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# Enforcement of competition policy in the retail sector: Competition issues in the food retail chain

## Note by the UNCTAD secretariat

*Executive summary*

The food distribution sector has evolved significantly in the last 30 years, and this has led to new marketing systems that facilitate consumer access to a wider variety of products at lower prices. However, the creation of superstores and supermarkets has evolved into a process of concentration that has radically changed the relationship of forces between producers, manufacturers and retailers. This process has had negative consequences in some developed countries, in particular the United States of America and some countries in Western Europe, and has begun to affect many developing countries. The asymmetry of power between providers and retailers has led to abusive and unfair practices difficult to counter through competition law, and this has led to the adoption of different regulatory measures to prevent and stop the market power of supermarkets from hindering competition and harming consumer welfare.

The present note[1] considers challenges to fair competition in the food retail sector and some remedies for its regulation, to promote fair competition in the market for the eventual benefit of consumers.

[1] This document has not been formally edited.

# I. Introduction

1. Distribution may be defined as the economic function of ensuring the flow of products from production to consumption. It is one of the realizations of the economic concept of markets as a meeting place of demand and supply. Thus, the fundamental principle of freedom of enterprise should prevail, yet this freedom is exercised within limits set by the law. In this context, distribution falls within the scope of the application of competition law, which aims to ensure equal conditions of access to markets for enterprises while helping to protect consumers. Companies operating in sectors such as retail are therefore free to organize their networks and strategies and to form contracts as they wish, without altering the rules of competition.

2. Distribution – the link between economic activities upstream and downstream – is instrumental in allowing producers access to downstream markets through distributors that are in direct contact with consumers. Among sectors, the retail sector has a major influence on the quality of life of citizens as it determines access to a wide choice of merchandise and services, including first-need products. Upstream, retailers interact with a wide variety of stakeholders, including suppliers, and also transport companies, logistics companies and energy or waste collection suppliers. Any measures affecting the operation of this sector have an impact on other economic activities and their respective actors. Responses to challenges arising from interactions between sectors should therefore take into account cross-sectoral influence and the overall impact on economic chains.

3. Among all areas of distribution, food retailing stands out as having experienced the most significant changes in market structure in the last 20–30 years. Supermarkets have emerged as the grocery retail channel of choice for consumers, as grocery demand has evolved towards a one-stop-shop model. Three simultaneous demand and supply factors have triggered this process, as follows:

(a) Demand – changes in the habits of consumers, who have switched to one-stop shopping mostly due to time constraints;

(b) Supply – innovation in logistics and distribution technologies, involving decreasing distribution costs and better management of stocks;

(c) Increasing size of supermarket chains, and economies of scale and scope involved in their expansion.

4. In addition, the pre-eminence of supermarkets over traditional and specialized grocery shops has radically altered the balance of power in the grocery supply chain and is likely to significantly impact both suppliers and consumers. It is widely recognized that this economic structural change is characterized by supermarket domination to the point where the listing decisions of supermarkets may affect the financial viability of their suppliers, and even listed suppliers must adhere to supermarket terms. Moreover, in some countries, large supermarkets have become the strongest competitors of their suppliers and may misuse confidential business information in favour of their own brands, to the point of replicating packaging and presentation. Supermarket terms may thus force independent suppliers to feed competing supermarket brands, in a process of unequal forces. Legal complaints are almost non-existent, however, as suppliers do not wish to upset their largest customers.

5. Traditionally, supermarkets have been portrayed as neutral traders that simply channel consumer demands to suppliers. Economic power and associated competition-related problems have been considered abstract concepts created by businesses and economists concerned with, respectively, profits and economic efficiency. However, in

recent years, especially in chain-store retailers in developed countries, the operation of a number of stores under the banner of a common retailer has become increasingly prevalent and the practice has grown at the expense of a diminishing, though still important, independent retail sector. As the retail sector has consolidated, typically, a limited number of major retailers have emerged to lead, if not dominate, key retail segments. Hence, over time, oligopolistic structures have emerged in retailing to replace once-highly fragmented structures. In the process, such retailers may have gained not only seller power over consumers but also buyer power over suppliers. Any competitive assessment of retailing thus needs consider how these two forms of power interact and how they may individually and in combination affect competition at successive stages of the supply chain.

6. This phenomenon has generated positive efficiencies but also introduced risks for competition. Innovation in logistics and distribution technologies and economies of scale of supermarket chains have implied efficiency gains from which consumers have benefited, through better prices and wider product availability. Nevertheless, the increasing size of supermarket chains and increasingly important role of supermarkets as market gatekeepers may present risks to competition that can lead to a decrease in social welfare. The impact of the growth of the supermarket sector on consumer welfare depends on the balance of two forces, namely, a fair degree of competition that allows consumers to benefit from the efficiency gains derived from the expansion of modern retailing (including a wide variety of store formats such as supermarkets, hypermarkets, hard discount stores and convenience stores).

7. From a regulatory perspective, conventional competition-related analysis of supermarket dealings with suppliers remains anchored in the view of supermarkets as merchants. Such analysis presents supermarkets as buyers of grocery products and equates buyer power for large volumes with lower purchase prices. Competition law addresses abuses of a dominant position and anti-competitive practices, yet most reported unfair trade practices do not fall under competition law, as most actors are in a strong but not dominant position. Some countries are thus currently adopting different solutions to alleviate the problem, including by extending the application of consumer protection legislation to business-to-business relationships or by using a variety of approaches, most of which are regulatory, while others are based on self-regulatory initiatives among market participants. In regulatory terms, the last few years have been a period of considerable change.

# II. The new economic paradigm: Supermarket platforms

8. The degree of competition in the modern retailing sector differs by country. In developed countries, supermarkets have increasingly become the main gate to the market for an important number of products. In developing countries, modern retailing still plays a limited role in comparison to its role in other countries such as the United States, or in Western Europe. However, it is expected that as economies grow, and per capita income increases and the size of the middle class converges, then the penetration of supermarkets will increase. In addition, some supply factors may hold back investment in and the growth of supermarkets. The adoption of policies that remove obstacles to competition, promote the development of wholesalers and incorporate fresh produce into modern supply chains may contribute to the development of the supermarket sector in such countries.

9. There are different demand and supply factors that affect the development of the modern retail grocery industry. Demand-side factors such as income growth, urbanization rate, size of the middle class and participation of women in the labour market (as a proxy for the opportunity cost of time for women) are necessary but not sufficient for the expansion of modern retailing. Relevant supply-side factors include policies, infrastructure development, modernization of supply chains (through the development of modern

wholesalers and centralized purchasing mechanisms) and level of foreign direct investment. Supply-side factors are normally more heterogeneous and difficult to systematize but not less relevant.

10. In recent years, mostly in developed countries, supermarkets have emerged as powerful platforms and networks, whose listing and category management decisions influence and condition how suppliers and consumers interact. Independent sources estimate that over 70 per cent of consumer purchase decisions with regard to specific brands take place once they are in a store. Consequently, supermarkets are no longer neutral traders that convey consumer demand to suppliers and ensure that this demand is satisfied in the most efficient way. Instead, supermarkets have the power to influence and even prescribe what consumers demand and how suppliers reach consumers. The retailing literature has extensively analysed this new economic paradigm and described the extent of supermarkets.[2]

11. Supermarkets now provide services to both consumers and suppliers. In dealings with suppliers, supermarkets have transferred more and more of the risks of their retailing operations to suppliers by means of remunerated service agreements, manifestly unbalanced product supply agreements and unilateral practices that disregard contractual terms and legal provisions. For example, supermarkets and their partners may impose access fees for the right to enter or be part of a supermarket product listing or request distinct sizes and/or packages that prevent customers from performing price comparisons across retailers. In relations between manufacturers and retailers, the following four types of unfair commercial practices are usually identified:

(a) One party unduly or unfairly shifts its own costs or entrepreneurial risks to the other party (for example, delivery to individual stores or provision by supermarkets of centralized delivery and warehousing services; in-store replenishment; in-store promotions and marketing activities; and product shrinkage);

(b) One party asks the other for advantages or benefits of any kind without performing a service related to the advantage or benefit asked;

(c) One party makes unilateral and/or retroactive changes to a contract, even if the contract specifically allows for this only under fair conditions;

(d) One party unjustly ends or threatens to end a business relationship.

12. If, despite all risk-transferring activities put in place contractually, supermarkets do not meet internal profit forecasts or wish to exceed them, there is scope for unilateral practices that extract rents from suppliers under threat of delisting. Supermarkets have in essence transformed themselves into service providers to independent grocery brands, and seek to maximize profits from access to and competition within their platforms.

13. Economies affected by such problems employ different types of measures to offset imbalances in markets. In the European Union, for example, most member States have defined criteria for identifying situations leading to unfair trade practices in the retail sector. Laws in the majority of member States apply to business-to-business relationships at all stages of a supply chain. As unfair trade practices can potentially occur at every stage, member States that have not yet done so should consider introducing legislation that covers the entire business-to-business food supply chain. Member States should also ensure that legislation covers operators from non-European Union countries.[3]

[2] See Clarke, Davies, Dobson and Waterson, 2002, *Buyer Power and Competition in European Food Retailing* (Edward Elgar), for a general discussion.

[3] European Commission, 2016, Report from the Commission to the European Parliament and the Council on unfair business-to-business trading practices in the food supply chain.

# III. Market structure and competition

14. The structure of most national markets for grocery retailing indicates that leading supermarkets have significant market power. The structure of markets is conditioned by a number of features that may reinforce the position of incumbent firms, hamper the entry of new firms and limit the exercise of certain activities. Market concentration is usually high, barriers to entry and expansion are prevalent, market transparency may have detrimental effects and consumer lock-in and switching costs are more critical than commonly thought.

## A. High concentration

15. While the strive for supremacy between different retail forms and retail formats is encouraging for consumers as a stimulus to competition, there is concern that increasing concentration in retail markets may result in less vigorous competition and increase the scope for anti-competitive practices, to the detriment of consumers, in particular with regard to mergers among already large retailers that may considerably increase market concentration and reduce the amount of head-to-head competition. While there may be efficiency benefits from such mergers, allowing merged parties to lower their costs, there is concern about anti-competitive unilateral effects from the increased market power of the merged parties and/or coordinated effects arising among remaining rivals following the conclusion of a merger. In such circumstances, competition assessment requires analysing the balance of efficiency and market power effects to determine the net outcomes of mergers.

16. Concentration is usually more acute at a regional or local level than at a national level, as retailers tend to follow what has been termed an oil-stain strategy, due to efficiency (and possibly strategic pre-emption) considerations. Both the United Kingdom of Great Britain and Northern Ireland grocery report for 2008 and Spain grocery report for 2011, for example, concluded that concentration was significantly higher at local market than national levels.[4]

17. In general, control of concentration helps prevent reconciliations by substantially restricting competition, for example, through the creation or strengthening of dominant positions locally. Competition authorities may be required to accept commitments by parties to limit local concentration levels through store sales.

18. Finally, merger control in the retail trade sector can often be a deterrent for operations likely to reduce competition, and control of concentration allows authorities to strengthen their overall knowledge of markets, particularly at local levels. In France, for example, the role of the authority in merger review strengthened in the sector, including through mandatory lowering of notification thresholds. The authority has recently refined its approach to decision account franchisees under control. Analysis of the retail sector is well-established, in terms of both delimitation of relevant markets and appropriate competitive assessment. Supermarket mergers may also increase monopsony (buyer) power and lead to lower prices paid to food suppliers. In Brazil, for example, the sector is characterized by national and local influences, as many distribution channels are formed at

[4] The report for Spain compared the degree of concentration, measured by the level of floor space, at national and regional levels. The authority in the United Kingdom relied on a combination of two factors to infer local-level market power, namely, high market share and a limited number of competitors.

regional and local levels, influenced by national recommendations.[5] As distribution centres are an important competitive variable in the retail market, they should be analysed through national and local perspectives.

## B. Legal barriers

19. In market studies, competition authorities, as well as observers, have denounced the huge and unique legal barriers restricting entry and expansion in grocery retail markets. Several types of retail activity regulation have the potential to impede effective competition and their design should be carefully considered to ensure that economic benefits outweigh economic costs. Such regulations include the following target areas:

(a) Foreign direct investment and foreign ownership restrictions. Such restrictions may protect incumbent national retailers and ensure that retail ownership remains in a country, yet this may be at the expense of retail markets by limiting access to innovative and efficient international retailers that could spur domestic competition and bring greater choice and other benefits for consumers;

(b) Planning, zoning and licensing restrictions. Such restrictions may protect incumbent retailers that have already established retail outlets – and prevent retail sprawl if seen as an environmental concern – yet may prevent the entry of new retailers and diffusion of new retail formats, for example planning restrictions that restrict the location and size of big-box superstores and hypermarkets or other modern forms of retailing;

(c) Opening hour restrictions. Such restrictions may protect worker rights with regard to number of hours worked yet, if applied differently for different retailers, may distort competition and restrict consumer choice and shopping convenience;

(d) Price controls and price discounting restrictions. Fixed retail prices may help ensure common prices for consumers wherever they shop and restrictions on discounting (such as preventing below-cost selling) may encourage competition on non-price aspects (such as service and quality), yet they may protect inefficient retailers, discourage efficiency improvements and lead to higher prices for consumers;

(e) Economic dependency laws and supplier protection regulations.

## C. Economic and strategic barriers

20. Economic barriers have traditionally been associated with corporate economies of scale. Large retailers have substantial economies of scale on input costs, the most important cost element of grocery retailing, and are able to exploit other types of economies of scale in the following areas:

(a) Management – increasing the specialization of managers;

(b) Finance – obtaining lower interest charges when borrowing from banks and having access to a greater range of financial instruments;

[5] Consideration of the market by the Administrative Council for Economic Defense is shown in the following: In 2013, the Council approved, subject to restrictions, an association between Pão de Açúcar and Ponto Frio, and between Pão de Açúcar and Casas Bahia, resulting in the creation of the largest retail company in Brazil – Via Varejo, a holding company created by Grupo Pão de Açúcar to manage the Ponto Frio and Casas Bahia appliance chains and an electronic commerce company responsible for sales by all three brands on the Internet. The association affected 117 municipalities and, to meet requirements, Via Varejo agreed to sell 74 commercial spots in 54 municipalities.

(c) Marketing – spreading advertising costs over a greater range of output in media markets;

(d) Technology – taking advantage of returns to scale in the production function.

21. Market-wide economies of scale may, however, play an even more important role in the configuration of highly concentrated local markets. In this regard, supermarkets may come close to natural monopolies or oligopolies, for example if the scarcity of commercial land available for grocery retailing, even in the absence of planning restrictions, de facto restricts the number of competitors in a given local market.

## D. Transparency

22. Transparency of supermarket services and prices facilitates rapid adaptation to the strategic actions of competitors, especially with regard to known-value items (basic items that are regularly bought and command higher price awareness), packaged goods and a representative basket of grocery products.

## E. Consumer lock-in

23. One-stop grocery shopping exhibits some unique features not always covered by economic analyses. Reductionist price-sensitivity models, no matter how developed, do not correspond to observed consumer behaviour. For example, a study in 2010 by the Ministry of Agriculture, Food and Environment of Spain showed the evolution of consumer loyalty to supermarkets as follows: 83 per cent of consumers surveyed stated that they preferred to shop at the same stores; 79.9 per cent of these stated that they normally shopped at the stores closest to home; with regard to shopping at stores in the same group, 58.4 per cent stated that they preferred to do so and 23.2 per cent stated that they switched stores with some frequency. As of 2005, these figures were relatively constant, despite the economic crisis faced by Spain in recent years.[6]

## F. Supermarket power

24. Taking into account the structural problems that are perceived and that condition the functioning of modern distribution in the food retail sector, the power of supermarkets is fourfold and self-reinforcing, as follows:

(a) The sector tends to be oligopolistic (few actors; transparency; high market shares; full acknowledgment of interdependence), reinforced by local strongholds;

(b) Consumers tend to develop strong links with individual supermarkets (power of habit) and information asymmetries and switching costs ease the competitive pressure on these platforms;

(c) The business model of independent brands relies on access to as many consumers as possible in order to sustain the virtuous research and development and innovation sales growth model, and this model places them at the mercy of supermarkets. As a rule, a supermarket can easily substitute a supplier, whereas the loss of a supplier may turn a virtuous growth cycle into a decline and market-exit spiral;

[6] A more recent survey by Instituto Sondea showed that 86 per cent of consumers shopped at the same store for their main weekly shopping, and that proximity was the main factor in selecting the store.

(d) Supermarkets have been vertically integrated into the food chain by producing and selling their own brands, therefore becoming strong competitors of independent brands.

25. Supermarket anti-competitive practices have a profound impact on producers of agricultural products and on the agrifood industry. Agricultural products may be impacted by such practices in different ways. If producers supply brand-name or non-branded goods directly to supermarkets, they may be subject to abuses regarding access fees and terms. If producers integrate vertically into industrial processing and develop commercial brands, they may be affected by the practices described in this section. Producers may also suffer indirectly as input suppliers for the agrifood industry. The imitation and price discounting model mostly adopted by supermarkets, however profitable it may be for them, does not foster innovation and productivity growth by producers and/or suppliers, thereby leading to zero-sum competition, as the latter may not earn sufficient profits.[7]

26. In many countries, especially developing countries, agriculture is a crucial pillar of the economy. However, competition law and policy usually do not include provisions to tackle competition-related problems in the agricultural and agrifood sectors. In most, if not all, countries, the scope of competition legislation is limited to handling market concentration and seller power at the production level under abuse of dominance provisions, and this does not address competition problems arising from buyer power. To achieve a sustainable and competitive agricultural sector, States should address competitive bottlenecks in food retail.

# IV. Main practices likely to impede competition in the food retail sector: Competitive bottlenecks

27. The ever-increasing power of large supermarkets has transformed them – as well as other sectors that have seen proactive competition and regulatory intervention (such as credit card networks, computer reservation systems and mobile telephony) – into competitive bottlenecks, as described in an economic theory that posits that the exploitation of suppliers by supermarkets will always outweigh any potential benefit transferred to consumers from a social (producer plus consumer) welfare perspective.[8] Moreover, if consumer welfare is measured not only in terms of price but as a complex bundle of innovation, quality, variety and price, the conclusion is that supermarket abuses against suppliers of independent brands undermine both social and consumer welfare.

## A. Access foreclosure

28. Supermarkets may distort independent brand access to their platforms as well as competition within such platforms, through practices with a horizontal dimension, by not only unfairly exploiting business partners but also, more importantly, foreclosing a competitor from a market. Access foreclosure takes place through the following practices:

(a) Misuse of confidential business information provided by independent brands to supermarkets in favour of supermarket brands;

(b) Imposition of access fees, preventing the distribution of independent brands;

[7] A Seth and G Randall, 1999, *The Grocers: the Rise and Rise of the Supermarket Chains* (Kogan Page Publishers).

[8] M Armstrong, 2006, Competition in two-sided markets, *RAND Journal of Economics*, 37(3).

(c) Abrupt termination of access, undermining the business viability of independent brands;

(d) Upfront access refusal for independent brand products and innovations that compete with supermarket brands.

29. Another practice that may lead to reduced access to platforms is the conclusion of joint purchasing agreements between retailers to increase their purchasing power. For example, in France, the proliferation of such agreements has significantly strengthened the degree of concentration and resulted in significant buying power for operators that already had significant weight in the retail distribution stage.[9] In a report prepared for the Minister of Economy, Industry and Digital Affairs and for the Economic Affairs Committee of the Senate, the competition authority identified several competition-related problems in such agreements in the following areas: exchanges of information; symmetry of purchase conditions; reduction of inter-company mobility; risk of limitation of supply and reduction in quality or the incentive of some suppliers to innovate or invest; risk of foreclosure of suppliers. The authority established a series of measures to avoid the negative aspects of such agreements, in particular, by significantly lowering barriers to entry existing in the retail market, establishing a legal obligation to notify of any new agreement and modifying the procedure to establish the existence of an abuse of economic dependence.[10]

## B. Pricing and non-pricing practices

30. Market foreclosure may also take place through pricing and non-pricing practices that distort in-store competition between supermarket brands and independent brands. Although supermarkets seem able to transfer most retail risks to suppliers and often operate as de facto providers of remunerated services to them, they have not formally foregone their retailer or merchant roles (that is, purchase for resale to consumers bearing all associated risks) insofar as they afford competitive advantages such as control of the retail prices of independent brands. Pricing and non-pricing practices include the following:

(a) Pricing power could undermine an independent brand's value proposition to consumers through the following:

(i) An artificial price gap between the targeted independent brand and the supermarket brand. Competition authorities have only recently begun to consider the anti-competitive implications of such gaps;[11]

(ii) A loss-making price for an independent brand that undermines its quality perception. Brand destruction through loss-leading retail prices has not necessarily been a concern for competition authorities, which have focused more on static intra-brand price competition than on dynamic inter-brand competition;

[9] As a result of such agreements, the market is clustered mainly into four groups of buyers (Intermarché-Group Casino; Carrefour-Cora; Auchan-Système U; E Leclerc), that together account for over 90 per cent of the market.

[10] France Competition Authority, 2015, Joint purchasing agreements in the food retail sector.

[11] As seen, for example, in grocery reports for Finland and Spain, and for Paris.

(iii) Refusal to pass on promotional wholesale prices for independent brands to their retail prices;[12]

(iv) Prohibition of on-package promotions of independent brands;

(b) Non-pricing practices may be used to distort in-store consumer choice through the following:[13]

(i) Degradation of in-store services provided to independent brands;

(ii) Switch-marketing techniques in favour of supermarket brands;

(iii) Better shelf positioning or disproportionate space allocation for supermarket brands;

(iv) Copycat packaging by supermarket brands of targeted competitors.

31. In order to address such unfair and exclusionary commercial practices, competition law and regulatory remedies may be adopted as necessary.

**Impact on markets and consumers**

32. Pricing and non-pricing practices may affect consumers in terms of greater access (choice) and new (innovation) products. Consumers may feel the impact of such restraints if they serve to reduce or inhibit product choice, quality and innovation, either as a direct consequence of restraints (through foreclosure effects) or indirectly if supplier competition is distorted, resulting in less intense product competition and/or underinvestment.

33. In this regard, a European Commission study considered the economic impact on consumer welfare of changes in the modern food retail sector, aimed at, in particular, identifying the impact of retailer and supplier concentration in the procurement market on choice and innovation, and at providing robust empirical evidence of this.[14] The study went beyond retailer and supplier concentration to assess other factors, such as shop type and size and sociodemographic characteristics, to account for structural differences that might influence choice and innovation. Findings showed that the choices available to consumers in local shops increased in terms of the number of alternative products, different brand suppliers and modern retail shops, yet the number of innovations declined in 2008–2012.[15]

[12] For example, the Groceries Supply Code of Practice in the United Kingdom attempts to strike a balance in this area by prohibiting supermarkets from requiring suppliers predominantly to fund the costs of a promotion and requiring supermarkets to hold such promotions after reasonable notice has been given to suppliers in writing (see https://www.gov.uk/government/publications/groceries-supply-code-of-practice/groceries-supply-code-of-practice).

[13] A Fernández and M Gómez, 1999, Estrategias de las marcas de distribuidor, *Distribución y Consumo*, 45:30–49.

[14] European Commission, 2014, Study on the economic impact of modern retail on choice and innovation in the European Union food sector.

[15] The increases were greater in 2004–2008 than in 2008–2012. Choice in alternative products, measured at a local level, increased on average by 5.1 per cent annually in 2004–2012 in the shops sampled in the consumer shopping areas covered by the study. During the pre-crisis period (2004–2008), the annual growth rate was higher (7.9 per cent) than during the crisis period since 2008 (2.4 per cent). The study concluded that the number of innovations increased in 2006–2008 (by +3.8 per cent annually) but this trend was reversed during the crisis period, with falls registered in 2008–2010 (-1.2 per cent) and 2010–2012 (-5.3 per cent). The share of innovations in the total number of products decreased steadily, from 43 per cent in 2006 to 30 per cent on average in 2012.

# V. Measures to address competition-related problems in food retail

## A. Competition law remedies

34. Several factors point to the need to supplement competition law and policy with economic regulation or self-regulation in the food retail sector, including the following:

(a) In developed economies, the retail market structure is not likely to become more competitive in the foreseeable future. Retail market concentration is growing and the possibility for new entries or the growth of small actors is diminishing;

(b) Competition bottlenecks may be better dealt with under an ex ante regulatory regime than under competition rules;

(c) Anti-competitive practices of supermarkets are widespread, simultaneous and multifaceted, pointing to a structural market failure;

(d) Vertical integration and foreclosure practices by supermarkets place the former vertical relationships between grocery brands and supermarkets in a new horizontal dimension, that is, a non-reciprocal commercialization agreement with competitors, whose brands compete head-on with independent brands in a store;

(e) For many years, competition law and policy enforcement has been biased against manufacturers (suppliers) and in defence of retailers. Supermarkets have benefited from an asymmetric competition regime (for example, prohibition of resale price maintenance);

(f) Public intervention in other sectors witnessing competitive bottlenecks (such as computer reservation systems, interconnections between mobile telecommunications networks, provision of Internet access and Internet domain name registration) suggests that economic regulation is a necessary complement to competition rules;

(g) The powers of supermarkets have enabled them to bundle two business models in order to benefit from their respective advantages, namely, their de facto behaviour as service providers vis-à-vis independent grocery brands while controlling retail competition through their formal roles as merchants.

35. For example, in articles 101 and 102 on competition of the Treaty on the Functioning of the European Union, competitive bottleneck issues in the food chain are not considered. European Commission guidelines on vertical agreements have addressed access fees, category captains and the foreclosure of independent brands and have not identified any practical solutions, yet consider that supermarkets are not competitors of independent brands when they source their own brands.[16] Intervention under article 102 is inadequate, as intervention is only considered if single-firm dominance is found, based on high market shares and a significant market share gap with competitors. Furthermore, there is no European Union legislation targeting business-to-business unfair trade practices across the food supply chain, and some member States have extended the application of European Union consumer protection legislation to business-to-business relationships. In light of the specific features of grocery retailing and its economic and social importance, it may be necessary to holistically supervise supermarket practices governing access to stores and in-store competition. The interpretation of abuse of dominance provisions of competition laws should take into account the particularities of competitive bottlenecks, especially economic dependence featuring many companies, especially small and medium-

[16] European Union, 2010, Guidelines on vertical restraints.

sized enterprises. Such shortcomings have prompted member States to consider introducing legislation that covers the entire business-to-business chain in the food supply chain to protect business customers as much as end-consumers from bottlenecks.

## B. Regulatory remedies

36. The need to supplement competition law and policy enforcement with regulation in grocery retailing in order to address unfair and/or exclusionary practices is becoming increasingly evident. Authorities have acknowledged that buyer power and competition bottlenecks are better dealt with under an ex ante regulatory regime;[17] competition law and policy enforcement has been biased against manufacturers and/or suppliers and in defence of retailers; and economic regulation may also take into account other policies worthy of protection, such as agricultural policy. The regulation of business activity is an important element of government policy to ensure the efficient functioning of economic markets, promote economic growth and prosperity, ensure that consumers benefit from and share in the rewards of economic advancements and support wider social and economic goals. The manner in which business regulation operates may provide benefits in one or more dimensions yet carry the risk of acting detrimentally in other dimensions. In this context, a number of issues in the regulation of the food retail sector to deal with anti-competitive practices are considered in this section.

### 1. Access to supermarkets and in-store competition

37. Access to supermarkets should be granted on fair, reasonable and non-discriminatory terms. The principle of fairness requires supply agreements to be written, to cover at least the most important elements of the contractual relationship and to provide for balanced rights and obligations on both sides, and includes the following:

(a) Supermarkets should not transfer to independent brands the risks of activities falling within their retailer functions;

(b) Public authorities should evaluate whether access fees should be regulated or prohibited;[18]

(c) The principle of non-discriminatory access which may come into play if a supermarket decides on its assortment strategy (light non-discrimination) or may be extended to the listing criteria used to select listed grocery brands (pure non-discrimination);

(d) In-store competition between supermarket brands and independent brands should be governed by fair, reasonable and non-discriminatory principles, to ensure the access of independent brands to supermarket platforms on equitable terms;

(e) In the field of non-pricing competition, the enforcement of fair, reasonable and non-discriminatory principles should be straightforward with regard to practices such as the degradation of in-store services, switch marketing and the allocation of preferential

[17] To date, ex ante regulations adopted in this field have assumed that suppliers and supermarkets are linked by a vertical relationship and have focused on abusive (exploitative) dealings by supermarkets with independent grocery brands. However, public authorities may note that the prohibition of such abusive practices (such as access fees), in the presence of supermarket power, incentivizes refusal of access or delisting of independent grocery brands by supermarkets.

[18] A European Union Green Paper and European Union Code of Conduct suggest this solution (see http://www.supplychaininitiative.eu/).

shelf space. It may be necessary to introduce a specific provision against copycats in this area, in light of the dual role played by supermarkets;[19]

(f) In the field of pricing competition, a fair dealing and non-discrimination obligation may apply to wholesale promotional prices and retail promotions (which should be reflected accordingly in the retail prices of independent brands).[20]

38. Considering the implications for competition of unfair pricing practices by supermarkets vis-à-vis independent brands, especially if supermarkets are vertically integrated and have an incentive to force competitors to exit a market, authorities may consider the option of not prohibiting resale price maintenance in certain cases.

39. Fair, reasonable and non-discriminatory principles regarding access to supermarkets and in-store competition may be applied more easily if the boundaries are delineated between the different roles of supermarkets (that is, as service providers charging access fees and providing all sorts of remunerated services, and as retailers who purchase goods and control all aspects of their resale). This may be done through the prohibition of access fees if supermarkets retain their retailer roles.

40. In order to respond to this market failure, public authorities may consider confining supermarkets to a service provider role, similar to a marketplace at which grocery brands pay upfront and/or variable fees to gain access to distribution services and can interact with shoppers directly or through agency agreements with supermarkets. Supermarkets, as service providers, may auction their shelf space and associated in-store services.

41. Member States of the European Union have different legislative approaches to addressing abuses of economic imbalance. Some States, such as Austria and Germany, have general legal provisions requiring assessment on a case-by-case basis of whether there is a significant economic imbalance between two operators, and whether the stronger operator has abused its position to impose unfair terms or conditions on the weaker party. Other States, such as the Czech Republic, Hungary and Slovakia, have introduced more detailed legislation specifically addressing unfair trade practices. Several laws contain extensive lists of practices considered intrinsically unfair and thus illegal (blacklists), with regard to which unfairness is not assessed on a case-by-case basis.

42. The Republic of Korea has enacted a specific law to prevent large-scale retailers (including department stores, large marts and home-shopping television programme providers) from unfairly disadvantaging – by using their superior bargaining positions – contract suppliers and store tenants, among others, who are transacting parties, the main provisions of which are as follows: “unfair return: returning all or some of the goods, either order-made or directly purchased, to the relevant supplier, except where it is recognized as a customary business practice or it is specifically agreed in writing in advance; ... unfair refusal of acceptance: delaying or refusing to accept all or some of the supplies despite no reason attributable to the supplier; ... unfairly charging promotion costs, etc.: transferring the cost, etc. unrelated to sales promotions for the supplied goods and transferring the cost not predetermined, etc.” [21]

[19] European Commission, 2010, Invitation to tender: Study on trade secrets and parasitic copying.

[20] Competition authorities have also identified artificial retail price gaps between leading independent brands and supermarket brands (that is, higher retail margins for the former cross-subsidize the latter), in recent market investigations in Finland, France and Spain.

[21] See http://eng.ftc.go.kr/policyarea/competitionpolicy_practices.jsp?pageId=0201.

43. At the regional level, the European Union regulatory experience with competitive bottlenecks in other sectors such as computer reservation systems may serve as an example in addressing concerns in the food retail sector.[22]

44. In Costa Rica, as part of work by the competent authorities, in 2012, a reform of the regulation was promoted to protect relative monopolistic practices, expanding the definition of behaviours that could arise as part of negotiations between buyers and suppliers that could be considered anti-competitive.[23] If the behaviours derive from an act, contract, agreement, arrangement or combination for the purpose or with the effect of displacing an economic agent, or preventing access or the establishment of advantages in favour of one or more people, a punishable behaviour may be defined. However, this is subject to verification of the substantial power that an agent may exercise in the market in practice.

### 2. Separation of independent brands from supermarket sales activities

45. In order to ensure equitable access by independent brands to supermarkets and fair in-store competition with supermarket brands, there is a need for supermarkets to maintain separate accounts for sales of their own brands and of independent brands. This obligation should apply to all supermarkets, in particular, those that are vertically integrated into grocery brands. Moreover, in order to protect and maintain the innovative efforts of independent brands, appropriate mechanisms should be put in place for supermarkets not to misuse confidential information received from independent brands.

### 3. Confidentiality of complaints

46. An effective enforcement system needs to address the weaker party’s fear of compromising its commercial relationship when complaining openly to authorities about unfair trade practices. This fear factor can obstruct authorities in penalizing market operators imposing unfair trade practices, as authorities require sufficient information to be able to follow up on a complaint. Many member States of the European Union allow confidential formal complaints, whereby the identity of a complainant is protected, and several member States allow aggregated complaints that better protect the identity of a complainant, or permit any interested party to lodge a complaint. Complainants thus do not need to act in person but may, for example, be represented by an association.

### 4. Independent regulatory authorities and possibility of own-initiative investigations

47. Regulation of the food retail sector should be undertaken by an independent authority with ex officio investigatory and fining powers. This responsibility may be given to either a newly created public authority vested with sufficient regulatory powers or an existing body such as a competition authority. If the sector is regulated by a newly created authority, the authority should be given sufficient powers to issue interpretative guidelines and regulations; settle or arbitrate in bilateral disputes; open infringement proceedings ex officio or follow up on complaints received from affected parties or their representative associations; and impose remedies and fines.

48. For example, member States of the European Union have appointed different national enforcement authorities to address unfair trade practices, which may be national competition authorities or dedicated bodies, such as national ministries, food agencies and

[22] For instance, European Council regulation No. 2299/89 of 24 July 1989 on a code of conduct for computerized reservation systems established regulatory remedies regarding access to computer reservation systems; competition in computer reservation systems; legal and functional separation between a computer reservation system and its parent air carrier; and effective guidance and enforcement by the European Commission with the help of independent auditors.

[23] Article 12 of the Law for the Promotion of Competition and Effective Consumer Protection.

anti-fraud agencies. Such authorities have the power to launch initiative investigations whenever there is sufficient indication that a company has been using unfair trade practices prohibited under national legislation. Most member States have introduced fines for companies applying unfair trade practices in breach of national law, with a maximum level of fines in absolute terms, while in other States, fines are calculated as a percentage of the annual turnover of the company that applied unfair trade practices against its weaker business partner.[24] For example, in the United Kingdom, the Groceries Code Adjudicator – an independent adjudicator – oversees the relationship between supermarkets and their suppliers to ensure that large supermarkets treat direct suppliers lawfully and fairly, and investigates complaints and arbitrates in disputes. In addition, in Spain, there is a new law on measures to improve the functioning of the food chain.[25] Finally, as vertical integration of supermarket and grocery brand activities and supermarket control over in-store competition under a retail business model raises significant competition-related problems, public authorities may consider establishing an audit mechanism such as that put in place through European Council regulation No. 2299/89, aimed at ensuring fair competition between air carriers and computerized reservation systems, to protect the interests of consumers.

## C. Voluntary supply chain initiatives

49. There have been a number of important investigations of retailer-led restraints, most notably in the retailer grocery sector, as described in the following paragraphs.

50. In the United Kingdom, the competition authority conducted two full market enquiries, identifying a multitude of different retailer-led restraints in operation. As a consequence, an industry code of practice was established, backed by the Government and overseen by an adjudicator to ensure that there are no anti-competitive abuses of retailer buyer power and unfair trade practices (such as delaying payments to suppliers without good cause).

51. Australia has adopted a code of practice designed to ensure fair and equitable trading practices among industry participants.

52. More tailored actions have been undertaken in other countries in which specific abuses of retailer buyer power were found, such as Bulgaria, Germany, Hungary and Japan.

53. There have been a number of other market investigations in other countries, including Austria, Chile, Finland, Hungary, Italy, Mexico, the Netherlands, Portugal, Romania and Spain. Thus, there is a growing body of studies and cases on which to draw for insights into investigating retail buyer power.

54. In Costa Rica, a code of responsible practices of enterprises within its value chain was established, making an important group of economic operators submit to self-regulation by actors in a chain – producers, suppliers and consumers – and achieving monitoring of the relationships between them.[26]

55. In the European Union, a supply chain initiative was developed within the framework of the High-Level Forum for a Better Functioning Food Supply Chain of the European Commission.[27] The aim of the initiative is to increase fairness in commercial relations along the food supply chain. To this end, in 2011, all market representatives

[24] Ranging from 0.05 per cent in one instance, up to 10 per cent of turnover in several member States.
[25] See https://www.boe.es/boe/dias/2013/08/03/pdfs/BOE-A-2013-8554.pdf.
[26] See http://www.aedcr.com/Documentos/Economico/Codigo_Practicas_Responsables.pdf.
[27] See http://www.supplychaininitiative.eu/.

involved in the Forum's working party on unfair trade practices, including farmer representatives, jointly agreed on a set of principles of good practice in vertical relationships in the food supply chain. However, despite significant efforts by stakeholders, those involved in the food chain have not agreed on a voluntary enforcement mechanism, as farmers and meat processors state that it does not address complainant confidentiality. The supply chain initiative, as a voluntary framework for implementing the set of principles of good practice, was launched in September 2013. Individual companies may join the initiative once they have complied with the principles and, under the initiative, disputes between operators may be addressed through mediation or arbitration. In addition, guidelines have been developed for the creation of national platforms, covering aspects such as composition, rules of procedure and the awareness-raising activities of national initiatives. Based on these guidelines, a process of mutual recognition may be launched between the supply chain initiative and national initiatives, to officially establish a platform. Such platforms, to date, have been established in Belgium, Finland and the Netherlands. In Germany, stakeholder associations throughout the food supply chain, including farmer representatives, envisage setting up a similar platform.

# VI. Conclusion

56. The retail sector is an important part of the food chain industry. Considering the dominant role of supermarkets in the distribution of food products to final consumers, fair competition in the food retail sector is crucial to ensure equitable access to the distribution chain for producers and suppliers. An environment in which supermarkets impose unfair sales prices and/or terms to suppliers adversely affects not only suppliers but also consumers with regard to product prices and choices. Regulation of the sector may help address this situation and promote fair competition in the market for the eventual benefit of consumers, as well as contributing to agricultural policy by ensuring fair commercial terms for small agricultural producers.