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Absence Of A Competition Law Restricts Retail and Wholesale Food Trade Practices in Hong Kong

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Report Highlights:
Although Hong Kong is widely acknowledged to be one of the world's freest import markets, the competitiveness of its wholesale and retail sectors suffers from the lack of a competition law to discourage price collusion and other anti-competitive practices. As a result, consumers pay higher prices, food retailing is highly concentrated, suppliers bear the brunt of price wars and the variety of product selection suffers.

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Although Hong Kong is widely acknowledged to be one of the world's freest import markets, the competitiveness of its wholesale and retail sectors suffers from the lack of a competition law to discourage price collusion and other anti-competitive practices. As a result, consumers pay higher prices, food retailing is highly concentrated, suppliers bear the brunt of price wars and the variety of product selection suffers.

Hong Kong's government has traditionally encouraged a laissez-faire trade policy in the belief that free competition will help maximize return on resources and stimulate continued economic growth. There are no trade barriers for most of Hong Kong's business sectors including the food retail business. In contrast to import policy, however, Hong Kong currently does not have a comprehensive competition law, the absence of which allows the existence of some trade practices which prohibit full competition to a certain extent.

The so-called "Resale Price Maintenance" (RPM) is a mechanism by which a supplier offers recommended retail prices for his products and he will stop supplying the products to any retailers who do not follow the recommended prices. In Hong Kong, most branded products are represented by exclusive agents. Being an exclusive agent in the market, the supplier can easily control the product supply and enforce RPM. In other words, he can prevent retailers from offering goods to customers at a price lower than the recommended resale price by means of RPM.

Industry sources agree that RPM is a widespread practice in Hong Kong. The consumer watchdog organization Hong Kong Consumer Council found evidence of the practice following a complaint received in 1997 from the French food retailing chain Carrefour, who closed its 4 stores in Hong Kong.

The supermarket industry in Hong Kong is characterized by two large players, Park N Shop and Wellcome, each of whom has around 200 stores. They already account for about 70 percent of supermarket sales. Other supermarket chains have far less stores. Supermarkets like China Resources, Guangnan KK and Dah Chong Hong have 35 to 60 outlets, far less than the two giants. Carrefour entered Hong Kong's supermarket industry four years ago, featuring a new hypermarket format with attractively discounted prices. Its emergence stimulated Park N Shop to adopt its "SuperStore" concept which has proved to be highly successful and is now in its fourth generation of development.

Ironically, after four years of bitter struggle this French supermarket leader deserted Hong Kong's food retailing battlefield by closing all its four stores in Hong Kong starting September 18. Carrefour lodged a complaint on RPM against 22 suppliers back in May 1997, without a favorable result. In the wake of Carrefour's closure, RPM still lingers in Hong Kong with an invisible hand influencing the retail market.

As a new market entrant, Carrefour adopted a "loss leader" strategy by offering discounted prices for a wide variety of products in order to draw customers to the store. Sometimes the prices were even lower than wholesale prices. For instance, Carrefour bought a local branded juice at HK$16 per bottle and it sold to customers at HK$11. Very often the discounted prices were lower than the recommended discounted price "suggested" by the suppliers. To protect their own interests, some suppliers put pricing pressure on Carrefour. They threatened that Carrefour must sell their products at recommended retail prices, otherwise, they would not supply goods to the store any more. Supplies were cut in some cases. Carrefour lodged a complaint to the Hong Kong Consumer Council in May 1997 and submitted names of 22 suppliers from which it claimed to have received pressure to adhere to recommended prices.

Consumer Council followed up on the complaint and confirmed that RPM exists in the Hong Kong food retail business after completing its investigation. Seven suppliers admitted their intention to enforce RPM levels; twelve said they had discussed the pricing policy with Carrefour, while three declined to give any comments. A medium sized supermarket chain, when interviewed by the Council, reported that it had experienced similar pricing pressure from suppliers. The Council established that RPM exists in Hong Kong and noted the comment by one of the suppliers that RPM in Hong Kong is very common.

There are many reasons for suppliers to advocate an RPM policy. First, RPM forces small retailers to continue paying higher per-unit wholesale prices to suppliers than the larger retailers - by preventing the small operators from obtaining their goods at the retail level from large retailers taking delivery of large orders and engaging in price-discounting. Second, the dampening effect of RPM on retail price competition tends to keep more small scale retailers in the distribution network, thereby reducing the reliance of suppliers on large retailers. Without RPM, large retailers able to obtain lower wholesale prices and pass them onto consumers would push more small operators out of business.

The reasons cited above for practicing RPM apply to suppliers only and do not fully explain its widespread practice in Hong Kong. The supermarket industry's retail structure may provide a clue to other factors. Hong Kong's supermarket industry is highly concentrated, with two large players. Their distribution network is vital to so many brands that they have very strong bargaining power. When a new supplier enters the market and tries to establish a foothold in the industry by luring customers with discounted prices, the two large players frequently respond by offering lower retail prices, but they are not prepared to sacrifice their profit margins. Instead, they will squeeze wholesale prices from existing suppliers. Not many suppliers are powerful enough to enforce RPM on the large supermarket players.

When these supermarkets want to offer discounts on specific products for promotion, suppliers are for the most part forced to join the promotion by offering lowering wholesale prices. Many suppliers have little bargaining power and have to give in to lowering wholesale prices, given the dominant distribution network enjoyed by the big retail players. Under such circumstances, supplier margins suffer as a result of the price discounting initiated by the new market entrant. To pre-empt a situation in which their profit margins are squeezed by large retailers, many exclusive agents are determined to enforce RPM and do not allow the new market entrant to offer discounted prices lower than the recommended prices in the first place. Many suppliers view RPM as an effective tool to ensure an acceptable profit margin and to secure distribution channels, given Hong Kong's unique market structure.

Evidence of RPM's continuing presence was provided again during the summer of 1999 when a severe supermarket price war broke out following the launch of adMart's direct delivery business. AdMart featured low prices from its beginning, but the invisible hand of RPM went to work. In cases, local suppliers of brand name goods were threatened that they would lose their business with one of the major retailers if they did business with adMart. The company found it difficult to line up local suppliers and eventually took recourse to parallel imports and direct shipment from consolidators. Admart admits publicly that it continues to run its retail operations at a loss and private speculation holds that the company is fighting hard for survival.

The Hong Kong Consumer Council continues to challenge these anti-competitive trade practices. It has lobbied the Hong Kong government to enact a comprehensive Competition Law and set up a Competition Authority to enforce it. Currently, the Hong Kong government has set up a "Competition Policy Advisory" group to review policy issues related to retail competition. In the broadcasting and telecommunications sector, it has already put measures in place to increase competition through deregulation. However, a comprehensive Competition Law is still not on the agenda. Earlier this year, the Council became a full member of the Advisory and it is expected to continue its campaign for enacting a Competition Law in Hong Kong. Perhaps the closure of Carrefour will provide the Council with more ammunition for its lobby.

Nonetheless, we do not see any sign of the emergence of a Competition Law in Hong Kong in the near future; RPM will remain in force. Smaller retailers and new suppliers will continue to face severe obstacles in the form of slim to no profit margins as larger and existing players conspire to limit price competition at the retail level and profit levels at the wholesale level. Indicative of this continuing pattern is that fact that Carrefour's four former store sites are being taken over by Park 'N Shop (3 sites) and Wellcome (1 site).

In the meantime, the presence of foreign food retailers is dwindling in Hong Kong with the recent Carrefour and Market Republic closings and Seibu's decision to hand over the operation of its supermarkets to Park 'N Shop. Rumors are also circulating that China Resources may merge its CRC supermarkets with those of Guangnan KK, a consolidation of the number 3 and 4 food retail chains. Also, that Carrefour may re-enter the Hong Kong market with up to 10 smaller scale stores under the name Dia.