

ENDING WALMART'S RURAL STRANGLEHOLD

**A plan to rebuild rural America's
food supply chain with the revival of
rural economies for workers, ranchers
and farmers by reinvigorating the
marketplace and reining in Walmart's
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A Plan to Rebuild Rural America's Food Supply Chain with the Revival of Rural Economies for Workers, Ranchers and Farmers by Reinvigorating the Marketplace and Reining in Walmart's Anti-Competitive Practices

The Department of Justice/Department of Agriculture workshops on agriculture and antitrust enforcement issues represent an enormous opportunity to rebuild and revitalize rural America by ensuring justice and fairness for working men and women across the food industry.

At the first Justice/Agriculture hearing held in March 2010, Secretary of Agriculture Tom Vilsack cut to the heart of this issue when he said the central focus of these workshops was to determine if the marketplace was "providing a fair deal for all."

In the food supply chain, these workshops have largely focused on the relationship between the food manufacturers and the producers (farmers), exploring whether the consolidation and partial vertical integration of manufacturers has unfairly disrupted their market relationship with producers.

In this paper, we suggest that just as important is the relationship in the food supply chain between retailers (dominated by Walmart) and food manufacturers. We would note that only one segment of the meat supply chain has managed to snag an ever-increasing share of the consumer dollar—the retailer.

It must be asked how did the distribution of the grocery store dollar get so skewed? What facilitated this shift? What impact has this shift had on workers and farmers? And what has this shift meant to rural agribusiness and rural economies?

We can't underestimate the importance of these questions. Agriculture is an important driver of the U.S. and global economies. Meat production accounts for over half of the total annual receipts generated by U.S. agricultural economy, exceeding \$100 billion in some years.¹

We believe that the increased power of America's largest retailer, Walmart, has been one of the major driving forces pushing increased consolidation in the packing industry and decreased farmer and packer revenues since 1980. This would suggest that the existing Justice/Agriculture investigation should be broadened to include the Federal Trade Commission and specifically investigate the role of a dominant retailer in dictating economic conditions down the entire food supply chain.

It is our belief that crafting appropriate antitrust responses to this historically unprecedented consolidation in the retail sector is critical to ensuring a stable and competitive marketplace for agriculture.

Without the development of such responses, we fear that antitrust initiatives pursued against meatpackers and other food processors will fail to

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¹USDA Online Briefing Room: *Animal Production and Marketing*; accessed 23 July 2010 at: <http://www.ers.usda.gov/Briefing/AnimalProducts/>.

effectively address the negative impacts of increasingly consolidated agricultural markets and would ultimately have a negative impact on hundreds of thousands of workers in our nation's meatpacking and food processing plants.

LESS MONEY FOR FARMERS, LESS MONEY FOR PACKERS

Much attention has been paid to the rapid consolidation in the meatpacking industry over the last three decades. Indeed the numbers are staggering, for red meat the four-firm concentration ratio (CR-4)—which measures the percentage of the market share of the top four firms—tripled from 19% in 1977, to 59% in 2002.²

For companies slaughtering hogs, the CR-4 nearly doubled from 34% in 1980, to 65% by 2007. For cattle slaughter, the CR-4 more than doubled from 36% in 1980, to 80% by 2007.³ There is no denying this dramatic growth in livestock market consolidation since market deregulation began in earnest in the 1980s. There's also no denying that this trend is troubling, and deserves the increased scrutiny being provided by these five Justice/Agriculture public workshops.

A superficial examination of this issue might conclude that meatpackers seeking the economies of scale—and associated increased efficiencies—is the only impetus for the consolidation trend. Indeed, in some instances, packers have sought and realized these gains. However, it has not only been the farmer that has borne the costs of this growth drive by the packing industry. The risks for meatpacking workers in increasingly large, fast-moving and industrial meatpacking facilities have not lessened as multinational packers have continued to grow and increase their market share.

But the large packing companies do not exist in a vacuum and it is important to take a step back to examine the entire meat supply chain.

In the 1980s, consolidation sent shock waves across the retail industry. By the late 1980's and 1990's that trend had accelerated, aided by an emerging player on the national grocery retailing scene – Walmart. Walmart hastened the trend of national retailers grabbing an ever growing share of the consumer dollar by using its size to extract lower prices from suppliers.

In fact, the concentration ratio for the top five food retailers (CR-5) doubled from 24% in 1997, to 48% by 2006.⁴ Walmart has clearly been a major driver of that concentration. The company is by far and away the

²U.S. Bureau of the Census *Reports on Concentration Ratios in Manufacturing*; cited in *Structural Change in the Meat, Poultry, Dairy, and Grain Processing Industries*; USDA Economic Research Service; Report Number 3, p. 12.

³2008 *Annual Report*; Packers and Stockyards Program; USDA Grain Inspection Packers and Stockyards Administration; March 2009; p. 46.

⁴*Concentration of Agricultural Markets*; Mary Hendrickson and William Heffernan; Department of Rural Sociology; University of Missouri; prepared with financial assistance from National Farmers Union; April 2007; p. 4.

Because of its sheer size, Walmart has tremendous impact on the markets for all agricultural products. Walmart's influence and its methodology for success are clear: use its strength and size in the market to drive down its costs by driving down the amount of money it pays its suppliers.

largest global retailer. It also is the largest retail grocer in the United States with revenues of \$150 billion annually, dwarfing its nearest competitors as discussed later in this paper.

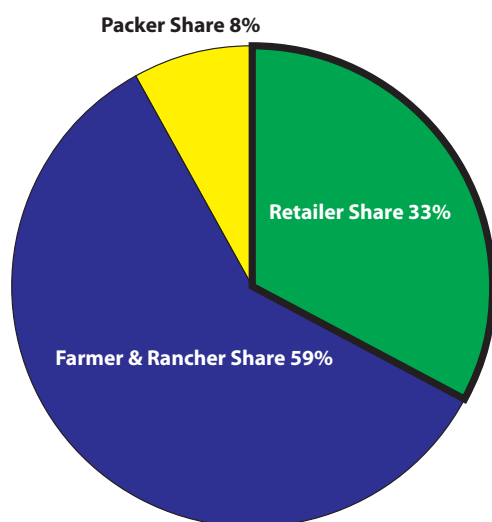
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The influence on America's agricultural economy has been staggering.

As seen in the charts below, in 1990 if you were to dissect the share of each consumer dollar spent on beef, it would have been distributed across the food supply chain as follows: \$.59 for the farmer and rancher; \$.08 for the packer and the packinghouse worker; and \$.33 for the retailer.

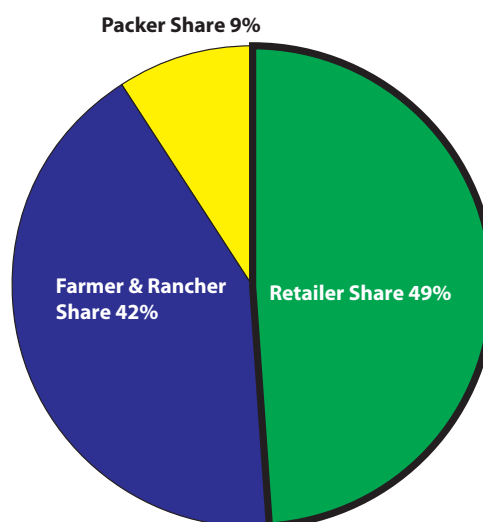
Distribution of the Consumer Beef Dollar in 1990

Source: USDA Economic Research Service



Distribution of the Consumer Beef Dollar in 2009

Source: USDA Economic Research Service



By 2009, the economics of the industry had drastically changed and the distribution of the consumer beef dollar had been significantly altered: Today, the rancher/farmer's share has plummeted to \$.42; the packers share has risen slightly to \$.09 (but still below their 1980 level) and the retailer's share has risen to \$.49.

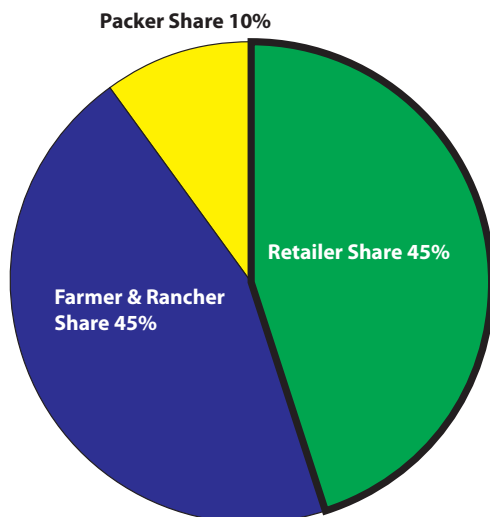
A similar shift can be seen in the consumer pork dollar over the same time period. If you were to dissect the share of each consumer dollar spent on pork in 1990, the farmer's share would have been \$.45; the retailer's share would have been \$.45; and the packer's share (including meatpacking workers' share) would have been \$.10. By 2009, the retailer had risen dramatically to \$.61 over its 1990 share of \$.45. In the meantime, the farmer share had fallen to \$.25; while the packer (and worker share) has risen slightly to \$.14 (also still below its 1980 historic levels).

While packers saw modest increases in their share of the consumer dollar over this period, the only real winners were retailers that took an ever-increasing portion of the consumer meat dollar.

Prior to Walmart's dramatic entry in the grocery retail market, meatpackers and workers in 1980 received 12% of the retail beef dollar and 19%

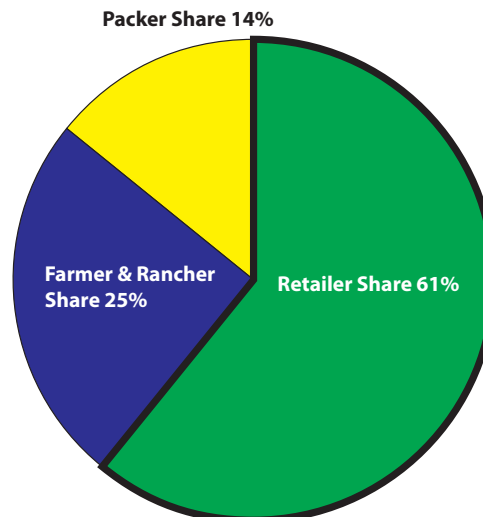
Distribution of the Consumer Pork Dollar in 1990

Source: USDA Economic Research Service



Distribution of the Consumer Pork Dollar in 2009

Source: USDA Economic Research Service



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of the retail pork dollar. Throughout the 1980s, however, the meatpacking industry had already begun to experience an initial phase of consolidation, which transformed the industry. New corporate players bought out established companies. Specialization, centralization and other factors—such as an intentional systematic effort of packers to break meatpacking unions—closed old plants and opened new ones, resulting in lower worker wages and devastation to the rural communities that had historically depended on meatpackers.

The unprecedented growth in meatpacker consolidation of 1980s continued throughout the 1990s and 2000s. But despite this unprecedented consolidation, Walmart's entry into the retail grocery market in the early 1990s, and the company's meteoric rise to become the number one grocery retailer, gave it unprecedented buyer power over the packers to continue exerting strong downward pressure on prices paid to suppliers, preventing the meatpackers, workers and farmers from recovering their previous share of the consumer meat retail dollar.

THE STAGGERING GROWTH OF WALMART

As Food & Water Watch noted, "The regional and local supermarket chains that dominated the economic landscape through the 1980s largely disappeared over the past 20 years. At the same time, national supercenters and discounters have emerged as new grocery retailer powerhouses. These consolidated retailers can exert seller power over consumers and leverage buyer power over the food manufacturing, meat processing and produce suppliers."⁵

And there has been no more powerful, and in many cases destructive, presence in this transformed retail landscape than Walmart,

⁵Comment of Food & Water Watch to joint Department of Justice/Department of Agriculture hearings on agriculture industry consolidation 12/31/2009.

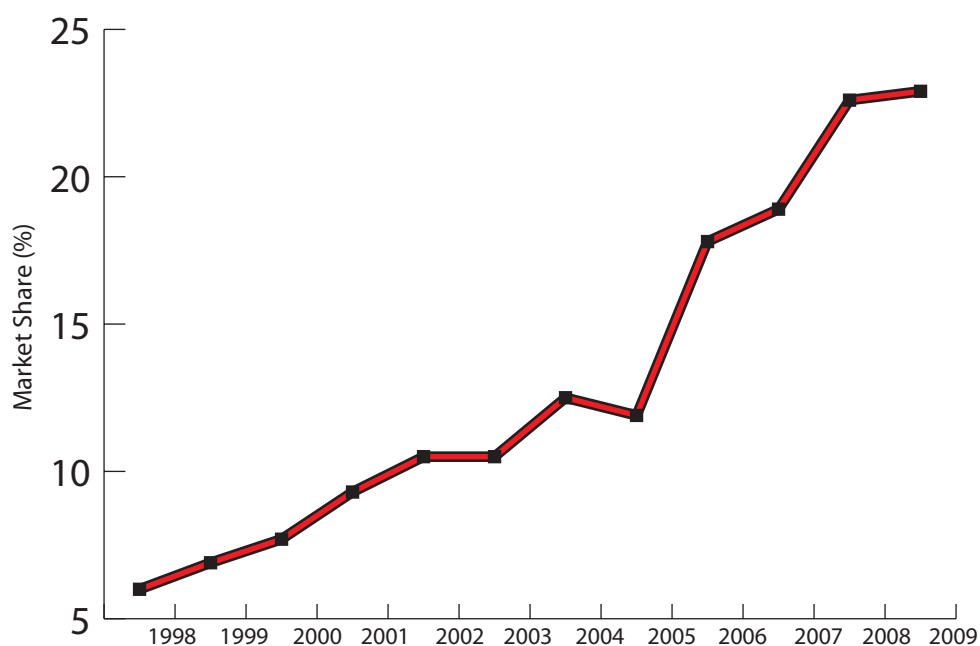
which hovers above our nation's agribusiness sector like a puppeteer, manipulating the strings of commerce in ways that are anything but entertaining for those who live and work in rural communities.

Walmart is the largest retailer (and the largest private-sector corporation) in the world, with total sales that are greater than the combined sales of the next five largest U.S. retailers: CVS Caremark, Kroger, Costco, Home Depot, and Target.⁶

Walmart's dominance also extends to the retail grocery sector. Walmart's 2009 U.S. grocery sales of about \$150 billion is almost twice the sales of its closest competitor, Kroger, and greater than the combined sales of its three closest competitors, Kroger, Safeway, and Supervalu.⁷

Walmart has reached this dominant position in a relatively short period of time, growing from less than 6% of the U.S. grocery market in 1998, to its current 23% of the national grocery market as shown in the graph below.⁸

Walmart's Share of the U.S. Grocery Market



Unfortunately, consistent data on Walmart's grocery market share are not available prior to 1998. However, for the more than a decade for which data is available, Walmart's stratospheric rise clearly parallels the rise in

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⁶Calculated from company sales disclosed in latest 10-K filings with the SEC.

⁷Walmart's total U.S. grocery sales calculated as the sum of grocery sales for its Walmart Stores and Sam's Club segments, using sales and grocery share of sales data from the latest 10-K. The comparison with competitors used total sales for Kroger and Safeway and retail grocery segment sales for Supervalu (which also has a wholesale segment); all figures were obtained from the respective 10-Ks.

⁸Market share for Walmart was calculated as the ratio of the grocery sales obtained as described in footnote 6 for each year analyzed to nationwide grocery sales for the respective year obtained from the annual *Directory of Supermarket, Grocery and Convenience Store Chains*, published by Chain Store Guide. The company reported grocery sales for both its Walmart Stores and Sam's Club segments starting in 1998.

In some states, Walmart controls more than 30% of the grocery market in every major region. In fact, in 29 markets across the country, Walmart's share of the grocery market exceeds 50%.

the amount of the consumer meat dollar that is kept by the retailer.

Additionally, no retailer has managed to concentrate and use their power more effectively than Walmart. In some states, Walmart controls more than 30% of the grocery market in every major region. In fact, in 29 markets across the country, Walmart's share of the grocery market exceeds 50%.⁹ This can be particularly crippling to perishable product suppliers located in these areas, such as dairies and dairy farmers, who may have no alternative sales outlets due to the temporary nature of their product.

This domination by Walmart of the retail grocery market nationwide and in local markets makes the company an effective gatekeeper between food producers and consumers. Any food producer intending to sell their products nationally or in specific local markets needs to sell their products in Walmart's stores in order to reach a sizable number of consumers. This gatekeeper role explains why Walmart accounts for such large shares of the sales of major meatpacking and food processing companies, as documented below. It also explains why Walmart's suppliers have no choice but to continue selling to Walmart in spite of the high-pressure negotiating tactics employed by the company documented later in this paper.

Despite a reluctance to speak publicly about the tactics of their largest customer, meatpackers and industry analysts tacitly admit the negative influence Walmart has had on their industry and how they dictate and control every aspect of meatpacking operations. When confronted by an activist farmer, John Tyson of Tyson Foods made it clear why Tyson believes they have to pay farmers less. "Walmart's the problem," he said. "They dictate the price to us, and we have no choice but to pay you less."¹⁰

Larry Pope, CEO of Smithfield Foods, admitted in a speech that meatpackers have trouble raising the prices they charge retailers even if costs increase because of Walmart's intense pressure.^{11,12}

In the same article, Tom Johnston of *Meating Place*, a meat industry journal, described an increasing consensus in the industry about Walmart's influence stretching beyond just prices: "[Walmart] is exerting even more leverage by demanding more information about how suppliers make their products and asking them to implement sustainable practices that don't financially correlate with low-cost production."¹³

Walmart's market power is such that despite their size, meatpackers

⁹Data reported for the year 2009 by Metro Market Studies, a commercial market share data provider.

¹⁰Walters, Chris "Restoring Market Access: Bypassing the Industrial Meat Monopoly," *Acres USA*, May 2010.

¹¹Johnston, Tom "Pope paints a bleak picture of future for meat industry" *Meating Place* February 12, 2010

¹²Johnston, Tom "The Issues: How low can you go?" *Meating Place* May 2010, p. 22

¹³Ibid.

are left with few other options. “Walmart today [is responsible for] anywhere from 15% to 30% of any supplier’s volume,” said retail analyst Neil Stern. “They are such a dominant force that as a supplier you can push back or say, ‘Hey, I’m not happy with this,’ but if you want that volume ... what are you going to do?”¹⁴

Raoul Baxter, a former Sara Lee and Smithfield executive acknowledged the tough spot the meatpackers find themselves in because of Walmart’s pressure. “Meat is really tough. You have such unbelievable, never-ending capital requirements, product uncertainties ... and then how much cheaper is it possible to go? Just to have the honor of saying, ‘I’m selling to Walmart but not making any money.’ Walmart is smart; they know they have to allow suppliers to live as long as their competitors are choking. And people wonder why packers have shrunk.”¹⁵

Additionally, those who might doubt Walmart’s influence on the meat-packing industry would do well to mind the cautionary tale of the produce industry. National retailers have forced increased consolidation to such a level that the top two bagged salad companies grow and bag 76% of bagged salad for grocery sales. Retailers increasingly buy from these grower-shippers, cutting out what middlemen and small operators that previously existed in the industry.¹⁶

In fact, an USDA study concluded that retailers were able to hold shipper prices below competitive levels for grapefruit, apples and tomatoes, and consumer prices in excess of purely competitive prices for apples, oranges, grapefruit, fresh grapes, tomatoes and lettuce.¹⁷

As Walmart continues to enhance its power and reaches further and further back into the supply chain, this could clearly be the future for America’s meat-producing farmers and ranchers.

SUPPLY CHAIN STRANGLEHOLD

In a recent essay in *Washington Monthly*, entitled “Who Broke America’s Jobs Machine?”, Barry Lynn and Phillip Longman illustrate how retailers, such as Walmart, use their enormous footprint, coupled with their vast buying power, to influence every aspect of a supplier’s business operations.

Lynn and Longman write:

“As behemoth retailers garner ever more power over the sale of some product or service, they also gain an ever greater ability to strip away the profits that once would have made their way into the hands of their

¹⁴Ibid.

¹⁵Ibid.

¹⁶Comment of Food & Water Watch to joint Department of Justice/Department of Agriculture hearings on agriculture industry consolidation 12/31/2009

¹⁷Dimitri, Carolyn, et al, “U.S. Fresh Produce Markets: Marketing Channels, Trade Practices, and Retail Pricing Behavior,” U.S. Department of Agriculture Economic Research Service Report Number 825, p. 4, September 2003.

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suppliers. The money that the managers and workers at these smaller companies would have used to expand their business, or upgrade their machinery and skills, is instead transferred to the bottom lines of dominant retailers and traders and thence to shareholders.”¹⁸

As the dominant seller of groceries in the U.S., it is obvious that Walmart would also be a dominant buyer of food products from suppliers.

Customer information from required Securities and Exchange Commission (SEC) yearly filings (also known as 10-K reports) of major U.S. publicly traded food suppliers was compiled, and it was found that a sizable number of major companies had large shares of their sales going to Walmart. The table below shows the shares of sales to Walmart of selected food suppliers with sales to Walmart exceeding 10%. This level, referred to as the “threshold of materiality,” is the level at which the SEC deems the relationship to be of such important value to a company that it must be disclosed to investors. It is a tacit acknowledgment of the power a client of that size has over a company.

SHARE OF SALES OF SELECTED FOOD SUPPLIERS TO WALMART¹⁹

Company	Sales (\$ millions)	Share of Sales to Walmart	Sales to Walmart (\$ millions)
Kraft	\$40,386	16.0%	\$6,462
Tyson	\$26,704	13.8%	\$3,685
General Mills	\$14,691	21.0%	\$3,085
ConAgra	\$12,731	16.0%	\$2,037
Kellogg Co.	\$12,587	21.0%	\$2,643
Dean Foods	\$11,158	21.0%	\$2,343
Hormel	\$6,534	13.0%	\$849
Smucker	\$3,758	24.0%	\$902
Del Monte Foods Co.	\$3,740	34.0%	\$1,272
Flowers Foods	\$2,601	20.5%	\$533
Cott Corp.*	\$1,597		
Cal Maine Foods	\$929	32.9%	\$306
Lance, Inc.	\$918	22.0%	\$202
Diamond Foods, Inc.	\$571	21.0%	\$120

* Cott Corp. has greater than 10% of its sales going to Walmart, but it does not disclose the exact share.

Even though two leading meat companies, Smithfield and JBS, state that not more than 10% of their sales, and not more than 5% of their sales, respectively, go to any single customer, they may be more de-

¹⁸Lynn, Barry C. and Phillip Longman, “Who Broke America’s Jobs Machine?,” Washington Monthly, March/April 2010.

¹⁹Company sales and share of sales to Walmart found from respective company 10-Ks.

pendent on Walmart than they appear.²⁰ This is because companies such as Smithfield and JBS rely on sales to further processors (such as Kraft) who are, in turn, highly dependent on sales to Walmart.

The dependence of suppliers on sales to Walmart creates an unequal bargaining relationship between Walmart and its suppliers. Anecdotal evidence continues to accumulate revealing the leverage that Walmart has in negotiating price and non-price terms with its suppliers; the sometimes disastrous impact on a company's finances when Walmart drops it as a supplier; the control that Walmart exerts on suppliers' businesses; the pressure on suppliers to consolidate in response to Walmart's buyer power; and the palpable fear that suppliers have of talking publicly about their relationship with Walmart.

Walmart uses its sales database to gain insight into its suppliers' sales that is sometimes superior to the suppliers' knowledge about their own sales. Walmart also demands access to routine business information from their suppliers, such as their material, energy and labor costs. Consequently, Walmart can exert a tremendous amount of control on the operations of its suppliers, by using this knowledge to "virtually dictate the terms of its contract on price, volume, delivery schedule, packaging and quality."²¹ Walmart squeezes suppliers financially by "shifting every imaginable cost, risk and penalty onto their books."²²

A few concrete examples of Walmart's power and control over suppliers follow.

- As part of its Sustainability Index initiative,²³ Walmart is collecting detailed information from suppliers on their use of materials, energy, water and packaging, the first step towards which is a questionnaire that Walmart suppliers are being asked to complete.²⁴ While this information is ostensibly to help Walmart and the suppliers collaboratively develop more sustainable means of production, it is also information that Walmart uses to pressure suppliers to reduce costs. According to Walmart, suppliers who do not participate would not be penalized, but "then they're probably less relevant to us."²⁵ The implicit threat in this statement is likely to pressure most suppliers to share their data with Walmart.
- Members of the United Food and Commercial Workers have had

²⁰JBS is a Brazilian company that is not yet required to file a 10-K with the SEC. However, they are in the process of an Initial Public Offering (IPO) in the U.S., and have filed a Registration Statement with the SEC. The statement that no single customer accounts for 5% or more of company revenues is from the Registration Statement (amendment #2), Form S-1, page 176, dated 12/23/2009.

²¹Lichtenstein, Nelson, "The Retail Revolution: How Wal*Mart Created a Brave New World of Business," Chapter 2, "Supply and Command," Metropolitan Books, Henry Holt and Company, 2009.

²²Ibid.

²³www.sustainabilityconsortium.org

²⁴The questionnaire is available at <http://walmartstores.com/Sustainability/9292.aspx>

²⁵"At Wal-Mart, Labeling to Reflect Green Intent," New York Times, 7/16/2009.

direct experience of the impact of Walmart's pressure on suppliers in the food processing industry. A UFCW member testifying at the Justice/ Agriculture joint workshop on dairy consolidation on behalf of another member (who wished to remain anonymous because of fear of retaliation), stated that the latter worked in a dairy processing facility in an area where Walmart has a greater than 30% market share in seven out of eight metropolitan areas, and almost 50% in one of these seven areas. Walmart had been a major customer of his employer, but ended the supply contract to find cheaper milk. Subsequently, the dairy processor pressured workers to "work harder and faster for no extra pay in an attempt to woo Walmart back."²⁶

- At the same workshop, John Wilson, Senior Vice President of the cooperative Dairy Farmers of America (DFA), stated that: "...in a world of consolidating retailers and consolidating processors...in order to help themselves, [members of the four cooperatives that merged to create DFA] would be better off coming together and working as one cooperative."²⁷ This statement is direct testimony to how increasing buyer power pressures food producers to consolidate—and how the greatest degree of retailer buyer power is exerted by one company, Walmart.
- In the late 1990s, pickle manufacturer Vlastic contracted with Walmart to sell gallon jars of pickles, for which Walmart set the price at \$2.97. Sales of the jars "went through the roof" according to the head of Vlastic's Walmart sales team, and consequently Vlastic experienced rapid sales growth and dominant market share in pickles. However, profits shrank as sales of the gallon jars cut into sales of its higher margin cut and sliced pickles. Vlastic's Vice-President of Marketing begged Walmart for relief: "We said we'll increase the price" —even \$3.49 would have helped tremendously—"and they said, 'If you do that, all the other products of yours we buy, we'll stop buying.' It was a clear threat." By the time Walmart finally relented and allowed Vlastic to go down to a half gallon size at \$2.49, profits had shrunk by 50%. Immediately thereafter, Vlastic filed for bankruptcy.²⁸
- Many Walmart suppliers (including major companies like FedEx and IBM) refused to be interviewed by journalist Charles Fishman for his book *The Wal-Mart Effect*, refused to talk about Walmart in their interviews, or agreed to be interviewed only on the condi-

²⁶Statement by Irv Connelly, UFCW member, at the joint Department of Agriculture-Department of Justice Dairy Workshop, Madison, WI, 6/25/2010.

²⁷Statement by John Wilson, Senior Vice President, Dairy Farmers of America, at the joint Department of Agriculture-Department of Justice Dairy Workshop, Madison, WI, 6/25/2010, from the complete transcript of the workshop made available by the USDOJ at: <http://www.justice.gov/atr/public/workshops/ag2010/wisconsin-agworkshop-transcript.pdf>

²⁸Fishman, Charles "The Walmart Effect: How the World's Most Powerful Company Really Works – and How It's Transforming the American Economy," Chapter 4, "The Squeeze," Penguin Press, New York, 2006.

tion of anonymity. According to the CEO of what Fishman calls “an instantly recognizable consumer products company,” who spoke on condition of anonymity: “You know they have a tremendous impact on innovation, on the development of new products. You know they are enormously damaging in that arena. I applaud you trying to get people to talk about it. People need to know. At the same time, I can’t be connected to it at all. They wield so much power. If I talk at all, I am putting this whole company in extreme jeopardy. I’ll have to lay off hundreds of people.”²⁹

Barry Lynn calls Walmart “one of the world’s most intrusive, jealous, fastidious micromanagers, and its aim is nothing less than to remake entirely how its suppliers do business, not least so that it can shift many of its own costs of doing business onto them.”³⁰

As if to demonstrate the point, Walmart recently announced that it was seeking to take over U.S. transportation services from suppliers in an effort to cut costs. A retail expert for Kantar Retail described Walmart’s new program as the company “reaching further back into the supply chain.”³¹ It is only the most recent example of Walmart’s quest for control over every aspect of its supply chain.

As Lynn summarized, “The problem is that Walmart, like other monopsonists, does not participate in the market so much as use its power to micromanage the market, carefully coordinating the actions of thousands of firms from a position above the market.”³²

THE DAMAGING ANTICOMPETITIVE EFFECTS OF WALMART’S BUYER POWER

Walmart’s buyer power has potential adverse effects on consumers of food in a number of different ways: adverse effects on price, product safety and choice.

ADVERSE EFFECTS ON PRICE

Paradoxically, Walmart’s pricing pressure on suppliers might actually lead to higher prices paid by consumers overall, because of a phenomenon called the “waterbed effect”.^{33,34} Briefly, the “waterbed effect” works as follows: suppose a large retailer and several smaller retailers have several suppliers in common, and that the large retailer negotiates favorable prices

²⁹Ibid.

³⁰Lynn, Barry C. “Breaking the Chain,” Harper’s Magazine, July 2006.

³¹“Why Wal-Mart Wants to Take the Driver’s Seat,” Business Week, May 28, 2010.

³²Lynn, Barry C. “Breaking the Chain,” Harper’s Magazine, July 2006.

³³Dobson, Paul, and Roman Inderst, “The Waterbed Effect: Where Buying and Selling Power Come Together,” Wisconsin Law Review, Vol. 2008 No. 2, 2008.

³⁴Inderst, Roman, and Tommaso M. Valletti, “Buyer Power and the “Waterbed Effect,”” Center for Economic and International Studies Tor Vergata, Research Paper Series, Vol. 6, Issue 1, No. 107, January 2008, accessed at <http://ideas.repec.org/p/rtv/ceisrp/107.html>

for itself from these suppliers, while the smaller retailers lack the capacity to do so. The suppliers will then have the incentive to raise prices charged to the smaller retailers to make up for the lost profits from sales to the large retailer. If the small retailers pass these increased costs on to consumers, then consumers overall may experience an increase in prices even if the large retailer passes its savings on to consumers.

There is some evidence that the waterbed effect could be occurring as a consequence of Walmart's pricing pressure on suppliers. In May 2010, Walmart started contacting U.S. suppliers, stating that it would start using its own trucking fleet to pick merchandise up directly from the suppliers' facilities, instead of having suppliers deliver the merchandise to Walmart distribution centers.³⁵ The stated rationale, according to a Walmart official quoted by Business Week, is to reduce costs by transporting goods more efficiently than the suppliers and to pass the savings on to consumers.

However, in at least two instances, Walmart has asked for wholesale price reductions of 6% in exchange for handling the trucking, while the suppliers' own estimate of trucking costs to Walmart distribution centers was 3% of the wholesale price. Additionally, suppliers will lose the economies of scale on their trucking fleets if their trucks no longer make deliveries for Walmart. There is a high probability of suppliers passing on these increased costs to other retailers, who in turn will likely pass them onto consumers, increasing prices paid by U.S. consumers overall.

"One side effect of the plan is that manufacturers may face increased transportation costs on deliveries to other retailers as they lose scale," said Randy Huffman, a former Walmart executive who now runs GBD 360, a Bentonville consulting firm that works with suppliers.

"That aligns with Walmart's taking cost out of the supply chain for their benefit and not their competitors," he said. "Suppliers are going to have to apply that increased freight cost somewhere, so it's more than likely it will be passed onto other retailers."³⁶

ADVERSE EFFECTS ON PRODUCT SAFETY

There is anecdotal evidence of pricing pressure from retailers leading to adverse effects on food safety. The 2007 pet food recall is an example of the food safety impact of pricing pressure.

Menu Foods is a Canadian pet food manufacturer supplying private label cat and dog food to a number of retailers, as well as supplying branded pet food companies on a contract basis.³⁷ In 2007, there was a major recall of pet food in the U.S., arising from use of imported wheat gluten from China that was contaminated with melamine to manufac-

³⁵"Why Wal-Mart Wants to Take the Driver's Seat," Business Week, 5/28/2010.

³⁶Ibid.

³⁷http://www.menufoods.com/about_us/customers.html

ture the pet foods.³⁸ Menu Foods was a key manufacturer implicated in the recall.^{39,40} Among the products recalled were Ol' Roy dog food⁴¹ and Special Kitty cat food,⁴² both Walmart private brands.

Immediately prior to the recall, Menu Foods had a large degree of financial dependence on its top three customers, who accounted for 42% of total sales, and particularly on its top customer, who accounted for 21% of sales.⁴³ As a result, Menu Foods appeared to have been particularly susceptible to pressure from its customers on pricing and terms. The company disclosed in its annual report for 2006 (the fiscal year immediately prior to the recall) that the price increases implemented that year were barely sufficient to make up for cost increases in the past, and that the benefits of the price increase were offset by ongoing increases in costs.⁴⁴ Also, the 2006 annual report states that Menu Foods' largest customer was reducing inventories, pressuring the company's sales.⁴⁵

The picture that emerges is of a supplier effectively dependent on sales to its top three customers (and particularly its one largest customer), and subject to pricing and other pressures from these customers. This gives the company the incentive to reduce its costs by seeking out cheaper supplies of ingredients, which in turn could lead to serious consequences for product safety.

The Menu Foods recall must also be seen in the context of Walmart's well-documented pressure on suppliers to cut costs, and evidence of Walmart's intense cost pressures leading to adverse social effects in areas other than product safety, such as sweatshop work conditions⁴⁶ or procurement of illegally logged wood.⁴⁷

³⁸U.S. Department of Health and Human Services, Food and Drug Administration, <http://www.fda.gov/ForConsumers/ConsumerUpdates/ucm048192.htm>

³⁹Ibid.

⁴⁰Menu Foods Income Fund, Annual Report, 2007, p. 2., available at <http://www.menufoods.com/Financials/docs/MenuFoods%20AR%202007%20FINAL.pdf>

⁴¹http://www.menufoods.com/recall/Dog/Ol'Roy%20US_043007.htm

⁴²http://www.menufoods.com/recall/Cat/Special%20Kitty%20US_043007.htm

⁴³Menu Foods Income Fund, Annual Report, 2006, p. 14, available at http://www.menufoods.com/financials/docs/annual_report_2006.pdf

⁴⁴Ibid., p. 2.

⁴⁵Ibid., p. 3.

⁴⁶"Wal-Mart Standards Fail, Workers Suffer: Investigation Shows Five Suppliers Fail to Meet Basic Standards," China Labor Watch, November 2009, available at http://www.chinalaborwatch.org/articles/2009_11_25/1109walmartstandardsfail.pdf. According to the report: "The case of Wal-Mart, the world's largest retailer, shows that corporate codes of conduct and factory auditing alone are not enough to strengthen workers' rights if corporations are unwilling to pay the production costs associated with such codes."

⁴⁷"ATTENTION WAL-MART SHOPPERS: HOW WAL-MART'S SOURCING PRACTICES ENCOURAGE ILLEGAL LOGGING AND THREATEN ENDANGERED SPECIES," Environmental Investigation Agency, January 8, 2008, available at www.eia-international.org. According to the report: "...costs must be cut from somewhere. A supplier might.....start procuring its raw material from cheaper sources, or turn a blind eye to how and where this raw material is being acquired. Low prices also translate into.....the squeezing of suppliers in ways that encourage unethical, unsustainable, and sometimes illegal practices. This chain of financially strategic decisions is precisely what facilitates and encourages illegal logging."

ADVERSE EFFECTS ON CONSUMER CHOICE

Pressure on food suppliers from their retail customers can drive mergers between competing suppliers as a means to form stronger companies to withstand these pricing pressures. This industry consolidation has the effect of reducing customer choice, by reducing the number of competing makers of products that a customer can choose from.

The growing buyer power of retailers, particularly Walmart, is one of the major factors driving this trend of consolidation, a fact that food industry leaders acknowledge. Bill Johnson, the CEO of Heinz, said at a recent consumer products industry conference:⁴⁸ “The increased concentration and power of our customers demands a different mindset...Larger retailers will drive the leverage scale, reduce inefficiencies, push down costs and improve top line results at our expense if we stand still....the pressure to perform will eventually lead to more efficient cross-industry sharing of assets, procurement capabilities and manufacturing capacity.”

THE CASE FOR GOVERNMENT INTERVENTION

“As you get over 30% and higher [market share], I am sure there is a point where government is compelled to intervene.” —Walmart CEO Lee Scott

The old saying goes that what’s good for the goose is good for the gander. Lee Scott clearly forgot that when he called for a government investigation into Walmart’s U.K. grocery rival in the Sunday Times.⁴⁹ In fact, Mr. Scott makes an unintentionally compelling case for government intervention in Walmart’s astonishing U.S. grocery market share growth. In 168 U.S. markets Walmart currently has more than 30% of the grocery market share, and in 29 of those markets Walmart has more than 50% of the grocery market share.⁵⁰ That means in 44% of U.S. grocery markets Walmart meets Mr. Scott’s threshold for government intervention.

What Mr. Scott recognizes, and what this paper argues, is that it is clear that in order to right America’s crippled agriculture economy caused by the oversized power that Walmart has over packers and farmers, appropriate government intervention is needed to curtail this company’s excessive buyer power and to bring fairness back to the marketplace.

Walmart’s market share far exceeds the amount necessary to wield

⁴⁸Bill Johnson, Chief Executive Officer, Heinz, speaking at the Consumer Analyst Group of New York (CAGNY) Conference, 2010, quoted in Barclay’s Capital Equity Research note to investors, 3/26/2010.

⁴⁹Fletcher, Richard “Wal-Mart calls for probe into dominant Tesco,” The Sunday Times, 28 August 2005.

⁵⁰Data reported for the year 2009 by Metro Market Studies, a commercial market share data provider.

“As you get over 30% and higher [market share], I am sure there is a point where government is compelled to intervene.”
—Walmart CEO Lee Scott

...in 44% of U.S. grocery markets Walmart meets Mr. Scott’s threshold for government intervention.

excessive power as a buyer. In previous cases, the Federal Trade Commission (FTC) has found that a market share as low as 20% was enough for a retailer to “call the shots” when it came to their suppliers and lead to an FTC complaint.⁵¹

As Albert Foer, President of the American Antitrust Institute, points out, monopsony power has grown in the retail sector:

“Channels of distribution have not remained in place, however. Today, with the emergence of big box retailers and the consolidation of chains at both the retailing and supplying levels into a much smaller number of mega-chains, the relative bargaining strength of manufacturers and retailers has been reversed.”⁵²

Additionally, some lawyers and academics have theorized that the regional concentrations of power, regardless of national market share can abuse their market power to increase their profits. Peter Carstensen, a Professor at the University of Wisconsin and former Justice Department anti-trust lawyer, points to the example of the dairy industry. A large regional retailer may be able to drive down the price of suppliers in one region, reducing output there, but might purchase additional supplies from other markets at higher prices, such that prices to consumers will not go up but monopsonist’s profits will increase.⁵³

The damaging effects of consolidation by a major retailer can be seen beyond just the prices and choices available to consumers. The aftershocks are seen across the market. Foer says “Consolidation at the supplier level is promoted because even very large suppliers are not able to bargain as equals with Walmart—so the strongest try to bulk up to create countervailing power while the weaker see a bleak future and conclude they must exit the market for the maximum current value—by selling out before it is too late. It is widely believed that the Proctor & Gamble acquisition of Gillette was of this countervailing power nature.”⁵⁴

WALMART’S GLOBAL BUYING POWER

Walmart, as a player in markets around the world, has brought its heavy-handed tactics to other countries where they are active. Their tactics have not gone unnoticed overseas, and the results of an investigation into retail grocery activity in the United Kingdom can provide an example of what might be found in the United States should the government conduct a similar investigation.

The Competition Commission (CC)⁵⁵, an agency of the U.K. government, works to “ensure healthy competition between companies in the

⁵¹FTC vs. Toys R US, cited at Foer, Albert A. “Mr. Magoo Visits Wal-Mart: Finding the Right Lens for Antitrust,” American Antitrust Institute Working Paper 06-07, 30 November 2006.

⁵²Foer, p. 6.

⁵³Ibid.

⁵⁴Foer, p. 19

⁵⁵www.competition-commission.org.uk

“Consolidation at the supplier level is promoted because even very large suppliers are not able to bargain as equals with Walmart.”

—Albert Foer,
President of the American
Antitrust Institute

U.K. for the benefit of companies, customers and the economy.” The CC investigates issues affecting free and fair competition, including markets in which there is a likelihood of competition being “prevented, distorted or restricted.”

In 2006, the CC was tasked with investigating the grocery retail market in the U.K., based on “reasonable grounds” for suspicion that competition was being prevented, distorted or restricted.⁵⁶ The CC performed an in-depth two-year investigation, obtaining submissions from multiple parties such as suppliers, retailers, wholesalers, consumers, trade associations, unions, and non-governmental organizations. The CC also used its subpoena powers to obtain e-mails and other communications, including communications between retailers and their suppliers. The investigation covered multiple areas in which it was suspected that competition was being distorted, including pricing and promotions, acquisition and retention of real estate by retailers and buyer power. The following focuses only on the buyer power issue relevant for this paper.

The investigation produced a series of preliminary reports, working papers, and recommendations. The entire output of the investigation as well as all submissions from stakeholders are available on the CC website.⁵⁷ All the large national grocery retailers (including Tesco, the parent of Fresh and Easy in the U.S.; and ASDA, a subsidiary of Walmart) were investigated, along with a number of regional chains and “symbol groups” (the U.K. term for chains of independently owned stores operating under a common franchise).

A number of small U.K. food producers provided written testimony to the CC – some of it anonymously for fear of retaliation – about how the large retailers pressure them to reduce costs to a point where it is unsustainable for them to stay in business. These submissions from producers speak directly to the issue of how large retailers use their buyer power to capture the profits from upstream suppliers, a fact that has also been documented in the figures previously in this paper.

For example, a free range egg producer testified that, after he was informed of a price increase for his eggs, leading retailers Tesco and Walmart dropped their retail price for eggs and informed him that he would not get the promised price increase. Subsequently, the supermarket prices of eggs rose by between 16 and 20 pennies per dozen, while he received a price increase of only two pennies per dozen.⁵⁸

One anonymous supplier stated that large retailers routinely demanded retrospective payments and “support” payments partway

⁵⁶Terms of Reference for the Competition Commission’s groceries market investigation, issued by the Office of Fair Trading (OFT) under Section 131 of the Enterprise Act of 2002, available at www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/core_terms_of_reference.pdf

⁵⁷www.competition-commission.org.uk/inquiries/ref2006/grocery/index.htm

⁵⁸Submission by Frank Thompstone to the Competition Commission Groceries Market Investigation, 1/23/2007, available at http://www.competition-commission.org.uk/inquiries/ref2006/grocery/third_party_submissions_suppliers.htm

through agreed supply periods, deliberately delayed paying invoices, and disregarded terms of contracts.⁵⁹

Another anonymous supplier of fresh produce testified that large retailers exert pressure on suppliers to sell at a loss: “I am pressured into supplying produce at a very hefty loss when there is a shortage. I get threatened that I will get a black mark if I don’t supply even if it is at a loss. We get score cards sent by e-mail every week telling us how we are getting on against other suppliers. If you fall below a certain percentage you get marked down.”⁶⁰

A supplier of ingredients to food manufacturers (and therefore an indirect supplier to large retailers), while offering testimony generally supportive of large retailers, admitted that: “My customers are under intense pressure from retailers to reduce prices. This is reflected back to us as suppliers. This pressure includes a progressive devaluation or reduction of the quality of the product reaching retailers.”⁶¹

A supplier of snack food products to independent retailers testified about the waterbed effect. According to this supplier, large retailers “are ruthless in their attitude to their suppliers, manufacturers and growers demanding cheaper prices, large discounts and rebates, forcing them to supply at very near cost prices. These suppliers then need to demand higher prices to meet the shortfall in profit. Added to this many [large retailers] demand large cash contributions from their suppliers to buy shelf space for their products. This means that, generally, the...independent retailer has struggled for many years to survive with this unfair competition from the [large retailers].”⁶²

A wholesaler, similarly, testified about the waterbed effect: “...supermarkets are selling products at around 24% cheaper than we as an independent wholesaler can buy at from the manufacturers.”⁶³ (Emphases in original.)

The following is a brief summary of the CC’s findings on buyer power.⁶⁴ A grocery retailer exercises “buyer power” when it obtains a better deal

⁵⁹Submission by “Supplier A” to the Competition Commission Groceries Market Investigation, 6/22/2006, available at http://www.competition-commission.org.uk/inquiries/ref2006/grocery/third_party_submissions_suppliers.htm

⁶⁰Submission by “Supplier B” to the Competition Commission Groceries Market Investigation, 8/15/2006, available at http://www.competition-commission.org.uk/inquiries/ref2006/grocery/third_party_submissions_suppliers.htm

⁶¹Submission by Parsons Trading Ltd. to the Competition Commission Groceries Market Investigation, undated, available at http://www.competition-commission.org.uk/inquiries/ref2006/grocery/third_party_submissions_suppliers.htm

⁶²Submission by Springvale Foods to the Competition Commission Groceries Market Investigation, 6/5/2006, available at http://www.competition-commission.org.uk/inquiries/ref2006/grocery/third_party_submissions_suppliers.htm

⁶³Submission by Willett Bros. to the Competition Commission Groceries Market Investigation, 2/20/2007, available at http://www.competition-commission.org.uk/inquiries/ref2006/grocery/third_party_submissions_suppliers.htm

⁶⁴“Market investigation into the supply of groceries in the UK,” Competition Commission, final report of investigation, April 30, 2008, Section 9, pp. 155-173; available at www.competition-commission.org.uk/rep_pub/reports/2008/fulltext/538.pdf

from its suppliers in terms of prices, product quality or purchasing terms, than competing grocery retailers who do not have buyer power are able to obtain.

According to the CC, while in the short term the exercise of buyer power by grocery retailers can lead to lower prices for the consumer, in the longer term it has the potential to harm competition by restricting production capacity, consumer choice, product quality and product innovation, ultimately leading to harm to consumers.

Reviewing all the available evidence, the CC found that large grocery retailers have buyer power over at least some of their suppliers. The CC concluded that this exercise of buyer power has adverse effects on competition in the following ways:

- Retailers sometimes use their buyer power to negotiate terms in supply contracts which “transfer excessive risks or unexpected costs” to the suppliers, reducing the suppliers’ incentive to invest in increased production capacity and new product lines. This can “ultimately have a detrimental effect on consumers.”
- The transfer of risk from the retailer to the supplier can also set up what economists call a “moral hazard,” in which the retailer has control over the degree of a particular risk but has no incentive to minimize the risk.
- While the CC did not find evidence of a decline in suppliers’ product innovation, they expect that the level of innovation they observed would have been even higher in the absence of retailers’ exercise of buyer power, and are “concerned with the levels of investment and innovation that might be realized in the future were the supply chain practices that we currently observe to continue.”

OTHER FACTORS NEEDING FUTHER INVESTIGATION

It is clear that share of the retail dollar is not the only metric which needs to be explored. Over time, higher productivity in the farm and rancher sector implies lower share of the consumer dollar for that sector. Other areas for investigation by the Departments of Justice and Agriculture, as well as the Federal Trade Commission, should include:

- profits for farmers, packers, and retailers;
- changes in real wages for farm labor, packing/processing workers, and retail workers;
- productivity changes in these three sectors;
- vertical integration within the sectors; and
- food safety and bioterrorism threats posed by excessive buyer power that pressures suppliers to weaken food safety protocols for both domestic and imported food ingredients and results in increased dependence on too few suppliers. This pressure makes

the food chain overly susceptible to catastrophic collapse from natural or man-made disasters.

A CRITICAL JUNCTURE FOR ACTION

Americans sit at an unprecedented juncture in our history. Rarely have we had such an opportunity to restore the values of equality and fair play to a skewed and dysfunctional market. Through the Justice/Agriculture workshops, and by engagement of officials at the highest levels of these departments, the Obama Administration has shown that it understands the concerns of America's farmers, ranchers and meatpacking workers.

However, as part of this process, Walmart's pernicious effect on our agricultural economy must not go unexamined if we are truly to address the current situation. The Agriculture and Justice Departments and Federal Trade Commission should look beyond the relationship between processing and packing companies and farmers when considering the state of consolidation of agriculture markets. We urge the Obama Administration to include in this investigation an assessment of the role that the retail grocery sector is playing in driving consolidation in various agricultural markets. This means that the involvement of the Federal Trade Commission in this process is critical, and they should be involved in examinations of agricultural consolidation going forward.

Walmart's actions affect every level of our nation's food supply chain—and the company's continuing conduct strongly indicates they have no intention of loosening their tight chokehold on our food production and distribution systems.

To secure its rural stranglehold, Walmart uses its enormous footprint, coupled with its pricing power, to literally dictate how whole industries must operate. They reach deep inside a company, effectively influencing every aspect of a supplier's business operations. We believe that this inevitably leads to lower wages for workers, less money for farmers, growers and ranchers and fewer choices for consumers. Instead of providing rural economic development, Walmart stores become wealth extraction points that bleed our rural communities dry.

Walmart's pricing strategy leads to incredible pressure on producers, customers, competitors, farmers and workers. It squeezes workers' wages and means less money in the pockets of hardworking farmers. It inevitably drives industry concentration and leads to the elimination of healthy competition in the marketplace—on products ranging from poultry to pet food.

If Walmart's actions are not addressed, if the downward pressure they put on workers, businesses, growers and farmers is not vigorously challenged, we will continue to see a destructive race to the bottom that will destroy rural communities and wipe out good jobs that are the backbone of our nation.

There is more than enough wealth in the food supply chain to provide all stakeholders an equitable share.

However, the unprecedented rise of Walmart's retail grocery market share, along with its monopsony power, has changed the rules of the game and shifted the balance of power to the point where this one company is taking an unfair share of the pie at the expense of other stakeholders.

In order to restore a better balance in the market, as well as to ensure a fairer distribution of the retail grocery dollar, we must rethink traditional antitrust strategies and policies that have proven ineffective in the face of current market realities.

With the agricultural market consolidation workshops, the Department of Justice and USDA have initiated a timely and critical dialogue. We believe these hearings represent an historic opportunity to rethink American antitrust policy as it applies to our nation's rural economies. We look forward to this ongoing debate and hope that this paper serves as a productive tool for regulators as they examine the effects of agriculture consolidation across the marketplace.

In order to restore a better balance in the market, as well as to ensure a fairer distribution of the retail grocery dollar, we must rethink traditional antitrust strategies and policies that have proven ineffective in the face of current market realities.
