

THE BUYER AND SELLER POWER INDICATION IN THE ECONOMY

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Abstract. The article analyses the reasons and the consequences of the origin of buyer power, requiring the definition of the supply chain and the groups of the participants of the chain that are identified by a number of properties: the producers, whether or not having the buyer power and supplying in the wholesale market their production for economic entities engaged in retail trade; the traders, and the retail traders obtaining, for a number of reasons, the buyer power and benefiting from it. The third group of the market participants is represented by the ultimate consumers, who purchase the products in retail trade outlets. Therefore, most frequently, the three groups of market participants become the object of analysis, since one of the reasons that prompted interest in the buyer power is the growth of the trade networks and the enhancement of the impact produced thereby upon the operations of the producers of the goods. Furthermore, it is necessary to bear in mind that indications of buyer power have been also observable in other chains of goods supply, e.g., growers of the agricultural production, processors, etc.

JEL classification: E010, E100, C820.

Keywords: buyer, seller, power, interface.

Raktažodžiai: pirkėjas, pardavėjas, galia, sąveika.

1. Introduction

The evolution of the retail trade during the past several years has exposed a sharp decrease in the number of participants in the market, and the increase in the average trade space per one sale outlet. According to the data of the Department of Statistics, starting from 2002, the number of entities engaged in retail trade has been steadily decreasing in Lithuania (on average, by 3% p.a.). Within the same period, the turnover in the sector has been growing at about 10% p.a. Within the total number of entities engaged in retail trade the trend of the shrinkage of the share of sole proprietorships is quite evident (in 2002, they accounted for 73% of the total retail entities, and in 2005, the share decreased to 61, in 2010—to 47%). The total number of the sale outlets, in

view of the changing number of the owners, within the period under consideration, remained virtually the same, while the average space area per store has been steadily growing—starting from 2002 by 6% per year. According to the findings of the survey conducted by *AC Nielsen Baltic* the ever growing trade networks, as far back as in 2004, accounted for half of the turnover of the retail trade sector in Lithuania, while in Western Europe the market share held by major trade networks was as large as 4/5.

The impact of the demand and competition upon the solutions of the producers to merge is also testified by the desire of several companies to purchase several loss-making companies managing the green-house facilities. Thus, early in 2005, a consortium made up of UAB “Domeina,” UAB “Šiaulių banko investicijų valdymas” and a number of natural persons expressed the desire to acquire AB “Kietaviškių gausa” and AB “Pagirių šiltnamiai.” In the meantime the approaches of the meat producers in view of the conditions imposed upon them by the traders and the resulting lower yields are, to a larger extent, prompted by the desire to increase the buyer power in the deals with the farmers, in particular, given a recent decline in the number of farmers breeding cattle or swine. As a result, a number of enterprises that liquidated the number of meat processors in the period from 2000 until 2010 dropped by 2.5 times.

In the dairy sector the number of producers decreased sharply as a result of the takeover deals in respect of smaller competitors: AB “Rokiškio sūris” purchased AB “Utenos pienas” and AB “Zarasų pieninė;” AB “Panevėžio pienas” and UAB “Pasvalio sūrinė” became branches of AB “Pieno žvaigždės;” and the owners of AB “Žemaitijos pienas” acquired the controlling interest in AB “Plungės pieninė” and UAB “Laukuvos pieninė.”

The impact of the enhancement of the concentration in the production sector resulting from the mergers of the producers upon the unit profits and yield margins of traders, where the growth of the producers benefit not only the merging companies but also traders (or traders only) provides a certain explanation as to why trade networks require the producers to ensure certain minimum volumes of the supplied production. E.g., UAB “VP Market” requires the 46 meat producers to continue increasing the volumes of the production supplies, and imposes fines in case of failure to achieve the contracted turnover. As a result of these requirements the producer’s profits decrease, however, producers often find it more profitable to surrender to the requirements of the trade networks than to opt to cease supplying their produce to such networks.

The buyer and the seller market powers have within the recent period been attracting significant attention, specifically in relation to the leaping inflation and, in particular, the skyrocketing food product prices. The Competition Council had conducted an investigation of the leaps of the prices of staple food products in 2006–2010.

The ultimate consumers, in the first instance, noted an increase in bread and bakery products. The Competition Council established that the principal underlying reason for that was the prices of the production supplied by the major grain processors AB “Malsena” and AB “Kauno grūdai.” Other grain processing plants purchase and process smaller quantities of raw materials, thus exercising an insignificant impact on the market. The companies have pointed out a nearly double increase in the grain

prices on the global markets as the main reason for the increase of the purchase prices, the growing demand for biofuels using grain as a raw material. The increase in the prices of flour and grouts has also been triggered by higher labour remuneration costs.

In view of the increase of flour prices, the major bread producers have been raising their prices on a continuous basis. All bakeries have noted that the increase in their production prices had been mostly caused by the prices of flour accounting for 40-60% share in the production costs of bread and bakery products, in addition to the increase in the prices of other raw materials and the wages in the sector. Under these conditions, the enterprises simply could do nothing but increase their production prices.

Within the period reviewed the prices in the meat and meat product market have been increasing or falling, since the nine major meat processors have been changing the beef and pork purchase prices very differently. The companies themselves have been explaining the trends in price changes by an enhanced competition in the meat production and meat marketing markets, as a sharp increase in the prices often make the produce loss-making and the companies are forced to reduce the prices again. Besides, the companies have noted that trade networks often refuse to increase the prices of the supplied products by exercising pressure upon the producers and threatening to refuse to buy the products supplied. Thus, in this specified case, we have at hand an express manifestation of the buyer's (large trade networks) market power.

Within the period reviewed the average dairy product sale price in respect to individual items was increased by AB "Pieno žvaigždės," AB "Rokiškio sūris," AB "Žemaitijos pienas." All companies have explained the growth in the sale price by the increase of the raw milk purchase prices and the growing labour costs.

2. Positive and negative aspects

A vast majority of the entities in the production sector are becoming increasingly dependent on the contracts concluded with the major trade networks and the volumes of their products marketed via such networks. The well-expanded trade network, on account of a larger number of sale points and manageable space, is partly responsible for the saving by the producers of the goods delivery costs (delivery to a single warehouse only, hence the saving, as compared to delivery to a number of a number of small traders), and selling a larger quantity of the goods alleviates the fixed trading costs per produce unit. In most cases the buyers then are offered the goods at a lower price than available in a small store "around the corner from home." Furthermore, a trade network, operating larger trading spaces, is able to offer the consumers a much larger variety of goods that definitely increases the choices and thus benefits the consumer.

However, despite the several positive outcomes of the growth of the trade networks there is also a "dark side" of the entire picture [1,4]. The commentaries and articles in the media on the operation of the trade networks have been putting a stronger weight upon the negative, rather than positive outcomes of the trade network growth: exploitation of employees, producers selling their products at zero profits, occupied recrea-

tional zones, and impact upon the habits of the ultimate consumers. Occasionally, some heads of the States have acknowledged that trade networks and their pricing strategies may have an impact upon the results of the public monetary policy.

The aspects of the relations between the trade networks and the producers is elaborated further serve as an illustration of the buyer power—the issue that has been lately often the focus of analysis and international organisations [3]. In accordance with the definition offered by the European Commission, buyer power is the capacity of one or several buyers, based on their comparative share in the market, to acquire the goods from the suppliers at more favourable terms. More favourable terms means a variety of agreements between the traders and the suppliers (producers), ranging from a lower wholesale price to deferred settlement, or the return of unsold goods. While complaining of the arbitrary behaviour of the trade networks Lithuanian producers claim that the larger retailers charge them for the sale of the products in a specific store (an entry fee), force them to assume part of the marketing costs of the trade network (fees for the inclusion of the goods into the catalogues distributed by trade networks, also promotion actions), reimburse part of the trader's costs related to the change of the bar code, the opening of a new store, or the repair of an old store, and that they are forced to purchase raw materials from specified suppliers. Some of the producers have mentioned fines for the failure to reach contracted turnover levels, etc. The buyer power, in the same manner as the seller power (the power at the disposal of a matured producer), by virtue of an economic entity's capacity to affect the choices of other market participants, has also deserved the attention of the institutions in charge of competition status in the market. For that reason, authorities of Lithuania and other Member States have been seeking to harness the power of the ever growing trade networks and adopting the legal acts and regulations limiting the number of clearances, minimum article prices, business hours, or instructing to submit certain items of the agreements with the producers, etc. The level of regulation of trade networks and the measures employed differ depending on the State. Therefore the European Commission, guided by the idea of a single European market, has been considering a possible approximation of the limitations upon the operation of trade networks with a view to ensuring the trade networks equal terms for operation in the entire EU. E.g. a major contribution to the single European market idea was the transaction completed early in 2008, whereby partners from the European voluntary trade alliance "Copernic" took over control of the trade networks IKI, IKIUKAS and CENTO managed in Lithuania and Latvia by UAB "Palink" [6].

One of the major challenges, when analysing the market and identifying the limitations upon the operations of the major trade networks, is the novelty of the buyer power issue in comparison to that of seller power. Up to the second half of the 20th century, buyer power, with an exception of the ordinary monopsony model in the labour market, has barely been investigated, thus its operation is still not adequately understood, as well as the possibilities to compensate it [2,7]. The European Commission refers to the seller power available to the producers as the market power that shows the capacity of the seller to raise the price of the goods above the marginal costs and sell

it with a profit. However, in order to avoid any further confusion, the market power shall be referred to as the buyer power. With a view to increasing such buyer power the producer seeks to sell its produce to a larger number of traders. For example, the cooperation between the Lithuanian furniture manufacturers and the Swedish concern yielded the situation in which, in individual cases, the concern that in individual cases purchase of over 50% of the output was forcing the Lithuanian companies to accept some unfavourable contractual terms. Therefore the latter sought to identify some new buyers: thus AB “Vilniaus baldai” established relations with the American trade network “Walmart,” UAB “Baldai Jums” started exporting part of its output to Great Britain, and AB “Venta” is now increasing its turnover, having found some new buyers in the Scandinavian region.

The phenomenon of buyer power is inherent not only in the retail trade sector, although, on account of a larger numbers of “the disadvantaged” it has constantly been the focus of the regulators. When seeking to market their produce, the agricultural producers also seek to deal with purchasers holding a significant market share. The trend has been specifically evident in the Lithuanian raw milk suppliers’ and the processors’ sectors, in which large farmers are offered exceptional terms.

Early in 2008, a highlight widely covered in the media was the agreement among the major milk purchasers and processors AB “Pieno žvaigždės,” AB “Rokiškio sūris,” UAB “Marijampolės pieno konservai,” AB “Vilkyškių pieninė,” AB “Kelmės pieninė,” UAB “Kelmės pieno centras,” UAB “Modest” who, via the Lithuanian Milk Producers’ Association, have been exchanging information of confidential nature on the amounts of purchased milk, produced and marketed quantities of individual dairy products. This activity then was duly considered and assessed by the Competition Council [6].

3. Market power factors

The decisions passed by the undertakings having a market power that further has an impact upon the position and the choices of other market participants are often affected by a number of other factors: number of entities, the qualities of the goods or services, limitations set forth in legal acts, or the buyer characteristics.

The ultimate consumers shopping in the outlets of a trade network are normally quite small (i.e., their purchases often account for just a minor, even insignificant, share of the total turnover of a large trader), often of low mobility (reluctant to go long distances for daily shopping), and scarcely informed (quite frequently not aware where and at what price a specific item is available and not able to determine the quality of the item prior to purchasing it). As a result, according to the analysts from the British Office of Fair Trade, a buyer when seeking to purchase the necessary goods incurs [8]: 1) pure shopping costs—even with a specific shopping list the buyer needs to travel to a specific trader, waste time in lines, pay for the trip etc.; 2) the search costs—in case the consumer does not exactly know what he wants he will have to spend part of his resources in the search of the desired item; 3) information on quality costs—prior to

purchasing a specific item the consumer needs to collect all related information, which is time and effort consuming. On the account of such characteristics of the buyer, each retailer in a specific territory and (or) the buyer segment becomes a conditional monopolist and is able to exercise seller power. This situation actually means that despite the loyalty of the ultimate consumers to a specific retail outlet, traders have to take into account the movements of their competitors, e.g., the retail prices, since in case the difference in the price for the same item at the closest and furthest trader exceed the net purchasing and search costs, the buyers may decide to opt for a competitor.

The seller power in the retail market emerges not only on the account of some characteristics of the ultimate consumers—they also stem from a number of entry barriers. These may emerge from the limitations, established by legal acts, the time consuming and costly operations licensing procedure and the strategic actions of traders incumbent in the market, such as the threat of predatory pricing, vertical mergers, agreements with producers etc. Also, not infrequently, in view of the leaping marginal article acquisition costs, the trader tends to purchase from the producer smaller amounts, and pay a lower wholesale price than under in the market of perfect competition.

The specialisation of the producers and the achieved economies of scale are both the positive and the negative outcome of the manifestation of the buyer power. As soon as a large trader enters the market and starts buying larger quantities from producers demanding larger price discounts, the producers start cutting the assortment of the goods and specialising in the production of one or several items. A reduced variety of articles lessens the costs both for the producer and the trader, which allows for some reduction in the price of goods. The impact of such developments upon the welfare of the consumers is not easy to define, since, on the one hand the buyer benefits from the possibility to purchase a larger amount of articles, and, on the other hand, the buyer's welfare suffers from a smaller assortment of goods (not able to locate the desired goods, the consumers are forced to be content with the substitutes). Since the producers normally specialise in the production of goods that are highly in demand (those preferred by a majority of consumers), it becomes highly probable that the impairment of the welfare will not outweigh the increase thereof due to price cut of the remaining goods or will even be higher.

4. Generalizations

OECD Notice on buyer power states that where a producer holding the seller market power markets a quantity of the goods that is smaller than in a competitive market, the society's welfare is adversely affected due to reduced production volumes. However, should a trader holding the buyer market power intervene between the monopolist producer and the ultimate consumers, a fall in the retail price becomes feasible due to the trader's capacity to reduce the wholesale prices. The conclusion is based on the assumption that the producer and the trader exercising the buyer power should realise that the gross profit maximising and sharing thereof, in respect to both parties, is more

advantageous that the selection of the optimal quantity on an individual basis (due to a larger gross profit). Therefore the quantity of the goods ultimately should not be smaller than the quantity that would be selected by a producer with the seller market power for the purpose of transactions with ultimate consumers. A retailer exercising the buyer power, for the purpose of maximising the overall profit generated by the supply chain, may purchase the goods from the producer at a lower price. In the market of competing traders the market retail prices may fall, in the meantime the producers may even increase their output volumes [7].

Despite the simplicity of the explications the researchers, when highlighting the benefits of the buyer power, not infrequently tend to ignore one condition to be met in order for the discounts negotiated by the traders to be transferred to the consumers: traders must compete fiercely and be at least approximately equal. Where the retailers do not compete, there they will not benefit from fixing retail prices lower than established by the producers selling directly to the ultimate consumers.

The Competition Council had established a number of instances where the bread, milk or meat producers would, in individual cases, reduce the prices while the trade networks would either refuse to lower the prices or even increase them. This clearly illustrates an instance of the manifestation of the seller's market price.

The impact of the demand and competition upon the solutions of the producers to merge is also testified by the desire of several companies to purchase several loss-making companies managing green-house facilities. Thus, early in 2005, a consortium made up of UAB "Domeina," UAB "Šiaulių banko investicijų valdymas" and a number of natural persons expressed a desire to acquire AB "Kietaviškių gausa" and AB "Pagirių šiltnamiai." In the meantime the approaches of the meat producers, in view of the conditions imposed upon them by the traders and the resulting lower yields, are, to a larger extent, prompted by the desire to increase the buyer power in deals with the farmers, in particular, given a recent decline in the number of farmers breeding cattle or swine. As a result, the number of enterprises that liquidated the number of meat processors in the period from 2000 until 2010 dropped by 2.5 times.

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PIRKĖJO IR PARDAVĖJO GALIŲ POŽYMIAI EKONOMIKOJE

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Santrauka. Straipsnyje nagrinėjant pirkėjo ir pardavėjo galių atsiradimo priežastis ir pasekmes, apibrėžiamos tiekimo grandinės ir jų dalyvių grupės, pasižyminčios tam tikromis charakteristikomis: gamintojai, turintys arba neturintys pardavėjo galios ir didmeninėje rinkoje savo produkciją tiekiantys mažmenine prekyba užsiimantiems ūkio subjektams – prekybininkams, ir pirkėjo galią dėl tam tikrų priežasčių gaunantys ir ja besinaudojantys mažmenininkai. Trečioji rinkos dalyvių grupė yra galutiniai vartotojai, reikalingas prekes perkantys mažmeninės prekybos vietose. Šios trys rinkos dalyvių grupės dažniausiai analizuojamos.

Pirkėjo galios reiškinys būdingas ne tik mažmeninės prekybos sektoriui, nors į pastarąjį reguliuotojų dėmesys dėl platesnio nuskriaustųjų rato krypsta dažniausiai. Žemės ūkio produkcijos gamintojai, realizuodami savo produkciją, taip pat susiduria su didelę rinkos dalį aprėpiančiais supirkėjais ir jų diktatu. O pagrindinė problema analizuojant rinką ir nustatant prekybos tinklų veiklos apribojimus yra pirkėjo galios problemos naujumas, palyginti su pardavėjo galia.

Pirkėjo galios naudą akcentuojantys tyrėjai „pamiršta“ paminėti vieną sąlygą, kuri turi būti įvykdyta, kad prekybininkų išsiderėtos nuolaidos pereitų vartotojams: prekybininkai turi smarkiai konkuruoti tarpusavyje ir būti bent apytiksliai lygūs. Jei mažmenininkai tarpusavyje nekonkuruoja, jiems neapsimoka nustatyti mažesnių mažmeninių kainų, nei jas nustato gamintojai, prekes parduodantys tiesiogiai galutiniams vartotojams.

Konkurencijos taryba nustatė nemažai atvejų, kai duonos, mėsos, pieno gamintojai kainas atskirais atvejais sumažindavo, o prekybos tinklai arba jų nekeisdavo, arba netgi padidindavo. Tokiais atvejais turime akivaizdžią pardavėjo galios išraišką.

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