BUYER POWER GUIDELINES

UNDER PART III OF THE COMPETITION ACT NO.12 OF 2010

COMPETITION AUTHORITY OF KENYA 2017

ISO 9001:2015 CERTIFIED

PREFACE

The Competition Authority of Kenya (hereinafter the Authority) recognizes abuse of buyer power as an emerging issue in the Kenyan economy where buyers fail to honor their contractual obligations to suppliers. In order to address this problem, in 2016, the Competition Act No. 12 of 2010 was amended and prohibited abuse of buyer power in the Kenyan market or substantial part of it under Section 24 of the Act. This Guideline is prepared and issued by the Authority in order to provide a clarity regarding areas of the application of the Act with respect to abuse of buyer power.

CITATION

This Guideline shall be known as the Buyer Power Guideline, 2017 ('BPG' 2017).

DEFINITION OF TERMS

Act refers to the Competition Act No.12 of 2010;

Authority means the Competition Authority of Kenya;

Buyer power has the meaning assigned to it under section 24 (2D) of the Act.

Countervailing buyer is the power of a buyer to create or reveal competition between its suppliers.

Monopsony power means the bargaining power of a single buyer against many suppliers.

Normal Selling Price means the Supplier's profit maximizing price in the absence of buyer power.

Opportunity Cost means the value of the choice of a best alternative cost while making a decision.

NOTE: *Other terms in the Guidelines have the same meaning as defined in the Act.*

EXECUTIVE SUMMARY

1. Buyer power is an important aspect of competition analysis. It enables a single buyer or a group of buyers to dictate or influence the terms of purchase to the upstream suppliers.
2. Buyer power of an undertaking enables it to influence the terms and conditions on which it purchases goods. In some circumstances, powerful customers may have the incentive and ability to defeat the exercise of market power. However, even the most powerful buyer has a disciplinary effect on a supplier if there is a credible threat that it could switch to another supplier(s) to a sufficient extent.
3. There are two types of buyer power; monopsony and bargaining buyer power. A firm has monopsony power if its share of purchases in the upstream input market is sufficiently large that it can cause the market price to fall by purchasing less and cause it to rise by purchasing more. Bargaining power on the other hand refers to the bargaining strength that a buyer has with respect to its suppliers.
4. Both types of buyer power results in lower input prices, though the lower price obtained from monopsony power is achieved through the act of purchasing less, whereas the lower price obtained from bargaining power is achieved through the threat of purchasing less.
5. Abuse of buyer power can arise through conduct by a buyer, motivated solely by the hope of gaining a competitive advantage that is likely to lessen suppliers' incentives to invest in new capacity, products and production processes, which is detrimental to the interests of consumers.
6. In determining whether abuse of buyer power exists, the Authority shall first assess in accordance with section 24 (2B) of the Act: the nature and determination of contract terms; the payment requested for access infrastructure; and the price paid to suppliers.

7. Once buyer power has been established, the Authority shall determine whether the conduct engaged in by the buyer amounts to abuse of buyer power and is prohibited under the Act.

A. INTRODUCTION

8. Contractual issues of buying and selling are no longer confined to trade law. This has become a topical issue in competition law and policy. An undertaking possesses buyer power if it can force sellers to reduce prices and/or impose other terms and conditions below the levels that would prevail in a competitive market.

9. This Guideline is not a substitute for the Act or Rules made under the Act and where there is conflict between the Guideline and the Act or Rules, the latter shall prevail.

10. The Guideline does not constitute legal advice, and should not be relied on as a statement of law relating to the Act and other legal documents.

11. This Guideline may be revised, supplemented, or replaced from time to time in order to keep at par with dynamics in the legal and market spheres.

B. BUYER POWER

What is buyer power?

12. Buyer power is concerned with how downstream firms can affect the terms of trade with upstream suppliers.

13. The Authority considers that buyer power is the ability of a buyer to reduce price profitably below a supplier's normal selling price, or more generally the ability to obtain terms of supply more favorable than a supplier's ordinary contractual terms.

14. Therefore, an undertaking or group of undertaking having buyer power may influence the bargaining process eventually earning more favorable terms of trade to the detriment of the supplier.

Buyer power and consumer benefits

15. In general, buyer power is beneficial in two circumstances. First, when there are large efficiency gains (that result from the factors like size) giving the buyer its power and the efficiencies are passed on to the final consumer (e.g. through downstream competition). Secondly, when it exerts downward pressure on a supplier's prices and the lower prices are passed on to the final consumer.

Types of buyer power

16. There are two types of buyer power: monopsony power; and bargaining power, also known as countervailing buyer power.

17. A monopsony is a single (or dominant) buyer dealing with multiple sellers. Monopsony is the mirror image of monopoly, which forces up the market price for what it sells by restricting the amount it produces and thus moves up the market demand curve. The defining characteristic of monopsony power is that a buyer obtains a lower price by reducing the quantity it purchases.

18. In the case where there is effective competition among suppliers, the normal selling price of a supplier is the competitive price, and the buyer power is *monopsony power*. On the other hand, in the case where competition among suppliers is imperfect, the normal selling price is above the competitive price, and the buyer power is *countervailing power*.

Determination of Buyer Power

19. In determining whether buyer power exists or not, the Authority shall take into consideration:

a. The nature and determination of contract terms;
b. The payment requested for access infrastructure; and
c. The price paid to suppliers.

20. The Authority will therefore consider an undertaking to have buyer power if, in relation to at least one supplier, it can credibly threaten to impose a long term opportunity cost (i.e. harm or withheld benefit).

21. In evaluation of buyer power, the Authority will among others review;

a. terms of supply contract between suppliers which include listing fees, discounts, slotting allowances, volume rebates, contribution to promotional expenses, most favored customer clauses, and exclusivity requirements.

b. The actual position and concentration of the buyer undertakings in the market relative to supplier undertakings; a monopsonist may extract the maximum from suppliers, without any reduction in output.

c. The commercial significance of the products in relation to the buyer undertaking. If the buyer is dependent on the delivery of the product on a short-term or steady basis, it will not be feasible to exert much pressure on the seller.

d. The buyer's significance to the seller: If the buyer accounts for a significant share of the seller's output, and the seller has poor alternatives, then the buyer's refusal to purchase may allow it to counter possible exercises of dominance. A case of particular importance is when the buyer is a gateway to a downstream market.

e. The ability of the buyer undertaking to easily switch to competing suppliers and the supplier to easily switch buyers. The credibility of a threat to use an alternative source of supply is closely connected to the switching cost that the buyer would have to incur. High switching cost may make it unprofitable for the buyer to change its supplier and, therefore, undermine any threat to resort to alternative sources of supply

f. Availability of substitutes: The ability of the buyer to credibly threaten to resort, within a reasonable time frame, to alternative sources of supply, and hence to refuse to buy products from the seller. Such sources may be actual or potential competitors of the supplier or encouraging and assisting market entry by new competitors. This also includes the nature of the products such as perishable goods.

g. Ability of the buyers to integrate vertically, for example, through acquisition of manufacturer or to establishing new production facilities for future in-house supply.
h. Buying habits and procedures: In circumstances where buyers choose their suppliers through procurement auctions or tenders, competition may be intense even though only a few suppliers exist and participate in the bidding or auction process.

C. ABUSE OF BUYER POWER

After the Authority has established that buyer power exists, it shall then determine existence of any practice(s) that constitute abuse of buyer power.

Must the buyer be dominant?

22. It is not necessary for the buyer to have a dominant position in the market. Although the provisions of abuse of buyer power are included under the provisions of abuse of dominant position, when assessing conduct that amounts to abuse of buyer power, proof of dominance is not a mandatory criteria.

Conduct that may amount to abuse of buyer power

23. Acts constituting abuse of buyer power, shall include:

a. bidding up prices of inputs by a buyer undertaking with the aim of excluding competitors from the market;

b. Late payment; where a buyer undertaking delays payment without justifiable reasons in breach of agreed terms of payment to suppliers;

c. demand for preferential terms by buyer undertakings which are unfavourable to the suppliers or demanding limitations on supplies to other buyers;

d. a buyer undertaking depressing prices by a small but significant amount where there is difficulty in substitutability of alternative buyers or a buyer undertaking reducing prices below competitive levels;

e. De-listing; Unilateral termination of a commercial relationship without notice, or subject to an unreasonably short notice period and without an objectively justified reason;

f. Threat of de–listing; Use of delisting threats to obtain undue advantage and suppress suppliers from raising genuine complains against the buyers,

g. Unjust return of goods; Return of goods which the buyer purchased from a supplier;

h. Transfer of costs; where buyers transfer costs or risks to suppliers by imposing a requirement for the suppliers to fund the cost of a promotion,

i. Transfer of risks; Transferring commercial risks meant to be on buyer to the suppliers;

j. Refusal to receive ordered goods; A buyer's refusal to accept delivery of goods for reasons not attributable to the supplier after having entered into a contract, and if it is unavoidable for the transacting party to accept such refusal from concerns about the possible effects on future transactions, unjustly impose a disadvantage on the transacting party in light of normal business practices; and

k. Unfavorable treatment like demanding lower buying prices than all other suppliers or demanding limitations on supplies to other buyers.

D. CONSEQUENCES OF INFRINGEMENT

24. Section 24(3) of the Act provides that any person who contravenes the provisions on abuse of buyer power commits an offence and shall be liable on conviction to imprisonment for a term not exceeding five years or to a fine not exceeding ten million shillings or to both.

25. The Authority also has the discretion to pursue remedies through administrative means provided under sections 34- 38 of the Act.

26. The Authority will endeavor to remedy breaches of abuse of buyer power through administrative procedures.