# BECCLE Seminar on Grocery Markets

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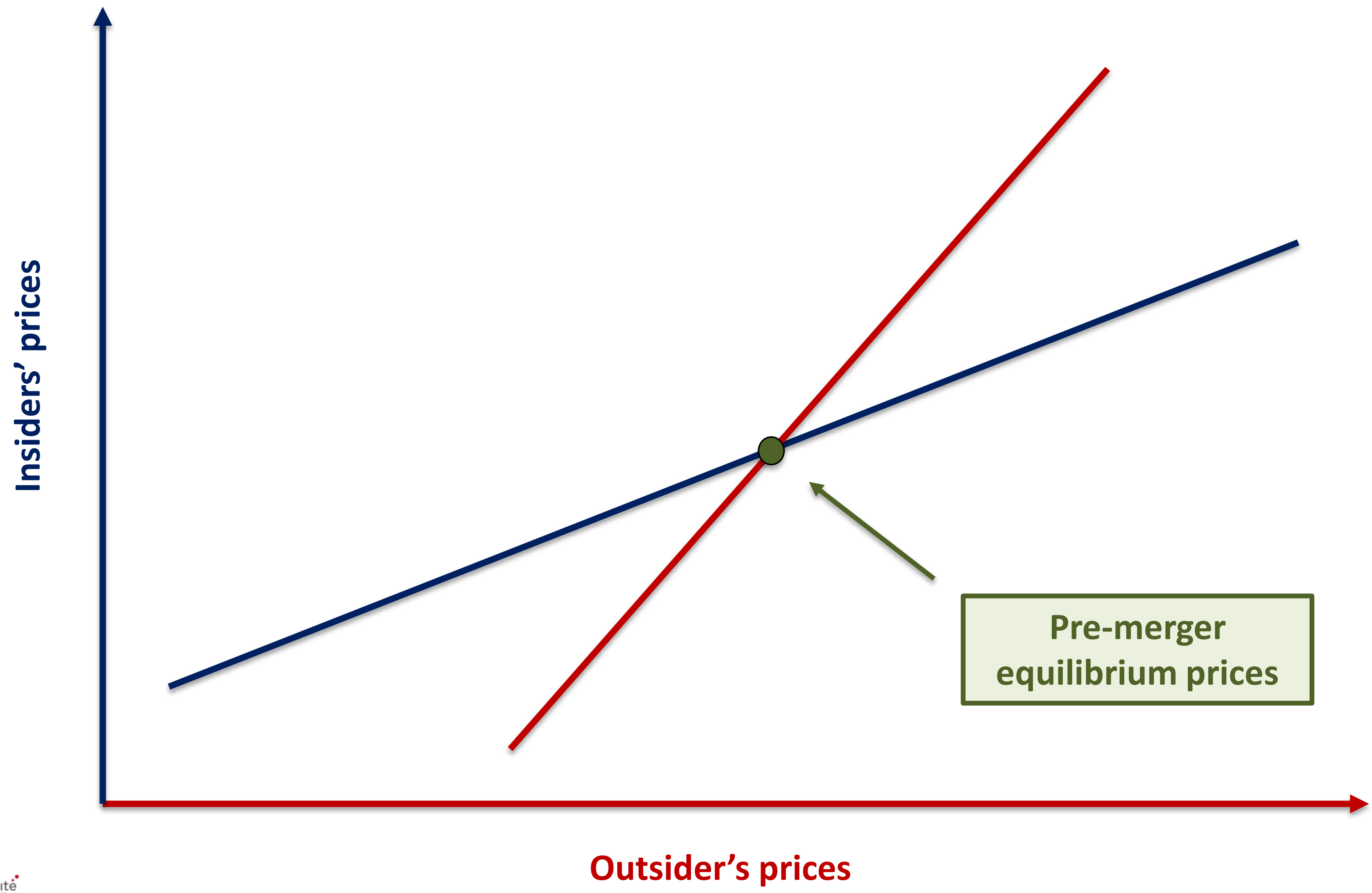
# Local UPP tests and purchasing power

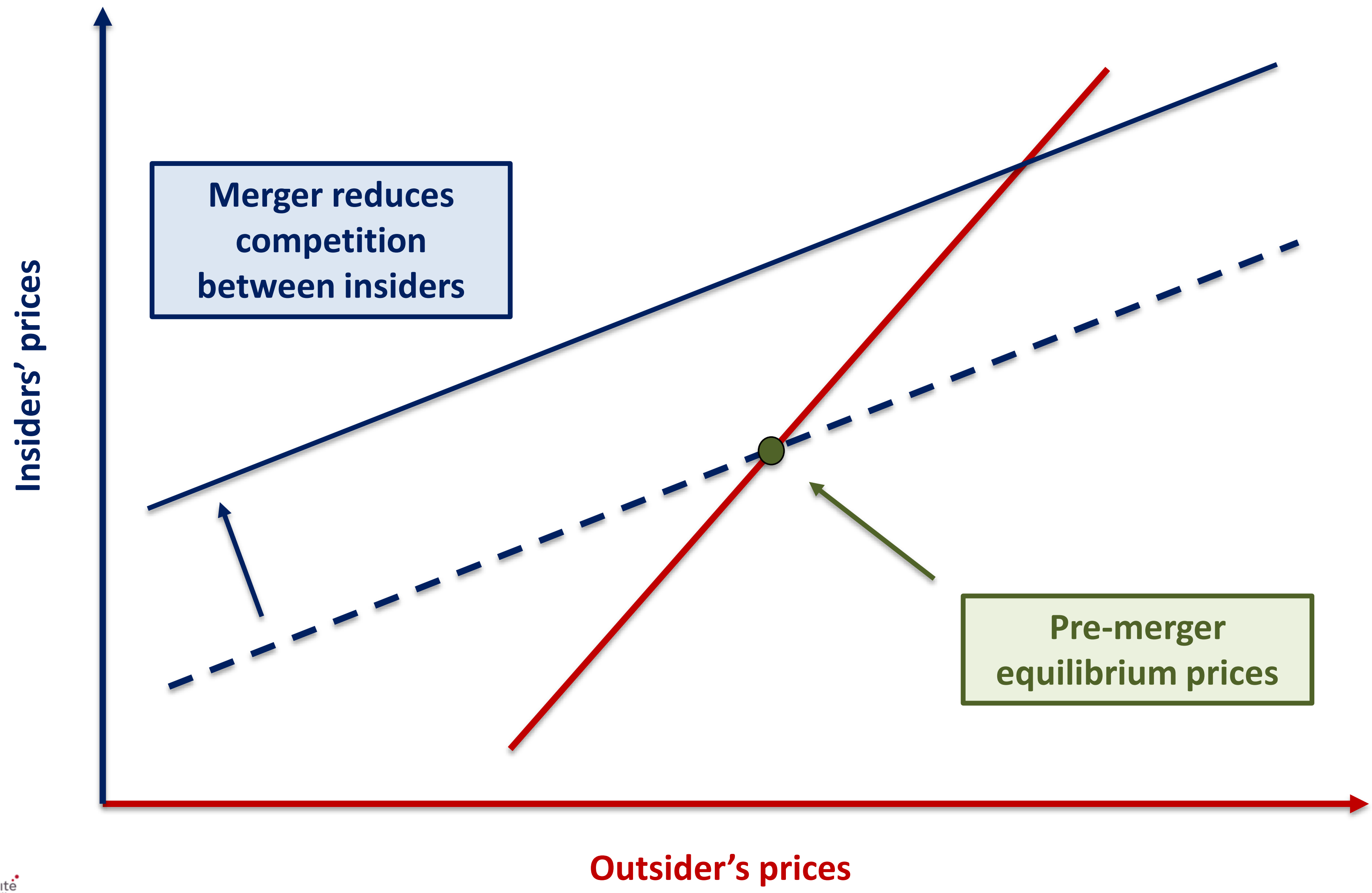
- **Basic UPP-test (full merger between A and B)**
  - $UPP_A^* = (p_B - (1 - e_B)c_B)DR_{A \to B} - e_A c_A$
  - Prices and diversion ratios are evaluated locally.
  - Cost are negotiated nationally.
  - **Efficiency gains are arbitrarily chosen**.

- **How does purchasing power affect the UPP-test?**
  - Efficiency gains could potentially be evaluated rather than simply arbitrarily chosen.
  - But this is not as simple as it seems since one will first need to estimate the relationship between input prices and size.
  - The costs used in the local UPP-tests should be the stores' total marginal costs. These include the products' wholesale prices (for a representative basket of products) but also the marginal costs of distribution (for which they maybe also be efficiencies generated by the merger).
  - What if they are also "waterbed" effects? In such a case, UPP-tests are insufficient and one should try to "simulate" the effect of the merger on prices, for instance by "estimating" a simple linear demand model.

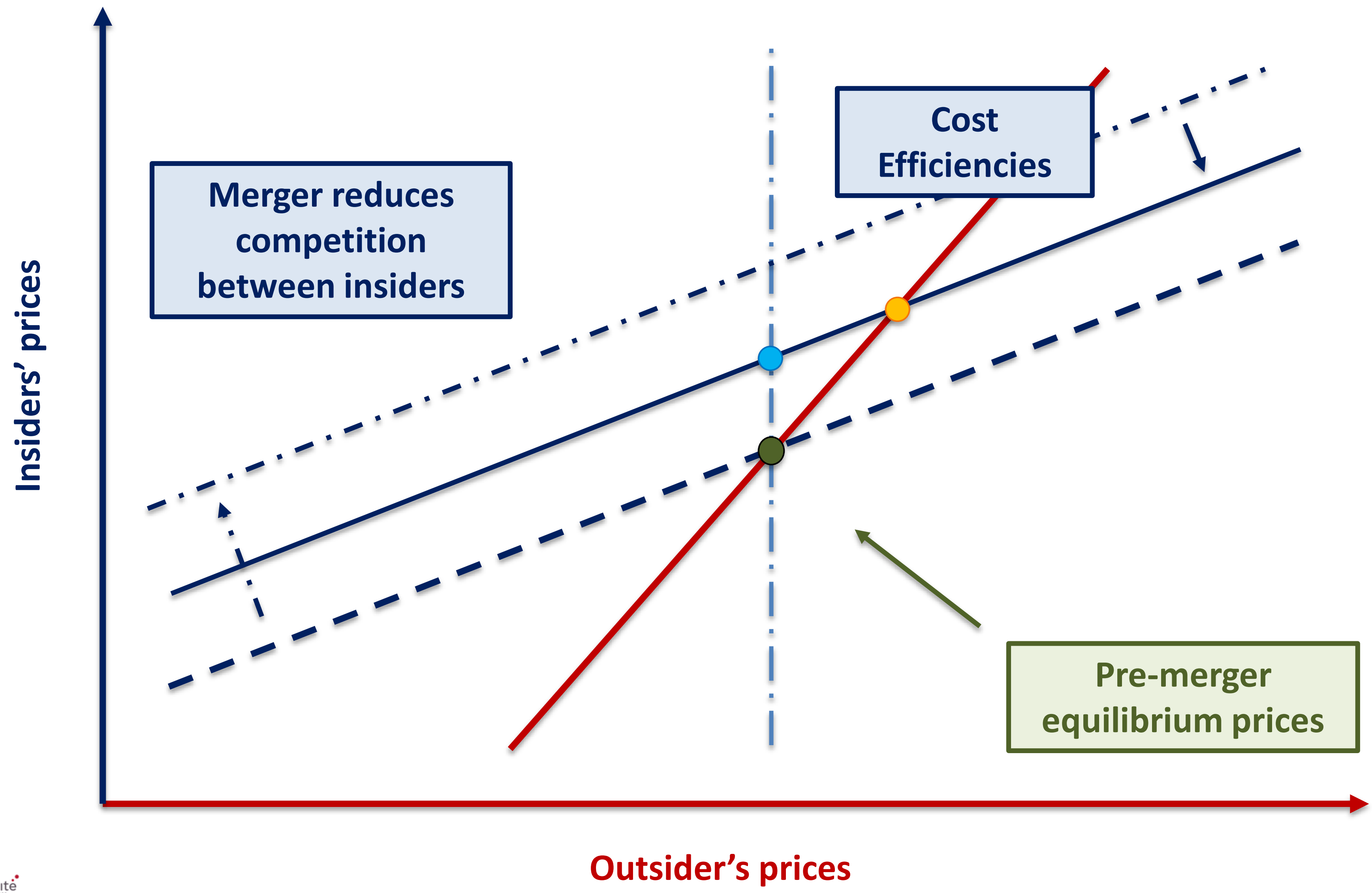
# Standard Price Competition



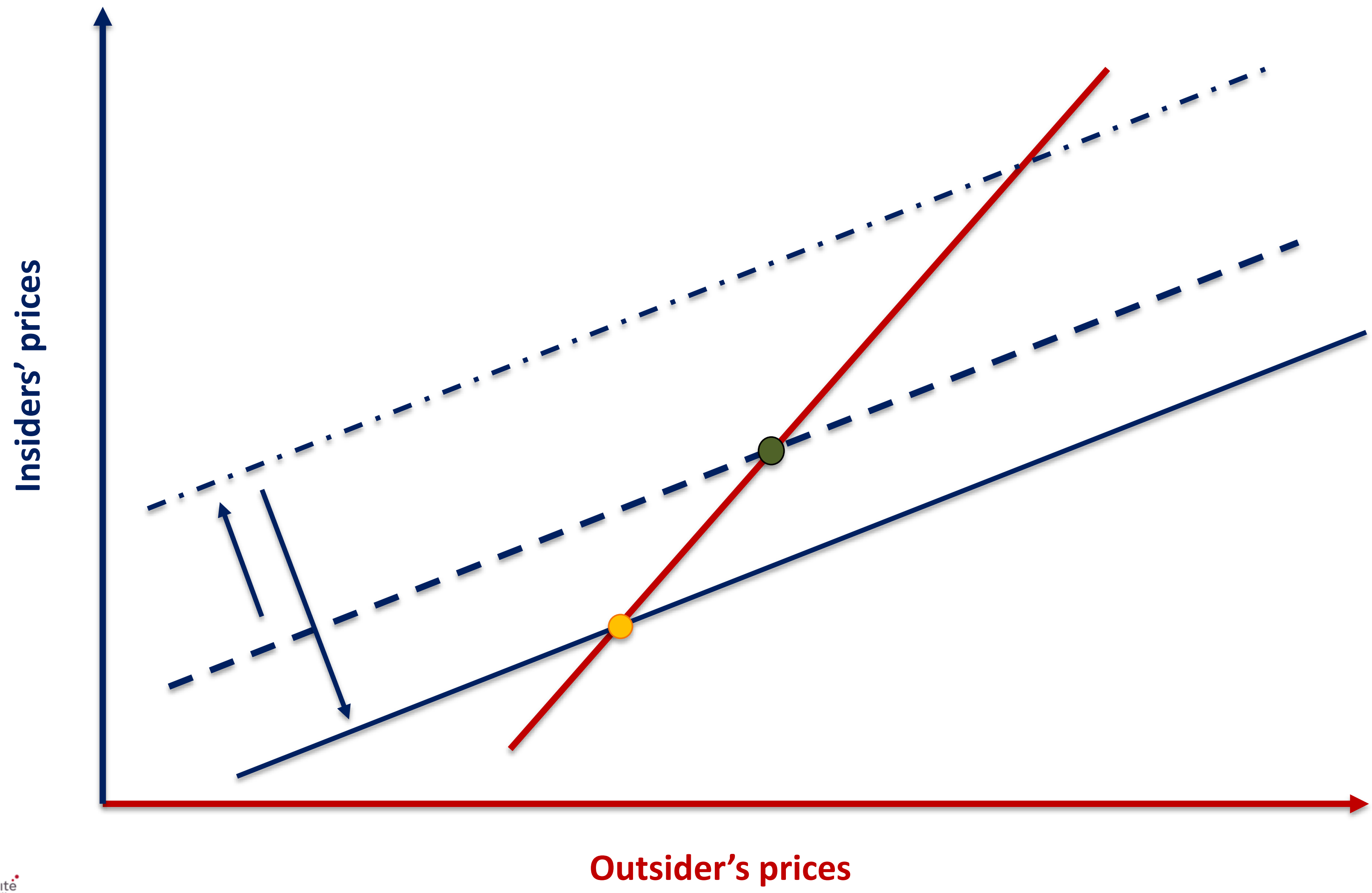
# Standard UPP test



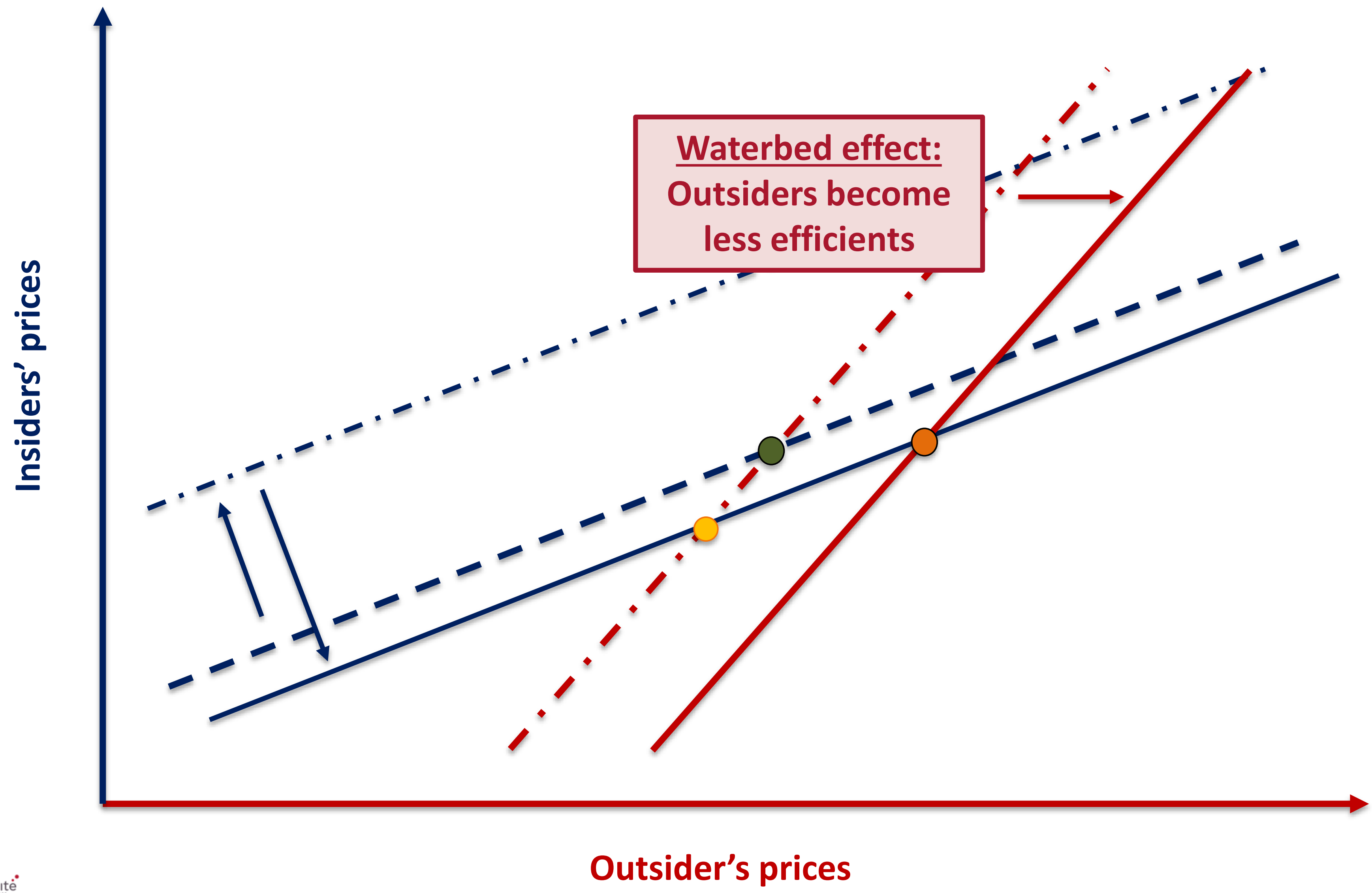
# Standard UPP test



# The problem with waterbed effects (I)



# The problem with waterbed effects (II)



# Pros and cons of purchasing agreements

- **Pros**
  - When size matters, purchasing agreements will allow retailers to benefit from **lower input prices**.
  - These lower input prices can then be **passed-on to final consumers.** This should also **induce rivals to lower their own retail prices** (strategic complementarity).

- **Cons**
  - **Risk of coordinated effects**.
    - Exchanges of sensitive information (especially on individual volumes).
    - Reduction of competition through promotional activities.
  - **“Waterbed” effects** (exclusion / marginalization of smaller rivals).
  - **Reduction in variety.**
  - **Reduction in suppliers’ investment** (e.g., on new products).
  - **Risk of exclusion for some upstream manufacturers**.

# How likely are the negative effects?

- **Coordinated effects**
  - Less of an issue if competition on prices and promotional activities at a local level is more important.
- **“Waterbed” effects**
  - **No strong evidence** of such effects (e.g., UK Competition Commission sector inquiry in 2008).
- **Reduction in variety**
  - May not be such a big issue for branded products (at least the well-known ones) but **more for private labels** if the purchasing agreements also relates to these products.
- **Suppliers’ investments**
  - Depends on the degree of competition (no unambiguous link between competition and investment).
- **Exclusion of small manufacturers**
  - Risk for some if this restricts their opportunities (weak brands or private label producers for instance) or **because smaller retailers will try to concentrate their purchases with a limited number of suppliers**.