

## **Grocery Market Study: Probe Called for into Alleged Abuse of Market Power (December 19, 2013)**

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The Consumer Council has raised deep concerns over the two supermarket giants, PARKnSHOP and Wellcome, for their growing presence in the grocery retailing market, with prima facie anecdotal evidence found in imposing restrictive practices on suppliers and competitors.

In the latest in-depth grocery market study, the Council has urged that when the Competition Ordinance comes fully into force, the Competition Commission should look into whether the two largest supermarket chains have abused their market power to engage in anti-competitive practices in the grocery retailing market.

The 120-page study aims to examine the state of competition and the existence of market power of relevant players in the Hong Kong foodstuffs and household necessities retailing sector; and to determine if prima facie evidence exists of alleged anti-competitive conduct to the detriment of consumer welfare and market competition in the long term.

Existence of market power is commonly associated with reference to barriers to entry and the market shares of the parties involved in the relevant market; and marketplace conduct exhibited by those alleged to have market power.

### **Possible Market Power of Supermarket Chains**

Findings showed that the market share in terms of weighted outlet coverage in the foodstuffs retailing market for the two largest supermarket chains are respectively 28.6% (PARKnSHOP) and 33.9% (Wellcome), together accounting for 62.5% of the market (562 outlets in total).

A market concentration threshold measure, the HHI, widely adopted internationally, which takes into account the relative size and distribution of the firms in the grocery market, indicated that the foodstuffs retailing market is moderately concentrated.

Given that the two supermarket chains have a market share below 40% but above 25%, arguably it cannot reject that either one does not possess a substantial degree of market power, that warrants further scrutiny.

The phenomenal growth of the two largest supermarket chains is further accentuated when compared with the dwindling number and market share of small supermarket operators (less than 2 outlets).

Data from the Census and Statistics Department showed that the number of small supermarket operators substantially declined by 16 % over 12 years from 1999 to 2011, with further data in 2011 revealed that the small supermarket operators only contributed less than 1% of the floor space of the total sector compared to the large operators.

Although retail development at different geographic regions is governed by factors like land use policy of the Government and the strategic decision of retail chains, many retail properties in Hong Kong are managed by the Link Real Estate Investment Trust ("The Link REIT") who owns a portfolio of internal retail floor space of approximately 11 million sq. ft. in purpose-built shopping malls.

The substantial price advantages in bundling rental arrangements between the largest supermarket chain operators and the Link REIT may not exist between single shop operators and the Link REIT, further favouring the large operators in market presence.

## **Marketplace Conduct and Unfair Contractual Deals**

The study has documented prima facie anecdotal evidence of the two supermarket chains exercising buying power over suppliers by engaging in restrictive trade practices and exerting pressure on suppliers.

Anonymous interviews and questionnaire survey with grocery suppliers in Hong Kong further revealed unfair trade practices that could require further examination: limited bargaining power in contract negotiation, attempts to prevent discount offers, introduction of own labels to compete with suppliers, and possibly imposing disadvantaged conditions on contract renewal.

From the information collected, it is evident that the two largest supermarket incumbents have in possession an extent of bargaining power capable of subjecting suppliers to harsh conditions upon contract renewal (75.6% of suppliers responded in the survey), and few (27.3%) can add favourable clauses in negotiations on values of supply contracts such as volume of trade, slotting and advertising fees, damaged goods allowances and cost absorption of unsold goods.

Some interviewees indicated that they were often asked to pay for various unknown items such as advertisement costs and unsold good payments not specified in supply agreements. Without control over their retail price and faced with price manipulation by supermarket chains, some suppliers found it difficult to compete with supermarket's own label products.

Not being an investigative body with powers to obtain information, the Council could gather no strong evidence that indicates the supermarket chains have misused their market power in affecting prices, quality, and the product range of goods and services at the local market level.

It also needs further evidence and investigation if certain chains have induced suppliers into exclusive dealing, resale price maintenance, and refusals to supply with the intent to inhibit competition.

These are the key findings and conclusions of the study on the grocery market the Council released today (December 19).

## **Recommendations**

The Council has recommended that on the basis of its findings, further assessment should be carried out by the Competition Commission as to whether there exists a violation of the Competition Ordinance once it comes into force.

Under the Second Conduct Rule of the Ordinance, "an undertaking that has a substantial degree of market power in a market must not abuse that power by engaging in conduct that has as its object or effect the prevention, restriction or distortion of competition in Hong Kong."

The Commission with its investigative powers will be in a position to examine and address such crucial issues as the definition of the relevant market (the relevant competitors), the existence and abuse of market power, as well as any specific allegations of anti-competitive practices.

If certain retailers are found to possess "a substantial degree of market power", the investigation should then determine whether the Second Conduct Rule of the Competition Ordinance is contravened by the practices observed in the course of the study.

At the same time, some measures should be taken by the industry to applying some form of redress to enable players in the sector affected by unfair practices to voice their concerns. The concerns of high-pressure tactics against suppliers may be considered unfair and problematic in other jurisdictions.

The Council has reiterated its proposal, in a similar study in 2003, for the introduction of a voluntary code regime, which envisages the development of a functional trade complaint forum within the Hong Kong Retail Management Association that could be acceptable to all sides in the grocery sector.

The Council sees self-regulation as a way to assist compliance with the Competition Ordinance by an industry collectively, designed not to displace but rather to supplement the law as is practiced in the supermarket sector in Australia and the UK.

The study also noted the recent concern over the issues of merger and acquisitions in the grocery sector in Hong Kong, since no such a provision forms part of the competition law (apart from the telecommunications sector).

In this regard, the Council notes that the Government has undertaken to review the Competition Ordinance a few years after the full implementation of the Ordinance. The Government is urged to consider, in that review, introducing a cross-sector merger control regime so that the Commission would have oversight where a merger and acquisition might arise that may have a detrimental effect on consumer interest.

Furthermore, notwithstanding the recommendations, the Council deems it important to keep monitoring the market through independent and vigorous market surveys and inquiries.

The objective is to apply pro-active measures, whenever the need arises, to safeguard market competition, and enhance public and business confidence for vibrant trade development in the grocery sector.