Joint purchasing agreements

The EC’s 2011 Horizontal Co-operation Guidelines

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Form

Joint purchasing can be carried out in many forms:
> jointly controlled company
> company in which many other companies hold non-controlling stakes
> contractual agreement
> looser forms of co-operation

Analysed under EUMR or Article 101 TFEU
> If full-function joint venture > EUMR
Aim

Aim of joint purchase agreements, according to the Guidelines:
> creation of buyer power; which will lead to…
  > …lower prices or better quality products or services

But can also involve illegitimate aims:
> Buyers’ cartels
Horizontal and vertical aspects

Two-tiered analysis:

1. Horizontal aspects – horizontal guidelines
2. Vertical aspects – vertical guidelines:
   - Between purchasers and suppliers
   - Between a joint purchasing “alliance” and its members
Measuring buyer power

Distinguish between:

- degree of buyer power necessary to act as a competitive constraint
- higher degree of buyer power required to give rise to the prospect of harm to upstream competition
- Key: Can the buyer group dictate industry terms of supply?
  - credible threat to switch purchases, sponsor new entry or self supply
  - buyer group is gateway to market
Benefits of buyer groups

The two main benefits are:

> Large efficiency gains (e.g. through size) that are passed on
> Downward pressure on supplier’s prices that is passed on

These are achieved through:

> Supply chain efficiencies (economies of scale or scope)
> Intensify supply competition by improved switching threat
> Larger part of profit sharing through better negotiation
Main theories of harm

1. Directly reducing downstream competition
   1. Explicit collusion (buyers’ cartel)
   2. Tacit collusion/ Reduction in rivalry (alignment is facilitated)

2. Indirect harm to downstream competition by adversely affecting competitors in upstream market
   1. Buyers outside the group pay higher prices
   2. Competition among suppliers is weakened

3. Vertical issues – “Rent sharing”
Directly reducing downstream competition

1. Explicit collusion (buyers’ cartel)
2. Tacit collusion/ Reduction in rivalry (alignment is facilitated)

Collusion in the downstream is not likely where:

> Different different downstream markets
> Combined market share is low (OFT: 25% or less)
> Other players provide effective competition downstream
> Low entry barriers in the downstream market
> Buyer power of end-customers is effective
Indirect harm to downstream competition

> Normally no incentive to harm upstream competition.

> These strategies are feasible primarily where the buyer group has substantial buyer power and can act in a gatekeeper role.

  > Input foreclosure

  > Refusal to purchase

  > Waterbed effects

> Collusion with suppliers – “Rent sharing agreements”
The new horizontal guidelines

> No dramatic changes compared to old guidelines

> One important clarification in the new guidelines:

Joint buying by retailers that operate in different geographic areas. The guidelines now make clear that joint buying by retailers that operate in different geographic areas are unlikely to infringe competition laws, even where the retailers’ market shares exceed the market share thresholds that define the safe harbour in this area.
Safe harbour

Market share threshold

> No presumption for restrictive effects above a certain threshold
> Market share of less than 15% BOTH upstream and downstream
> Comparison:
  > R&D 25%
  > Production agreements 20%
  > Commercialisation agreements 15%
Safe harbour

Critique of safe harbour in consultation:

> 15% is too low

> Markets are too narrowly defined for calculating market shares – introduce a requirement of a “significant overlap“

> Threshold should be only on downstream markets where market power is exercised and anticompetitive effects are felt
15 % threshold

> Purchasing agreements are generally pro-competitive and anticompetitive effects are only plausible with high degree of downstream market power

> Joint purchasing is often only way for small companies to compete with bigger vertically integrated companies (e.g. in retail)

> OFT report proposes 25% in the downstream market based on economic theory
Requirement of significant overlap

Joint buying often takes place between companies that do not significantly compete downstream (e.g. in the retail sector)

> However, these markets are often narrowly defined geographically

> Hence, two retailers active in different countries may fall outside the safe harbour because they compete in one small regional market with a high market share, (e.g. an outlet over the border)

> Solution: Introduce a requirement for a significant overlap downstream

> For example, a requirement that downstream market power will only be assessed if it concerns more than 5% of the goods or services purchased jointly
Correlation between upstream/downstream markets

According to guidelines purchasing agreements where the parties are not downstream competitors could cause competitive concerns

> para 202: “… risk that they may force suppliers to reduce the range or quality of products they produce, which may bring about restrictive effects on competition such as quality reductions, lessening of innovation efforts, or ultimately sub-optimal supply.”

> para 204: “In general, however, joint purchasing arrangements are less likely to give rise to competition concerns when the parties do not have market power on the selling market or markets.”
Correlation between upstream/downstream markets

What incentive would a buyer group have to harm competition among its suppliers if that would lead to “quality reductions, lessening of innovation efforts, or ultimately sub-optimal supply”?  

> Only if rivals were to benefit more from innovation  
>  This presupposes that they are rivals downstream

In theory if buyer group’s willingness to pay for innovation is less than social value of innovation, a buyer group might block innovation. However, if the buyer group cannot recoup the cost of the innovation, this implies that end-customers are not willing to pay the increased cost but expect to free ride. This is hardly a competition concern.