 313, December 20, 2012, *available at* http://ssrn.com/abstract=2192189 *or* http://dx.doi.org/10.2139/ssrn.2192189.

26 They measure concentration using dollar sales from box stores (e.g., Wal-mart and Target), conventional grocers, and club stores in a Core-Based Statistical Area (CBSA).

27 *See also* Dan Hanner et al., Dynamics in a Mature Industry: Entry, Exit, and Growth of Big-Box Grocery Retailers, 24 *Journal of Economics and Management Strategy* 22-46, (2015).

30. Incumbent firms may also be able to reposition their existing stores by, for example, remodeling stores to refresh appearances, expanding, and repositioning to cater to changing local tastes.[28]

31. For these reasons, entry and repositioning are important considerations in supermarket merger review. In some economic models, high margins attract entry until prices are such that fixed entry costs are unprofitable for the next entrant. For this reason, the incorporation of store margins into the competitive effects analysis may implicitly account for general entry conditions, since pre-merger store margins may reflect fixed entry costs. However, the FTC also identifies likely entrants and incumbent expansions through competitor interviews and subpoenas during merger investigations, and incorporate known or expected opening of specific stores into its analysis.

6. Monopsony

32. In some circumstances, the FTC may be concerned that a proposed merger would increase monopsony power or otherwise adversely affect retail suppliers. A grocery chain may have monopsony power if it purchases such a large quantity of a food product that it has the ability to influence the market price of the food product. As lower food prices are generally beneficial to consumers, this should not ordinarily be a source of concern in antitrust analysis unless the merged firms would lack incentives to pass the savings on to consumers, or would have incentives to diminish output. For example, a grocery chain with monopsony power may have an incentive to purchase less of an input than it would were it one of many purchasers if, in doing so, it would receive a lower price on the product. The idea is that the chain with monopsony power would find it profitable to work its way down an upward sloping supply curve of the input suppliers by purchasing less of the input at a lower price than a firm without monopsony power would. Monopsony harm comes from the reduction in the input quantity and not from the lower price for the input.

33. In the United States, grocery store mergers rarely raise monopsony concerns. National firms supply many of the products purchased by retail grocery store chains. Recent grocery chain mergers have not raised concentration levels to a point that would warrant concern over monopsony power at the national level. As the Horizontal Merger Guidelines suggest: "Market power on the buying side of the market is not a significant concern if suppliers have numerous attractive outlets for their goods or services."[29] If a proposed grocery merger were to present potentially problematic increases in local purchasing power over some set of products, it is likely that the downstream competitive effects of that same merger would also be of concern because the suppliers of the product are almost certain to have at least as many alternative buyers as the customers of the retailer have viable alternative stores.

34. Although some supermarket mergers could generate a retailer capable of negotiating for lower input prices, it is important to understand the economic underpinnings of those lower prices. Unlike typical competitive effects analysis in horizontal merger investigations, a focus on prices can be misleading in analysis of buyer power. If the merged firm is able to obtain lower prices due to volume discounts or distribution efficiencies, those lower prices will likely benefit the consumers who shop at that retailer. However, if the merged firm obtains lower prices by restricting output, then consumers may be harmed. The focus of the antitrust analysis of monopsony power in grocery mergers should be on the quantity impact of the buying behavior of the merged firm. Consumer harm comes from quantity reductions, not lower prices.

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28 Id.

29 2010 HORIZONTAL MERGER GUIDELINES at 33.

7. FTC 2003 Slotting Allowance Study

35. Outside of the merger context, the FTC has occasionally been called upon to examine allegations that supermarket chains can adversely affect competition through arrangements with suppliers through which they are paid to stock the suppliers' products or give their products preferential display of their products. In general, supermarkets, like other businesses, are free to deal with whichever suppliers they choose.[30] The FTC examined concerns that these practices might amount to anticompetitive agreements or might contribute to monopolization.

36. In 2003, FTC staff issued a study entitled "Slotting Allowances in the Retail Grocery Industry: Selected Case Studies in Five Product Categories."[31] Slotting allowances are one-time payments that a supplier makes to a retailer as a condition for the initial placement of the supplier's product on the retailer's store shelves or for initial access to the retailer's warehouse space.

37. Previous academic literature had suggested various ways that slotting allowances might theoretically be procompetitive or anticompetitive.[32] There was little systematic empirical work to assess these different theories. Previous studies of slotting fees relied on purely qualitative information. The FTC staff study provided qualitative and quantitative information about slotting allowances paid to certain retailers in certain geographic areas for five product categories: fresh bread, hot dogs, ice cream and frozen novelties, shelf-stable pasta, and shelf-stable salad dressing.

38. Some of the key findings of the study are: (1) there is considerable variability across product categories, both in the likelihood of paying fees and in the magnitude of fees paid; (2) slotting fees can make up a large fraction of the revenues earned by grocery stores for some products in their first year; (3) most surveyed retailers reported that slotting allowances help defray costs associated with new product introductions; and (4) slotting allowances were less frequent and in lower amounts for products that did not go through retailers' warehouses because suppliers delivered them directly to retailers' stores. However, the study's results are at most suggestive, and not probative due to small sample size in the number of retailers and limitations on available information.

8. Conclusion

39. As the grocery industry evolves and new data become available, the FTC updates its analysis of competition issues in the grocery industry. Although industry developments have sometimes led to changes in the assessment of product and geographic markets in the course of merger review, the fundamental analysis of competition remains grounded in an assessment of customer substitution patterns.

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30 United States v. Colgate, 250 U.S. 300 (1919).

31 FTC STAFF, SLOTTING ALLOWANCES IN THE RETAIL GROCERY INDUSTRY: SELECTED CASE STUDIES IN FIVE PRODUCT CATEGORIES (2003), available at https://www.ftc.gov/sites/default/files/documents/reports/use-slotting-allowances-retail-grocery-industry/slottingallowancerpt031114.pdf.

32 The literature had suggested that slotting allowances might be procompetitive: by signaling the quality of the new product; by screening among products that might be stocked; and by increasing manufacturers' incentives to invest in demand enhancement. The literature also had suggested that slotting allowances might be anticompetitive: by softening retail price competition among manufacturers; and by excluding fringe product suppliers. *Id*. at 1-4.