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Price trends and competition in the groceries market

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THE ICELANDIC COMPETITION AUTHORITY
Borgartúni 26, 125 Reykjavík, Iceland
www.samkeppni.is

2. Summary

Grocery prices in the retail market have risen almost 60% during the six-year period from the beginning of 2006 to the end of 2011. Supplier prices for these goods have developed in a similar manner. A comparison of the development of grocery prices, currency indexes and production indexes for foods and beverages, indicates that this price increase can first and foremost be attributed to external conditions and particularly to the collapse of the exchange rate of the króna following the economic crash in 2008. This is not to say, however, that the above rise in prices was normal and inevitable in all cases, as more dynamic competition in both the supplier and the retail sectors could have led to greater economy and lower prices than is the case.

The Competition Authority’s investigation indicates that there are considerable entry barriers to the grocery market. The root of these barriers can be traced to the different terms that suppliers offer grocery retailers. Three large retail groups; Hager, Kaupás and Samkaup, have a market share of approximately 90%. Shops that are not members of these retail groups pay suppliers a significantly higher price for goods, i.e. a price that is on average 15% higher than the largest retail group, Hagar, pays to suppliers. Other shops would, therefore, enjoy very small margins from their sales if they tried to match the price offered by the discount supermarkets within the larger retail groups. In several product categories the lowest retail price offered by the discount supermarkets is in fact lower than smaller outlets pay to suppliers.

Other retailers, therefore, have to compete on the basis of aspects other than price to attract customers, such as a beneficial mix of price policies, services, range of goods and location. Such diversity in the range of grocery stores can certainly be advantageous for consumers. The problem posed to other shops, however, lies in the increased strength of discount supermarkets, as their share in the total turnover of the groceries market has risen from approximately 20% in 1999 to approximately 63% in 2010. Other shops that do not enjoy comparable supplier business terms as those enjoyed by discount supermarkets have, therefore, limited opportunity to engage in price competition in the largest and growing part of the market.

There are a number of reasons that can justify suppliers offering different business terms to retailers. Thus it is natural that large retail chains enjoy bulk discounts. Bónus, for example, buys six times the average volume that retailers buy of common goods and 75 times more than the volume purchased by the smallest retailer. Efficiency in distribution systems is also important in this respect. This argument applies to a lesser degree in cases where suppliers deliver directly to shops and, in some cases, are responsible for stocking shelves and arranging the goods.

It is unlikely that the terms suppliers offer to retail outlets are in all cases based on objective reasons. In many cases suppliers will find it difficult to prove this as many of their business terms agreements are not in writing. It is particularly important that suppliers consider whether the different prices offered to retailers are the result of normal volume efficiencies or competition restrictive buyer power. Abnormal pricing may also constitute a violation of Article 11 of the Competition Act if the supplier is market dominant. The Competition Authority encourages suppliers to examine their pricing policies in this respect, particularly as regards smaller retailers. The Authority, however, cannot at this stage decide whether the considerable difference in prices in shops is the result of the competition restrictive buyer power of retail groups and retail chains or of normal views on volume efficiency. A final decision on this issue can only be made in an administrative case where an assessment is made of the nature of the transaction in question and the market position of the companies involved.

3. Conclusions

3.1. Rising grocery prices attributed to external environment

Grocery prices rose almost 60% from the beginning of 2006 to the end of 2011. Grocery price increases were negligible in 2006 and 2007. A decrease in the VAT percentage on foodstuffs from 14% to 7%, as well as a decrease in excise duties, particularly on soft drinks, in March 2007, led to a comparable decrease in grocery prices in the retail market. Prices, however, rose significantly following the collapse of the exchange rate of the króna in 2008. Grocery price increases were also significant in most product categories in 2009 to 2011.

There is significant difference in price trends in grocery categories during the period. An example of goods where prices have increased significantly in excess of the general groceries index are cleaning agents and cosmetic products, eggs, rice and pasta. The price of some goods, however, has risen much less than the groceries index. Such goods include soft drinks, juices, ice-cream, cheese, butter and meat products.

There are also significant differences in the price development of domestic and imported groceries. The price increase for Icelandic goods, approximately two thirds of all groceries, was approximately 50% from 2006 to 2011, while foreign goods rose by approximately 80%.

In assessing whether this increase in the price of groceries could be attributed to normal causes, the Competition Authority examined the following:

- Comparisons of the development of grocery prices and other consumer goods.
- Comparisons of price developments in the production stage of domestic food and beverages and the price developments in the retail stage of the same goods.
- Comparisons of the currency rate index and price changes to imported foods and beverages and the price development of imported goods. In addition, in this context, account was taken of the development of world market prices for raw materials for food production, such as cereals, wheat, coffee, etc.
- Information on price changes obtained from suppliers for several common products in each product category. These were then matched with the same goods in the consumer price index base of Statistics Iceland.

The results of these comparisons do not indicate that grocery prices have increased more than what might be expected from exchange rate developments and price increases to the same goods and raw materials from overseas suppliers. Furthermore, the index for domestic foodstuffs and beverages production has risen to a similar extent as the retail price of the same goods.

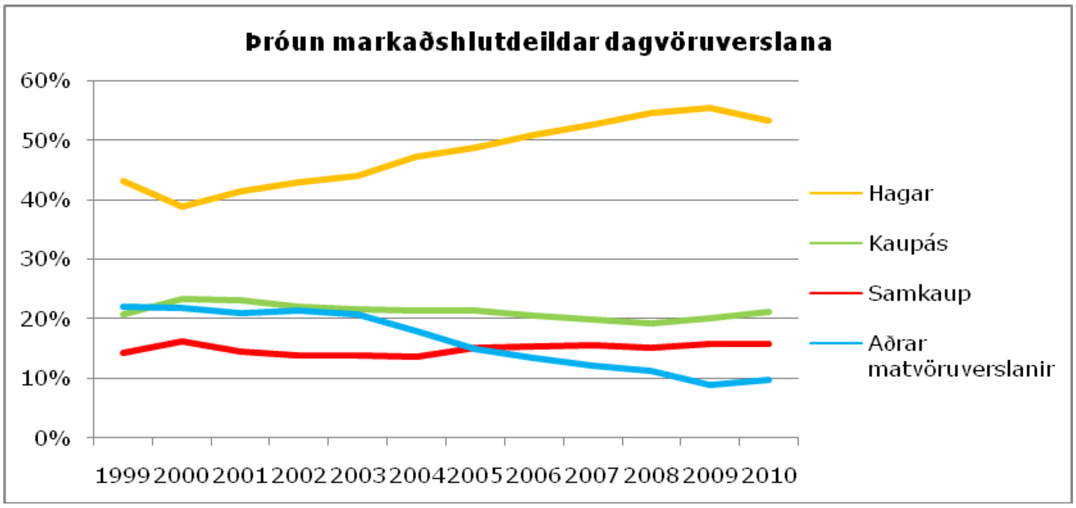
Following the devaluation of the króna, food prices in Iceland have moved from being proportionately higher to being almost equal to average food prices in EU countries when measured in EUR at the listed exchange rate. In ISK, however, food prices rose dramatically after the collapse. Disposable income in Iceland, moreover, has fallen even further when compared to averages in EU countries. The purchasing power of wages has fallen since the collapse and the proportion of food and beverages in consumer expenses has increased. Consumer interests, therefore, have worsened.

Although grocery price increases in recent years are first and foremost attributable to external conditions, it cannot be assumed that competition and conditions in the competitive market are perfectly normal. As a result, this study does not specifically examine whether grocery prices and price formations were normal at the beginning of the investigation in 2006. In this context, it is possible to take account of developments and price formations in the agricultural sector as some of the sector's fields have enjoyed protection from competition for a long time.

3.2. Considerable concentration in the grocery market

There were 174 grocery stores, selling groceries for approximately ISK 100bn, operating in Iceland in 2010. Groceries are defined as being imported and domestic foodstuffs, including agricultural goods, beverages and cleaning products and cosmetics. Three retailer groups control by far the largest part of the grocery market; Hagar, which operates the retail chains Bónus and Hagkaup (it also operated the convenience store 10-11 until 2011); Kaupás, which operates Krónan, Nóatún, 11-11 and Kjarval; and, finally, Samkaup, which operates Nettó, Kaskó, Samkaup-strax and Samkaup-úrval. The combined share of these three retailer groups was approximately 90% in 2010. Hagar had a 53% share, Kaupás had a 21% share and Samkaup had a 16% share.

Hagar increased its share in the groceries market every year from 2001 to 2009. Hagar's share of the market was 39% in 2000 and had risen to 55% by 2009. Hagar's share decreased to 53% in 2010. Hagar's share decreased further in 2011 due to the sale of the 10-11 retail chain. Kaupás' share remained quite stable during the first decade of the present century, around and about 20%. It rose highest in 2000 (23%) and was lowest in 2008 (19%). Samkaup's share has also remained quite stable, although it has risen somewhat. Thus Samkaup's share was generally 13-14% during the first half of the decade while being 15-16% in the latter part. The share of other entities, i.e. co-operatives and smaller retailers that are not part of the above groups, has fallen considerably since the turn of the century. In 1999, the market share of other retailers was 22% but had fallen to 9% by 2010. The share of other retailers fell significantly from 2003 to 2009.



Grocery store market share trends
Other grocery stores

In general, it could be said that Hagar strengthened its position during the first decade of the present century, at the expense of co-operatives and other smaller outlets. Kaupás and Samkaup, however, have retained their share.

Hagar had an approximately 60% market share in the greater Reykjavík area in 2010 and a 42% share outside Reykjavík. Kaupás also had a significantly larger share within the greater Reykjavík area than outside it (26% as opposed to 13%). Samkaup, however, had only a 5% market share in the greater Reykjavík area, while having a strong position outside Reykjavík with a market share of 35%. Hagar has improved its market share in the greater Reykjavík area almost continuously since 2000, although the company's market share did decrease in 2010. Hagar and Samkaup have increased their market share in areas outside Reykjavík while Kaupás, the co-operatives and other retailers have retreated. In most cases, Samkaup has increased its share by taking over co-operatives or other grocery retailers, while Hagar has increased its share by opening new outlets. Many of them have achieved a very strong position in their local markets.

In earlier cases, the Competition Authority has confirmed that Hagar holds a market dominant position within the understanding of the Competition Act[1]. A market dominant position means, according to the Competition Act, that an undertaking enjoys the economic strength which enables it to prevent effective competition being maintained on the market and being able to behave to an appreciable extent independently of its competitors, customers and consumers. When assessing whether a company has a market dominant position, in addition to taking account of market share, account is taken of issues such as economic strength, the position of competitors and what opportunities new competitors have to enter into the market, as well as the purchasing power of customers.

Competitive conditions in the groceries market can generally be inadequate if the negotiating position of individual retailer groups or chains is so strong that they enjoy disproportionately better terms from suppliers than can be considered reasonable, taking volume benefits into consideration. Furthermore, it is likely that competitive restraints are inadequate if a retail company enjoying significant buyer power marks-up its goods more than is generally the case, i.e. it can retain the major part of the benefits of its buyer power[2]. The Competition Authority believes that there are indications that the significant buyer power of individual retail groups or chains leads to greater differences in prices to retail outlets than is justifiable on the basis of direct volume benefits. If account is taken of a sample of popular goods, however, there are no indications that the largest company in the groceries market, Hagar, is retaining all its buyer power through greater mark-up.

The Competition Authority is of the opinion that the banks should have taken better advantage of the opportunity provided by the collapse to split up large, important companies and thereby increase the number of competitors in the market. This would have increased competition and thereby led to more prosperity in the long term. It would

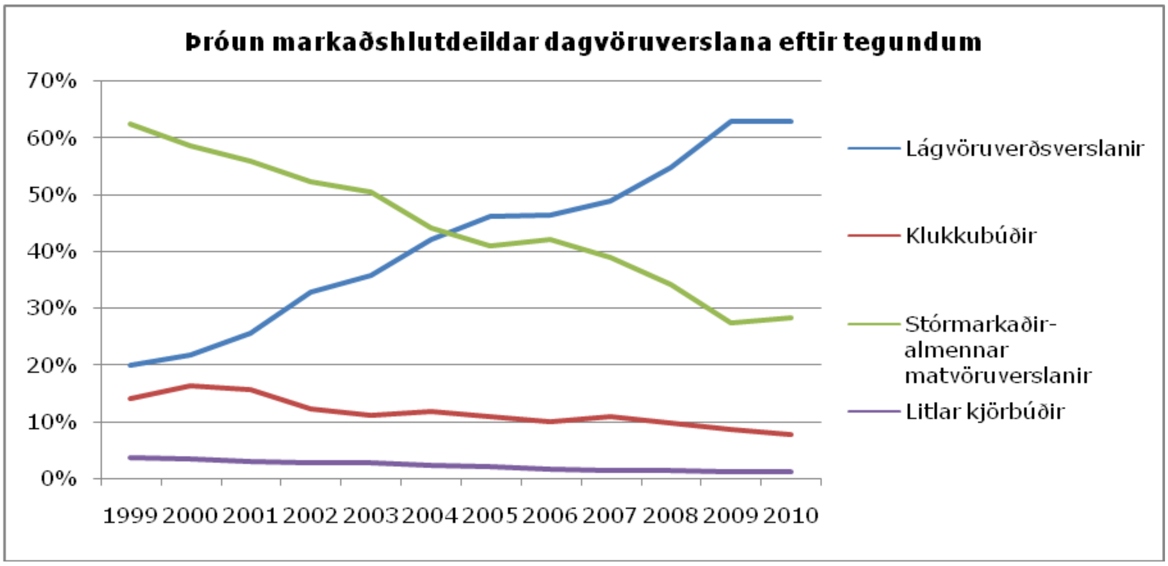
1 The ruling of the Supreme Court of Iceland from 18 November 2010, in Case No. 188/2010 confirmed the conclusion of the Competition Authority that Hagar held a market dominant position in the groceries market. The Competition Authority's ruling in Case No. 6/2010 The takeover of 1998 ehf. by Arion Bank hf. also reached the conclusion that Hagar was market dominant in the groceries market. The Competition Authority is of the opinion that there are no indications that the market dominant position of Hagar in the groceries market has changed in any way. In the ruling of the Supreme Court, Hagar's share was approximately 50%, similar to Hagar's present share.

2 In this report, the term buyer power is used in a general manner. This report does not take any position on whether buyer power in individual fields is so great that it cancels the strength that the supplier has on the basis of market share and/or trademark strength.

also have returned greater profits for the banks than the short term view of higher sales values and larger units. It can be argued that this applied to Hagar and various other companies in other markets. It must be noted however, that the sale of the 10-11 retail chain from Hagar in 2011 was beneficial, even if there are no indications that the sale fundamentally changed Hagar's position in the market.

3.3. Increased strength of discount supermarkets

The grocery market has been revolutionised with the increased strength of discount supermarkets. Thus Bónus' importance within Hagar has increased significantly, while Hagkaup's has decreased. Krónan's importance within Kaupás has increased while Nóatún's has decreased. The market share of discount supermarkets overall was approximately 20% in 1999. By 2010, however, this share had risen to 63%. The market share of all other types of grocery stores has fallen during the same period. By far the greatest market share reduction was suffered by supermarkets and general grocery stores which had an overwhelming share in 1999 or 62%. This proportion was down to 27% in 2010. The market share of convenience stores fell from 16% to 8% during the same period, and the share of small grocery stores fell from 3% to 1%. This development has been extremely fast, although it is interesting to note that the trend towards the increased share of discount supermarkets halted temporarily during the period of greatest economic growth, from 2005 to 2007, and then again in 2010.



Þróun markaðshlutdeildar dagvöruverslana eftir tegundum	Grocery store market share trends according to type
Lágvöruverðsverslanir	Discount supermarkets
Klukkubúðir	Convenience stores
Stórmarkaðir – almennar matvöruverslanir	Supermarkets – general groceries
Litlar kjörbúðir	Small groceries

Looking at the separate retail chains, it is clear that Bónus is by far the largest retail chain in Iceland, with a market share of approximately 40%. The next largest chain is Krónan, with a 16% market share, thereafter are Hagkaup (10%), Nettó (7%), Samkaup

Úrval (5%), Nóatún (4%) and 10-11 (4%). Other chains and shops have a total market share of 14%. The two largest retail chains are discount supermarkets.

A number of changes, such as changes in ownership, have been taking place in the retail stage of the groceries market over the past few years. Most important in this respect is that Hagar's owner, Baugur, was declared bankrupt and was taken over by Arion Bank in October 2009. Hagar was listed on the stock market in December 2011. Other changes in ownership are that the 10-11 chain was sold out of Hagar to a new owner in June 2011, and that Samkaup purchased the operation of the shops of Kaupfélag Héraðsbúa (a co-operative) in east Iceland in February 2009. In addition, new shops have been established in recent years. These are shops such as Kostur in Kópavogur in 2009 and Víðir in Reykjavík and Garðabær in 2011.

The Competition Authority is of the opinion that a number of positive things have been happening in the grocery market recently. These include the sale and listing of Hagar on the stock market, the sale of 10-11 out of Hagar and the establishment of new entities in the market. It is clear that consumers can choose between a number of different outlets when purchasing groceries.

3.4. Negotiating position of suppliers has weakened

The aggregate income of suppliers from the sale of groceries to grocery stores amounted to approximately ISK 75bn in 2010. This included goods imported by the three large retail groups and that were sold from their own warehouses. These suppliers then sold groceries to retailers other than retail chains for approximately ISK 30bn. Retailers' turnover from the sale of groceries amounted to approximately ISK 100bn in 2010.

The largest suppliers, which are independent of the three large retailer groups, are Mjólkursamsalan (milk and dairy products), Ölgerðin Egill Skallagrímsson (soft drinks, juices and imported dry goods), Íslensk-Ameríska (bread and cakes and imported dry goods), Sláturfélag Suðurlands (meat and meat products and imported dry goods), Nathan & Olsen (imported dry goods and cleaning products and cosmetics), Norðlenska (meat and meat products), Vífilfell (soft drinks) and Innnes (imported dry goods).

Prior to the establishment of retail groups and chains, the market was controlled by the suppliers. Small retailers had no-one else to turn to for purchasing goods. When the grocery shops began to grow, retail chains formed and discount supermarkets came into the market, then retailers began importing their own groceries in considerable volumes. This increased retail competition and supplier power in negotiations with retailers dwindled. The negotiating power of larger retailers grew considerably following the formation of groups such as Hagar and Kaupás. A report issued by competition authorities in 2001 on the foodstuffs market revealed that the market was characterised by the buyer power of retail chains.

These circumstances are still in evidence. The Competition Authority is of the opinion that the purchasing power of the larger retailer groups has strengthened as a result of the increased range of goods that they import. Grocery stores have reduced the supply of goods to consumers in some product categories and are increasingly focusing on offering their own goods, i.e. either goods labelled with the chain's logo or their own trademarks.

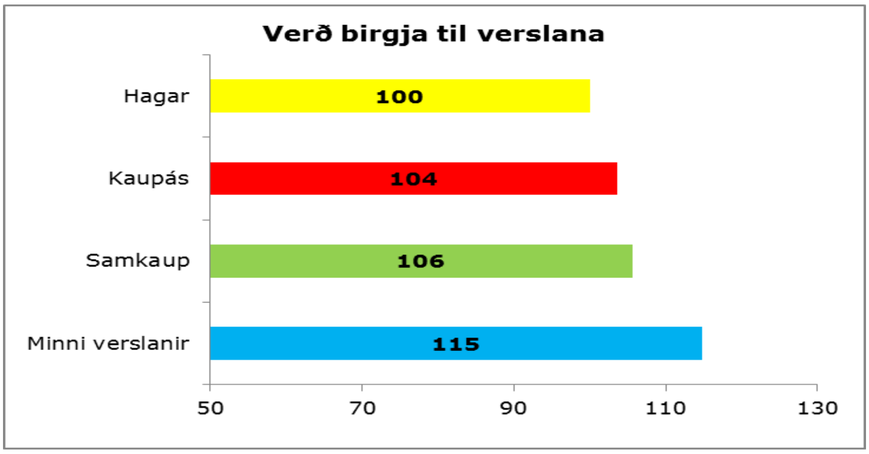
This trend has led to a reduction in the number of suppliers in addition to the fact that the customers of importers are now also their competitors.

The Competition Authority’s report No. 1/2008, which examined business agreements between suppliers and grocery stores, revealed that approximately 40% of suppliers do not make written contracts with resellers. The majority, however, issued price lists. Information obtained from suppliers and grocery stores in connection with this report shows that there are still many companies that do not make written contracts for their transactions. This contravenes the guideline rules on business transactions between suppliers and groceries that the Competition Authority issued in December 2002. The rules were intended to provide guidance to undertakings in the groceries market as to what conduct and behaviour is considered in accordance with good competitive and business practices and, at the same time, what may contravene competition laws. The point was made in the discussion of the rules that although the provisions were guidelines, it could constitute a violation of competition laws if companies with significant market strength used that strength to negotiate themselves away from the provisions of the rules. The rules also touched on companies’ interference in the pricing and business terms of other companies.

As a result of the above, it is clear that business agreements between suppliers and groceries are in many cases inadequate, at least formally. With the entry into effect of Act No. 14/2011, on amendments to the Competition Act, the Competition Authority has been granted powers to enforce the obligation of suppliers and groceries to make written contracts. This would be possible, for instance, if an investigation revealed that informal agreements were likely to disrupt competition at the expense of the public.

3.5. Different prices from suppliers to shops

The Competition Authority examined the wholesale prices from suppliers to groceries in approximately 350 common goods, belonging to 21 categories. Hagar paid suppliers the lowest price in 17 of the 21 categories examined in this report. Supplier prices to Kaupás were 4% higher than to Hagar on average and prices to Samkaup were 6% higher on average. The suppliers’ selling price to small retailers (Fjarðarkaup, Kostur, Melabúðin, Miðbúðin and Verslunin Einar Ólafsson), however, was much higher, 15% higher on average, than to Hagar.

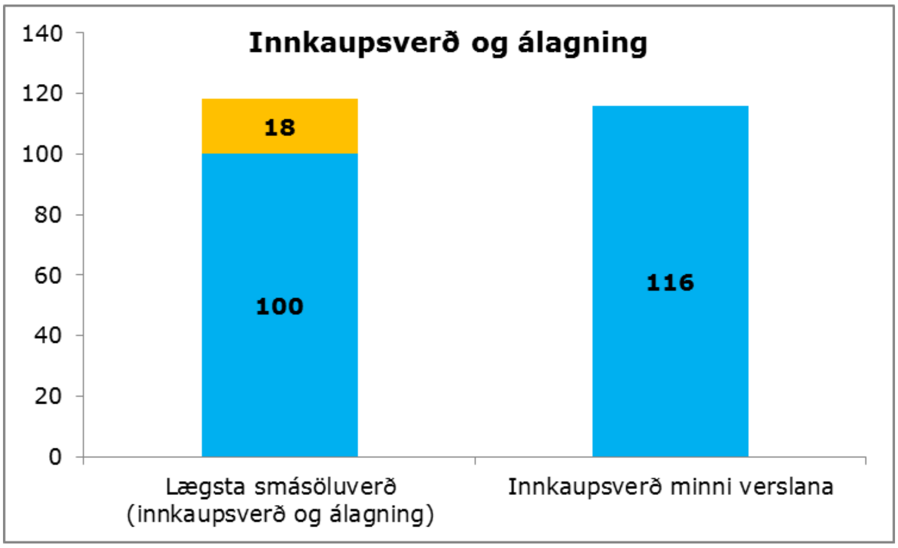


Supplier prices to shops
Smaller shops

There were significant differences between product categories as to how great the difference in prices was from suppliers to retailers. There was relatively less difference in prices from suppliers to retailers in meat, milk, cheese and butter, while the difference was relatively much greater for e.g. coffee and tea, ice-cream, bread and cakes.

3.6. Difficult competitive position of smaller shops

The Competition Authority compared the purchasing price and the mark-up in discount supermarkets on the one hand, and the purchasing price of several smaller groceries on the other, for approximately 300 common groceries. The mark-up of discount supermarkets was commonly 18% on top of the purchasing price of the shops in question or warehouses within the same domain as the shops. Account was taken of the mark up of the discount supermarket that had the lowest price in each case. The purchasing prices offered to smaller retailers was on average 16% higher than the purchasing price offered to discount supermarkets for the same goods. These shops would therefore have been forced to sell the goods with an average mark-up of only 1-2% if they intended to match the lowest prices of the discount supermarkets. .



Innkaupsverð og álagning	Purchasing price and mark-up
Lægsta smásöluverð (innkaupsverð og álagning	Lowest retail price (purchasing price and mark-up)
Innkaupsverð minni verslana	Purchasing price of smaller shops

The results of this comparison, however, differ between categories. In 15 of 21 product categories, the lowest retail price of the discount supermarkets was slightly higher than the average purchasing prices of smaller outlets. This means that smaller shops would have had a small mark-up if they intended to sell at the lowest price in the market. In six product categories, however, the purchasing price of the smaller shops was higher than the lowest retail price of the discount supermarkets. This means that the smaller shops would have to sell their goods at a loss if they intended to offer the lowest price in the market.

It is clear that shops that do not belong to larger retailer groups receive much poorer terms from suppliers. These entities, therefore, have to compete for customers on the basis of aspects other than price, such as a beneficial mix of price policies, services, range of goods and location. If these shops intended to match the competitive prices of discount supermarkets (i.e. match the lowest price in the market), they would have to sell their goods with little or no mark-up or even at a loss. In the opinion of the Competition Authority, this constitutes an access barrier to the groceries market, as it is almost impossible for smaller shops to provide discount supermarkets with any price competition[3]. In this respect, the fact that the share of discount supermarkets has increased significantly over the past decade, from 20% in 1999 to 63% in 2010, has had a huge impact.

It should be noted that there is nothing in competition laws that obligates suppliers to sell their customers the same product at the same price. Differing business terms, particularly in the case of market dominant suppliers, which are not based on objective views and which disrupt competition, can, however, contravene competition laws.

It should also be noted that a number of considerations can justify differing supplier business terms to shops. As an example, the three larger retailer groups operate numerous shops that are distributed throughout Iceland. There may, therefore, be significant cost benefits for suppliers to deliver their goods to the warehouses of the retail chain in question, instead of delivering the goods to each outlet. This means that the efficiency of the supplier's distribution system is important.

It is clear that the above argument for differing business terms between suppliers dealing with warehouses that purchase in bulk, on the one hand, and individual retail outlets on the other, does not apply in cases where suppliers deliver the goods directly to shops and may even be responsible for stocking shelves and arranging the goods. In such cases one would expect the volume that is delivered to each individual shop to have the greatest impact on business terms. For example, the store Fjarðakaup is one of the largest independent groceries in Iceland and yet the shop enjoys poorer terms than the larger retail chains, even though fresh produce, which suppliers generally deliver directly to each shop, is involved in many cases.

Other considerations must, however, be kept in mind. For instance, the decision of a large retail chain to accept a product for sale from a domestic manufacturer may make it beneficial for that manufacturer to add a new production line that reduces unit prices. It can also have a great impact on an importer's profits if a discount supermarket chain decides to accept goods for sale (or stop selling goods from him), even though the importer's mark-up on the sale to the chain is minimal. Finally, the transaction costs saved by sending a single invoice for transactions instead of numerous small invoices can have an effect.

The Competition Authority considers it to be a key issue to assess whether powerful suppliers discriminate unreasonably between resellers, having taken into account volume benefits. It is also possible that some suppliers do not take sufficient account of volume benefits and that their prices are too uniform. This can also disrupt competition.

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[3] New shops have been established recently, as previously mentioned. However, there is insufficient experience of their operation to assess their impact.

In addition, it is clear that the business terms groceries enjoy as regards fees paid to acquirers for the use of payment cards has an impact on their ability to participate in price competition. There can be considerable differences in the terms offered by payment card companies to retail undertakings in this respect. It should be noted that the Competition Authority is engaged in an examination of Valitor's alleged violations in the market for acquiring services to sellers.

3.7. Greater volume leads to better terms

There is a clear relationship between the price offered by suppliers and the volume that groceries buy. An examination of 100 common goods that retail chains purchase directly from suppliers, and which do not go through warehouses, show that Bónus pays suppliers the lowest price, or on average 9% less than the average price. Bónus, moreover, buys six times more than the average volume purchased by retail chains. Krónan pays on average a 5% lower price than the average price and purchases 2.5 times the average volume. The shop that purchases the least volume purchases 8% of the average volume.

The Competition Authority performed a simple statistical analysis (with the normal method of least squares) on the relationship between the prices and volumes of various product types that grocery stores purchased from suppliers in 2010. The analysis revealed that the volume purchased has statistically significant effects on the price. The overall correlation in the analysis (R^2), however, was relatively low, or only 25%, which means that volume only accounts for 25% of the variations in price. This indicates that a number of variables other than volume account for suppliers' prices to shops.

Figures can be inserted into the equation to calculate the manner in which price and volume interact. A small grocery store, which buys e.g. 10% of the average volume purchased by grocery stores, can expect to have to pay a 3% higher price than the average price. A large grocery store that buys e.g. three times the average volume can, however, expect to pay a price that is just over 7% lower than the average price.

3.8. The Competition Authority's actions in the groceries market

In its monitoring of the Icelandic economy over the past few years, the Competition Authority has spent most of its time on the foodstuffs market. At the beginning of 2006, the Competition Authority formulated its policies for its monitoring activities in this market. These were revised following the collapse of the banks. The Competition Authority has focused its efforts on the following four main aspects:

1) The position and conduct of the largest retailer chain, Hagar
2) Business terms agreements between suppliers and retailers
3) Co-operation between interest groups involved in the pricing of foodstuffs
4) Competitive conditions in agriculture

This work has had the result that Hagar, as a market dominant entity, has been set clear limits, which again has led to the company changing its pricing policies. Likewise, Vífilfell has been ordered to cease making competition restrictive exclusive purchase agreements with its customers.

More active competition has been encouraged in the sale of meat products and illegal collusion between suppliers and groceries has been eradicated. This means that suppliers no longer label goods with recommended prices. Misleading price labels (discounts from prices that were never actually available to consumers) have been stopped and products have been standardised to a greater extent than previously. This issue has had an effect in other product categories, such as cheeses.

In addition, competition authorities have sent a clear message to companies in this market to the effect that any form of competition restrictive collusion on their part will not be tolerated, as shown by the fines imposed on four such associations in 2008 and 2009.

Finally, the Competition Authority has sought to instruct the market and the authorities and pointed out ways to strengthen competition, such as in Report No. 1/2008, *The Supplier Business Agreements and Other Collaboration by Undertakings in the Foodstuffs Market* and Report No. 2/2008, *Vigorous Development – the opening of markets and strengthening of economic activities*.

3.9. The Competition Authority's proposals

As stated, this report is a stage in the Competition Authority's monitoring of the groceries market as formulated in early 2006. It provides views on the market that probably require further discussion. With its report, the Competition Authority encourages such debate and will take account of the submitted views and comments when preparing for further actions.

On the one hand, the report puts the spotlight squarely on grocery price developments and price formation over the past six years and, on the other, on the conditions that new and smaller grocery stores face as regards competitive pricing. The Competition Authority's proposals at this stage are directed at these two issues:

Competitive conditions of smaller shops

The Competition Authority encourages suppliers to revise their pricing policies in light of the results of the report. It is important that suppliers, not least the larger suppliers, can at any time show that their business terms are based on objective views. Price differences to retail outlets can thus be based on objective views, such as bulk benefits. On the other hand, the significant buyer power of individual retail groups or chains can lead to greater differences in prices to retail outlets than is justifiable on the basis of volume benefits. This can work against the entry of new entities to the market and can restrict the growth of smaller competitors. It must also be kept in mind that if a supplier is in a market dominant position, then that supplier is under strong obligations to refrain from taking any action that could disrupt competition unnaturally. The rulings of the competition authorities and courts provide instruction in this respect.

The Competition Authority may be expected to initiate administrative cases to assess whether a supplier's business terms are legitimate. Further decisions in this respect will be made after the views and comments of companies in the grocery market as regards this report have been processed.

Grocery price developments

This report describes the significant increase in grocery prices. In addition, the purchasing power of wages has fallen and the proportion of food and beverages in consumer expenses has increased since the collapse. Under these adverse conditions it is even more important than ever to seek all means to strengthen competition in all the stages of the grocery market, and it is important that both undertakings and the authorities work as a team in this respect. The Competition Authority will for its part make every effort to support and continue work on this goal, as described in the discussion in Section 3.8.

More, however, needs to done. It is important that undertakings in the grocery market carefully examine their work practices and policy formulation, with the goal in mind of strengthening competition. This applies not least to the owners of the companies operating in the grocery market. It is particularly important that the banks that have direct and indirect control over the companies in question pay attention to this issue.

It is also extremely important that the authorities embark on actions to strengthen competition. Experience has unfortunately shown, however, that the authorities have, almost without exception, ignored the recommendations of competition authorities to improve competitive conditions in the groceries market. This applies not least to issues relating to the processing and sale of agricultural goods. The authorities have clearly not sufficiently understood the positive effects that, experience shows, a healthy competitive environment has on various agricultural sectors. In this respect, special mention should be made of the fact that the authorities followed the recommendations of the competition authorities and eliminated customs taxes on vegetables, following the discovery and exposure of illegal price collusion in the production and distribution of vegetables in 2001. To offset this, support for domestic producers was adopted at the wholesale stage. At the same time, market disruptive access barriers were removed from the retail stage. The positive effects of this action were soon seen; domestic production grew, retail prices fell and consumption increased. These changes, therefore, benefitted both domestic vegetable growers and consumers.

In light of the above, the Competition Authority is of the opinion that it is very important that legislation applicable to agricultural goods be revised, with the goal of balancing competitive conditions and increasing active competition in markets for agricultural goods for the benefit of consumers, and Icelandic society as a whole. These changes must involve considerable reductions of import restrictions on agricultural products, and other access barriers must be reduced without disrupting the present competition between undertakings. Changes following such revisions must, among other things, lead to the entry of new competitors being made easier, irrespective of whether they are new domestic producers (i.e. farms, product stations and/or meat processing companies) or importers. Such actions need not prevent normal support to domestic production, as evidenced by the previously mentioned improvements to the vegetable sector.

THE ICELANDIC COMPETITION AUTHORITY
Borgartúni 26, 125 Reykjavík, Iceland
www.samkeppni.is