The Competition Council examines dairy prices – from raw milk to market shelves

Published more than 1 year ago

Published: 09.11.2023.

The Competition Council (CC) launched a market surveillance on the market for eggs, fish, dairy, meat, grain and bread products in spring 2023, taking into account the aggravated situation in the food sector and rising retail prices. The study on the dairy product group (of cows' milk) does not reveal any price collusion by retailers or violations of the Prohibition of Unfair Trading Practices Law (PUTPL) in the cooperation between retailers and suppliers. At the same time, price transmission failures have been identified at the production stage and retail stage of some dairy products (cheese, sour cream), where price changes have been delayed or disproportionate. To improve the situation in the sector, the CC made recommendations to the stakeholders, including relevant industry bodies.

The study covers the period from January 2021 to May 2023. The CC assessed cooperation between suppliers and retailers, as well as the correlation of price changes along the supply chain and retail price variability. In total, data were requested from 28 retailers and 40 producers/suppliers based in Latvia and abroad, e.g. from the Baltic states, Germany, Italy. Altogether more than 100 000 data units from the first round of the conducted study and more than 70 000 data units from the second round of the study have been analysed.

> Juris Gaiķis, the Chairman of the CC: *"The cost of food production increased rapidly, along with products' shelf prices in the shops, due to Russia's war on Ukraine and shortages of raw materials, the energy crisis and inflation. Consumer food prices had risen by 44.9% at the end of 2022 compared to December 2018. Questions have been raised at the Competition Council, at the political level and in society at large as to whether the high prices in shops are reasonable. Although the Competition Council is not entitled to regulate prices and inflation issues are not within its competence, we were very interested in competition conditions in the market, cooperation between producers and retailers, and independent pricing. With this study, we have obtained unique data, including data on the pricing of food products, which can now be used by the relevant authorities to make data-driven decisions."*

Fragmented producers and suppliers versus powerful retailers

There is relatively a high number of small dairy farms in Latvia producing raw milk and a high number of raw milk processing companies. This provides consumers access to a wider variety of dairy products. However, this market structure does not facilitate economies of scale for producers, nor does it ensure them the buyer power and bargaining power with dairy buyers.

At the same time, both the number of retailers and the number of people employed there have declined over the decade. Nonetheless, the turnover in non-specialised retail stores selling mainly food, beverages or tobacco has increased year over year.

The two largest retailers had an aggregate market share of over 50%, while the five largest players had an aggregate market share of around 80% in 2022. Although the concentration ratio is high, since 2019 it has declined for the two largest retailers, and since 2021 it has also declined sharply for the five largest retailers, driven by the entry of the LIDL chain on the Latvian market.

Price transmission for drinking milk, cheese and sour cream at different stages

As part of the market surveillance, the CC analysed how prices of food products are passed on at different stages of the supply chain, for example, from farmer to producer and from producer to trader, while also assessing whether there were any signs of unfair trading practices in buying these goods or other conditions unfavourable to competition. Price transmission analysis is most often used to determine whether consumers can enjoy price reductions when commodity input prices fall.

When looking at the prices of drinking milk, cheese and sour cream, the most consistent price transmission has been for drinking milk. Retailers and producers have most often changed prices in line with the farmers' stage, both in terms of price increases and reductions. The CC found that when the purchase price of raw milk increased in the agricultural stage in the previous month, producers' prices changed in the following month.

However, for cheese and sour cream, price transmission has been flawed, i.e. prices have not been transmitted symmetrically and with the same speed from one stage to the next, nor within a certain magnitude. For example, in the first months of 2023, there was a significant drop in the farmers'/producers' price, but the price transmission to the next stages of the supply chain did not occur with the same magnitude and speed, so the final consumer continued to pay a high price for cheese and sour cream.

Pricing of domestic and imported products at retail stage

The CC also assessed price transmission at different stages, i.e. by analysing pricing of domestic and imported products at retail stage. Consumers had to pay more for drinking milk produced in Latvia than for drinking milk produced outside Latvia until September 2022. The situation has changed with locally produced drinking milk fetching lower average retail prices than drinking milk produced outside Latvia since November 2022.

However, pricing of cheese and sour cream produced in Latvia and outside Latvia differed significantly at the retail stage. During the study period, cheese produced in Latvia was on average 59% more expensive than cheese produced outside Latvia. Similarly, the mark-up of sour cream produced in Latvia was by 32% more than the mark-up of sour cream produced outside Latvia. Thus, during the whole analysis period from 2022 to May 2023, consumers at retail points had to pay more for locally produced cheese and sour cream than for products produced outside Latvia.

Pricing of retailers' private labels and branded goods

Within the market surveillance the CC also examined price transmission of retailers' private label dairy products as well as of dairy products which are brands of independent producers. The CC found that over the 17 months analysed, the average mark-up for branded drinking milk was 3.5 times higher than for retailers' private label drinking milk. Cheese which was the brand of producers was also 59% more expensive and sour cream was 77% more expensive than retailers' private label products.

The CC emphasises that if retailers would apply equivalent pricing policies to both producers' brands and retailers' private label products, branded dairy products would become more accessible to consumers and would contribute to consumer purchasing power. The same applies to pricing policies for dairy products produced in Latvia.

Price monitoring and price-matching

LIDL and Stockmann have the lowest price variability. The price variability index of Rimi and Maxima is similar, indicating both regular promotions and retailers actively tracking each other's prices, adjusting them and holding regular promotions accordingly. This is known as 'intelligent matching', where competitors do not collude on prices, but actively monitor each other's prices and adjust them accordingly to offer competitive prices.

Competition law does not prohibit such adjusting if it takes place independently, by independently assessing competitors' offers and setting its own price. Consumers have limited possibilities to compare prices across online shops and choose the best deal, resulting in information asymmetries between the retailer and the consumer. Therefore, the CC recommends that industry / responsible industry bodies develop a price comparison tool that would allow consumers to make informed decisions in favour of buying given products for the best price at retail stores over a given period of time. A similar monitoring tool has been implemented in Romania since 2009, developed in cooperation with private operators.

Market surveillance for the remaining product groups – eggs, fish, meat, grain and bread products – is planned to be finalised and presented between the end of the year and the beginning of next year. In the next phase, the group of grain and bread products will be analysed in more depth.