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Competition in the Food Supply Chain – Contribution from Sweden

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Competition in the Food Supply Chain

- Contribution from Sweden -

1. Introduction

1. The following contribution is based on a series of studies into the food chain conducted by the Swedish Competition Authority (SCA) in light of rising food prices in 2022 and 2023 and within the context of a government-assigned inquiry.¹ The contribution outlines key insights from the studies by explaining the competition concerns identified in the food supply chain and presenting recommendations of how to promote competition.

2. Observations about competition in the Swedish food supply chain

2.1. High market concentration in several stages of the food supply chain

2. Several stages of the Swedish food supply chain are characterized by a high degree of market concentration, meaning that a few actors collectively hold a large market share in specific industries and stages of the food supply chain. The purchasing market on which the four largest retail actors operate, through their own full-range wholesalers or purchasing organisations, is considered national. However, the retail stores where consumers shop compete at the local level. The SCA's sector inquiry shows that in one-third of Sweden's 290 municipalities, there are only one or two established grocery retailers. Furthermore, there are no discount stores in 102 of Sweden's 290 municipalities, meaning that about one million residents do not have access to a discount store in their municipality. The presence of discount stores has been shown in previous studies to lead to lower food prices. The already concentrated grocery retail sector has become even more concentrated in recent years through mergers.

3. Increased market entry of new actors could lead to increased competition and downward pressure on food prices. However, the SCA's analysis has shown that the opportunities and incentives for a new nationwide grocery retailer to enter Sweden are limited as a result of the behaviour of different actors, established market structures and Sweden's geography. A low probability of market entry contributes to the established grocery retailers being able to achieve higher profit margins with a lower risk of losing customers to a new entrant.

4. Market concentration is also high in several sectors of the food processing industry. Examples of markets that the SCA has studied more closely include edible oil, dairy products, eggs and chicken. The SCA's assessment is that concentration in the food supply chain has increased over time and that there are relatively few examples of new actors entering the markets.

¹ The SCA's various reports can be found here (in Swedish): <https://www.konkurrensverket.se/informationmaterial/rapportlista/konkurrensverkets-genomlysning-av-livsmedelsbranschen-20232024/>. This note derives particularly from the introductory chapter of the authority's report of summary conclusions and recommendations (report series 2024:5).

2.2. Lock-in effects

5. The SCA's studies have shown that there are contractual restrictions and other lock-ins at several stages of the food supply chain that make entry difficult and lead to more rigid market structures where some actors find it difficult to expose their buyers or suppliers to competition. In addition to contractual terms, lock-ins can be due to the lack of alternative buyers or suppliers, which means that companies can be effectively locked in to one specific contractual partner.

6. Lock-ins include, among other things, long contract durations, which the SCA has observed in examples between primary producers and processing companies. In several cases, the contracts also contain exclusive delivery obligations, where a primary producer is only allowed to sell its production to one buyer. Long-term contracts can restrict market entry at both stages of the food supply chain. Long-term contracts, combined with the fact that primary producers typically have little ability to influence the price that the processor pays them for the goods, can also mean that the price does not reflect demand in later stages of the supply chain, thereby reducing incentives to increase primary production where shortages occur. For a primary producer, these long-term contracts, sometimes reinforced by other factors, make it difficult to effectively expose its buyers to competition.

7. At a later stage of the food supply chain, retailers steer affiliated stores' demand towards their own purchasing organisation or full-line wholesaler, which reduces sales by other suppliers outside these distribution channels. The grocery retailers' direct or indirect steering of affiliated stores' purchases towards their own wholesale operations, through supplementary services and incentives, may benefit stores in terms of lower purchasing costs and simplified distribution, but at the same time it leads to a more uniform supply within the retail chain. It can also prevent innovative independent distribution and wholesaling companies from expanding and exerting competitive pressure with respect to the retailers' own wholesaling operations. In addition, long-term contracts between retail companies and affiliated stores and other strong lock-ins can negatively affect market entry and expansion opportunities at the retail level and, indirectly, at the purchasing level.

8. In Sweden, trade organizations for grocery retail and the food industry have agreed on the structure and time windows for revisions of product ranges. This is something that a large proportion of the grocery retail market follows. This form of coordination appears to differ from practices in other European countries. The coordination involves the timing of the launch of new products, new flavours or varieties of existing products, packaging changes, and product phase-outs. The stated purpose of the collaboration is to achieve an efficient launch process with respect to supply chain management and service levels. However, the SCA notes that this collaboration somewhat restricts or limits both suppliers' and grocery retailers' ability to make independent decisions about the timing of new product launches or product varieties. For each product category, the timing is the same for all participating suppliers and retailers, and this is known to all, including those who have opted out of the collaboration. This makes it easier for competitors in the grocery retail and food industry to anticipate each other's product launches. This type of cooperation can indeed lead to efficiency gains, potentially resulting in lower consumer prices if such gains are passed on to consumers. However, it also results in reduced dynamism and a risk of coordination or uniformity concerning other competitive parameters such as price and product range.

9. The SCA has not examined whether the various agreements and collaborations described above are compatible with the Swedish Competition Act's prohibition of anticompetitive agreements within the scope of the sector inquiry. The inquiry has focused on the food industry as a whole and not on the supervision of the conduct of individual

actors. In general, it can be said that viewed individually, the various lock-ins that arise through agreements and collaborations are not necessarily anticompetitive or in conflict with the rules the SCA enforces. On the other hand, they can reinforce each other and together have negative effects on competition in the food supply chain.

2.3. Imbalances in the food supply chain

10. The SCA also notes that the factors mentioned above, together with an imbalance in power between actors both within and between the stages in the food supply chain, mean that in practice there is an uneven playing field for companies in the food supply chain. There are major differences in the influence that different contracting parties have over the agreements they can enter into and how risk is distributed between the contracting parties. This can be seen as an expression of market power of some actors. The fact that companies compete for market share by offering a better range of products, services and lower prices is what characterises a well-functioning market. However, a higher market share can lead to an actor using its market power to increase profits in a way that disadvantages consumers in both the short and long term, with higher prices for consumers, and less profit at the producer level, which can inhibit product development and better production methods. Overall, the imbalances may mean that the highest risk-taker does not receive the highest reward, which negatively affects overall production efficiency in the food supply chain.

11. The inquiry and the authority's supervision of unfair trading practices in the agricultural and food supply chain² have shown a relatively high incidence of unbalanced agreements. The food supply chain is characterised, among other things, by the fact that external factors, such as the weather and Sweden's geography, have a major impact on the supply of products. In some sectors, such as parts of the grain sector, contractual models have emerged to enable the actors to balance this risk, while in other sectors there is no similar contractual risk allocation.

12. One effect of the concentrated Swedish grocery retail market is that there are few sales channels for the food manufacturing industry. This makes it difficult for suppliers to expose their buyers to competition and there is also a high risk of losing a customer. The SCA has noted that the agreements between the grocery retailers and the food manufacturing industry in the sectors examined are characterised by short notice periods and a lack of volume commitments on the part of the grocery retailers, unlike the previous levels in the food supply chain. At the same time, the food manufacturing industry is required to deliver a very high proportion of what can be ordered under the contracts at short notice and at the risk of penalty. This may be regarded as an expression of the strong bargaining position of the grocery retailers vis-à-vis the food manufacturing industry and is an indication of imbalance in the food supply chain. However, it should be noted that the market power of grocery retailers varies in relation to different food manufacturers. In some parts of the food manufacturing industry, the markets are in many cases also highly concentrated and dominated by a few actors.

² Directive (EU) 2019/633 on unfair trading practices in business-to-business relationships in the agricultural and food supply is an EU directive which aims to improve the protection of farmers – as well as small and medium-sized suppliers – and to prohibit certain unfair trading practices.

2.4. Lack of access to retail locations is a barrier to entry

13. Sweden's geography and low population density mean that, in parts of the country, there are natural barriers to entry and expansion in the food industry. In addition, there are other barriers that can be eliminated or at least mitigated.

14. Access to store locations is central to competition in the grocery market. The SCA has noted that both municipalities and grocery retailers act in ways that make it unnecessarily difficult to establish new grocery stores. The municipalities' spatial planning is of great importance to the opportunities to gain access to competitive locations. The SCA has therefore examined the conditions for grocery retailers to establish new stores, taking into account the municipalities' spatial planning.

15. There are also elements in the grocery retailers' own actions which may constitute unnecessary barriers to the establishment of new stores and actors in the market. For example, a grocery retailer may affect the opportunities for competitors to establish new stores or take over existing ones through clauses in agreements with property owners or with affiliated stores.

16. The SCA has noted that there is untapped potential for the establishment of new actors with new competing concepts, such as discount stores, which could challenge the existing large actors, and which in turn would increase competition and could lead to lower food prices for consumers. It is therefore important that the conditions for establishing grocery stores are improved.

3. The Swedish Competition Authority's recommendations to improve competition in the food supply chain

In its inquiry, the SCA presented a number of recommendations to improve competition. The recommendations are aimed partly at lowering barriers to entry and partly at reducing lock-ins resulting from the design of agreements. They also include suggestions with regard to the possibilities for the SCA to intervene against competition problems.

3.1. Make it easier for grocery retailers to set up new stores

17. In order to make it easier for grocery retailers to establish new stores, the SCA believes that measures are needed with regard to the municipalities' spatial planning work and the grocery retailers' use of various forms of restrictive contract terms.

3.1.1. *The municipalities spatial planning*

18. Through its study, the SCA has found that a legislative provision which states that spatial planning shall promote effective competition plays a minor role in the municipalities' spatial planning.

19. Many municipalities have stated that the rule regarding effective competition is difficult to interpret and apply in practice. Moreover, it is also clear that the interpretation and application of the rule varies between different municipalities, which leads to a lack of predictability which can hinder the establishment of new grocery stores.

20. The SCA will therefore produce informational material and guidance on how municipalities can promote effective competition in their spatial planning. In this work, the SCA will inform and consult with the Swedish National Board of Housing, Building and Planning, which is responsible for the review of spatial planning.

21. In addition to the provision on effective competition, there are other parts of the planning process that should be characterised by a more predictable application of national rules on municipal planning. The SCA believes that the municipalities' investigations, which form the basis for amendments to zoning plans and building permit assessments, should be more standardised. Furthermore, the SCA considers that the municipalities should ensure greater uniformity, both within and between municipalities, in terms of what can be considered a minor deviation from a zoning plan.

22. There is no requirement for municipalities to produce so-called retail policies.³ Although the grocery retailers that the SCA has been in contact with are generally in favour of retail policies, there have been examples of when the policy does not fulfil any function or even frustrates competition. Against this background, the SCA believes that it would be beneficial for municipalities - both those that already have a retail policy and those that are considering developing one - if there were a clear template to work from. The SCA will also draw the attention of the Swedish National Board of Housing, Building and Planning to the need to develop new and clear guidelines for what a retail policy should generally address and what municipalities should consider when developing such a policy.

23. Municipalities can also enable the establishment of new grocery stores and concepts through land allocation. The land allocation process can take the form of tender allocations and direct allocations. Both methods have advantages and disadvantages. Regardless of the method, the SCA believes that municipalities should increasingly take existing competitive conditions in the grocery retail market into account when allocating land for new grocery stores. This may be particularly important in municipalities where market concentration is high or where certain types of actors are not present in the local market.

24. The SCA has also noted that the dialogue between municipalities and grocery retailers is often inadequate. Several grocery retailers state that it is often unclear who they should contact in the municipality, which may hinder the development of new grocery stores. The SCA has therefore urged municipalities to develop clear contact interfaces and efficient processes to enable the establishment of new grocery stores.

3.1.2. Use of various forms of restrictive covenants by grocery retailers

25. The major grocery retailers in Sweden control a large share of existing stores and store locations, either through ownership or through first-hand leases. Shorter leases between grocery retailers and affiliated retailers and increased transparency on the duration of leases would increase the possibility for new or competing retailers to enter the market by taking over existing store locations or acquiring existing standalone or affiliated grocery stores. Provisions in the grocery retailers' contracts with affiliated stores often prevent the individual retailer from fully disposing of or selling its store, creating a lock-in of stores to the grocery retailer. The establishment of new stores may also be hampered by right-of-use restrictions and restrictive clauses in the grocery retailers' contracts with third parties such as property owners. Competition would likely improve if these constraints were removed or at least mitigated.

26. In practice, decisions on new store openings are usually made at the wholesale level by the grocery retailers. The grocery retailers take into account the customer base in a particular area prior to establishment, and also choose the concept or brand for the store location. Existing stores may thus be de facto protected from the opening of new stores in

³ A retail policy is a strategic document that sets out the agreed policy direction for the development of the retail sector in the municipality.

the neighbourhood, at least in the case when store openings are controlled by their own grocery retailer. Such strategic behaviour with regard to the establishment of new stores could be a competition law problem for a grocery retailer owned by its affiliated retailers, if it means that the retailers can dampen the local competitive pressure among themselves through the procedure. The SCA has thus encouraged the industry to voluntarily review the issue and will inform grocery retailers and trade associations of problems identified by the authority. The SCA does not rule out that the issue could become the subject of the authority's enforcement work.

3.2. Increased flexibility for grocery retailers in terms of purchasing and product launches

27. The SCA has identified several different types of contractual clauses, collaborations and commercial practices that make it more difficult for actors in different parts of the food supply chain to expose their suppliers or buyers to competition. This reduces, to varying degrees, the dynamics and uncertainty about competitors' behaviour that should characterise a competitive market. As noted above, not every contractual restraint is necessarily problematic in itself, but the cumulative effect justifies taking measures. Where entry is unlikely or insufficient, it is even more important to safeguard competition between existing actors.

28. The purchasing activities of grocery retailers have expanded to include a wide range of supplementary services that guide stores' sourcing of goods to their central wholesale and purchasing function. These include store profiles and practical management to facilitate daily operations, such as ordering and pricing support systems. This, together with requirements and incentives in the form of discounts, assortment requirements and recommendations linked to purchases from the own purchasing function, reinforces the stores' lock-in to the existing grocery retailer. Increased access to other suppliers may increase competition at the store level, especially between stores within the same chain, by giving stores greater opportunities to differentiate their offerings. It could also lead to increased pressure on full-line wholesalers to improve their offerings. For suppliers and specialised wholesalers, increased access to the retail level may provide better conditions for entry and expansion, and smaller suppliers in particular would have greater opportunities to gradually scale up their operations, thereby exposing the full-line wholesalers to competition and lowering the barriers to entry for new retailers.

29. As noted above, not every individual cooperation, contractual clause or commercial practice need in itself be restrictive of competition and possible to remedy with existing competition rules. Nor does the SCA have any ongoing investigation into purchasing cooperation or the possibility for stores to buy from other central wholesale and purchasing operations. However, the various lock-in arrangements can reinforce each other and greater opportunities for stores to buy directly from other suppliers and wholesalers would be positive for competition.

30. The SCA considers that increased flexibility regarding the windows for product launches and other product range revisions in stores would be positive for competition at both the supplier and retail levels. However, it is the market actors that must firstly make the assessment of whether the cooperation is restrictive of competition and whether it can be justified by the existence of efficiency gains that outweigh the potential negative effects and benefit consumers. In a concentrated industry such as the food industry, it is necessary that such an assessment is made on an ongoing basis and that the industry can demonstrate that the efficiencies arising from the cooperation are sufficient to outweigh the competitive disadvantages of the cooperation. A limited number of opportunities for product range

revisions may decrease competition. In addition, a collaboration between competing companies always runs the risk of cooperation that has negative effects on competition. The SCA does not have any ongoing investigations into cooperation on time or trade windows for product launches and other product range changes. However, the SCA will inform the actors involved of its conclusions.

3.3. More flexibility for primary producers in relation to processors

31. A clear finding of the inquiry is that in several sectors it is common for primary producers to be locked into selling their goods to one buyer for a long time and rarely change buyers. Meanwhile, the buyer has the greatest influence over the price that the primary producer receives. For primary producers, this means that they cannot change buyers even if there is another buyer that offers better terms. This discourages mobility in the sector and makes it more difficult for new entrants to gain access to sufficiently large production volumes to justify entering the market. In the dairy sector, primary producers are allowed to supply a certain proportion of their production of raw milk to actors outside their own dairy co-operative, which favours competition between dairies and lowers the barriers to entry for new dairy companies. The SCA believes that such sales practices should be feasible in other concentrated primary production sectors, such as chicken and eggs. This would require that the agreements between the processing companies and the primary producers are adjusted by the contracting parties. The effects of this could be increased competition between the processing companies and reduced entry barriers at both the processing and primary producer levels.

32. The SCA has also identified contractual solutions in certain sectors, such as the grain industry, where primary producers have the opportunity to choose between different pricing models year by year, based on their risk propensity. In addition, some pricing models include elements whereby the primary producer can receive a portion of the processing company's value added based on certain factors, usually the relevant market price. When primary producers choose a pricing model, the buyer can also be exposed to competition from other buyers. This results in an increased control over the risk that primary production typically entails, while also meaning that buyers are more often exposed to competition. This is typically positive for competition.

33. The issue of imbalanced contracts is not unique to Sweden, and several EU Member States have recognised the need to regulate it. When implementing the EU Directive on Unfair Trading Practices, several Member States introduced national provisions on general clauses that prevent problematic contractual terms in the food supply chain which go beyond what is required by the Directive. In several investigations of unfair trading practices, the SCA has noted terms that appear imbalanced between the contracting parties. These can, for example, be manifested in the fact that it is the buyer, an egg packer, that unilaterally decides how the price of eggs is to be set and when it is to be adjusted, without the supplier, primary producers, having any opportunity to influence the price. The sector inquiry has also given indications that there may be a need for stricter rules in Sweden. The SCA will review and return to this issue within the framework of a government assignment to evaluate the Swedish law on unfair trading practices.

3.4. Stricter merger control to counteract high market concentration

34. Several mergers in the food industry have been scrutinised over the years, and in some cases it has not been possible to implement them at all or only possible after certain commitments from the companies.

35. However, there are certain limitations in the current Swedish merger framework. The SCA can only intervene when a merger affects the whole country, or a substantial part of it. In many areas, such as grocery retail markets, the markets are local and there are therefore limited possibilities to intervene against mergers. As a result, mergers that deprive consumers in local markets of store choice may not be prevented. In most other European countries, it is possible for the competition authority to intervene against mergers that have effects in local geographic markets. In Denmark, for example, Salling Group's acquisition of competitor Aldi's 13 Danish stores and 8 ongoing store projects was only approved after Salling Group (which includes the discount chain Netto) committed to selling a store in the city of Rødbyhavn and leasing a store in the city of Stubbekøbing for 6 years.⁴

36. The SCA mainly investigates mergers involving companies with a certain minimum turnover, which must then be notified to the SCA before they can be implemented. In some cases, the competition authority can oblige companies to notify mergers that are not subject to notification, but this presupposes, among other things, that the SCA is made aware of them. In some countries, including Norway, companies in particularly vulnerable sectors can be required to inform the competition authority of mergers, even if they are not notifiable, partly because smaller acquisitions can affect local competition. In Norway, this possibility has been used in the grocery retail market, among others.

37. In previous reports concerning competition in the food supply chain, the SCA has emphasised the need to review the Swedish merger rules in a manner similar to the Norwegian rules. In Norway, the competition authority can oblige companies in concentrated industries to inform the authority of all acquisitions they make, including minority acquisitions. If there are sufficient grounds for doing so, the authority can then investigate and intervene against the merger. In Norway, the obligation to inform applies, inter alia, to large companies in the grocery, fuel and energy sectors. The SCA's inquiry has confirmed the need for such a possibility, and the authority therefore welcomes the fact that a government inquiry regarding new competition tools will address this question.

38. The SCA has also previously expressed the need to adjust the merger rules in order to safeguard competition throughout Sweden. At present the SCA cannot intervene against a merger that affects a town with only two stores, even if they would be part of the same chain after the merger, which would mean that consumers would be completely deprived of choice. In the current circumstances, the SCA can only protect the competitive conditions in a small town if it, together with others, constitutes a significant part of the country. Therefore, if the competition authority is to be able to protect competition in all parts of the country, a change in the law is required. The sector inquiry has also confirmed that there is a pressing need for such an adjustment.

3.5. Examining the need for a market investigation tool

39. In order for the SCA to intervene under the Swedish Competition Act, it requires that an infringement of one of the prohibitions of the act can be shown. However, the act cannot be used to address broader problems involving markets as a whole or involving the structure of markets rather than practices. In the SCA's view, the inquiry has shown that there is a need for a new broader competition tool to address specific problems, such as certain types of contractual clauses that raise barriers to entry or reinforce other structural

⁴ Decision of the Danish Competition Council of 29 November 2023, <https://www.kfst.dk/media/ktqi1qjf/20231129-salling-group-og-aldi-danmark-fusion.pdf>

problems. The SCA therefore welcomes the fact that the government has appointed an inquiry to analyse and assess whether there is a need for a new broader competition tool.

4. Concluding remarks

40. An overall conclusion that the SCA can draw from its studies of the food supply chain is that there are shortcomings in competition in several respects. These can be explained by a high level of market concentration at several stages in the food value chain, lock-ins and imbalances through agreements and trade practices, and the existence of various forms of entry barriers. This means that consumers pay more for many foods than they should need to, and that money does not always end up where it is needed to provide incentives for market entry, investment and increased production.

41. The Swedish retail grocery sector is concentrated with a few vertically integrated actors with central purchasing functions. The presence of large actors in a market is not necessarily bad and does not necessarily lead to higher prices. When there are economies of scale, large actors can be more cost-effective and also have greater opportunities to push down purchase prices. Similarly, cooperation between operators can lead to more efficient distribution and logistics. However, effective competition is needed to pass on efficiency gains in the form of lower retail prices to consumers.

42. In recent years, the food industry has been characterized by a sharp increase in costs, including higher prices for essential inputs. The coronavirus pandemic and Russia's invasion of Ukraine are factors that have affected the prices of input goods. The SCA analysis shows that the cost increases of recent years have been passed on to consumers to varying degrees in the form of higher consumer prices. Some actors in the food value chain, for example in grocery retail, have been able to maintain the same percentage gross margins as before the costs began to rise sharply, leading to an increase in margins in Swedish kronor. Increased prices do not appear to have stimulated increased production or market entry to any significant degree in any of the stages of the food value chain examined by the SCA. Nor are there any clear indications that alternative and cheaper products have been developed or begun to be sold to consumers, which could have happened if competition worked well. Later in 2024, the Swedish Competition Authority will publish a brief analysis of the profitability of companies in the food supply chain, and further studies may be produced in the future.