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LATIN AMERICAN COMPETITION FORUM

Session I - Structural Issues in the Groceries Sector: Merger and Regulatory Issues

-- Contribution from Costa Rica --

23-24 September 2015, Montego Bay, Jamaica

The attached document from Costa Rica is circulated to the Latin American Competition Forum FOR DISCUSSION under Session I at its forthcoming meeting to be held on 23-24 September 2015 in Jamaica.

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LATIN AMERICAN COMPETITION FORUM



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Session I - Structural Issues in the Groceries Sector: Merger and Regulatory Issues

ANTICOMPETITIVE PRACTICES IN THE SUPERMARKET SECTOR AND THE REQUIREMENTS ESTABLISHED BY PROVIDERS

-- CONTRIBUTION FROM COSTA RICA --

1. Case sanctioned by COPROCOM

1. At the end of 2005, the Commission to Promote Competition sanctioned one of the most important supermarket chains in the country and dedicated to the retail of basic household items through a self-service system with extensive geographic presence and a significant number of establishments located within the national territory. The foregoing was done because they were carrying relative monopolistic practices, by establishing purchase constraints to acquire products from their providers.

2. This sanction had its origin in the complaint filed by a provider company against a Supermarket Chain, due to constraints related to increases in the price differential, changes in payment terms, prices and discount percentages, among other conditions added to the negotiation process between supplier and supermarket.

3. In the case of this type practices, the competition law establishes that to be considered that a behavior is a violation of the Law on Promotion of Competition (Law No.7472), it has to be proven that "... a) the alleged responsible has substantial power in the relevant market and b) are carried out in respect of goods or services or related to the relevant market in question."

4. Therefore, the analysis of the anticompetitive conduct basically involved the determination of substantial power that had the agent to act independently on the market. These actions seen as those behaviors which are carried out by an economic agent with the purposes of achieving better purchasing conditions than it could obtain by competing with others. However, this type of behavior were reflected in various events, ranging from obtaining higher discounts from their suppliers up to formalizing other acts to achieve their ends.

5. Another important aspect was that the investigation was based that the supermarket chain was composed of various establishments around the country and this obeyed to various modes of the sales points with variations in aspects such as: as scope, the range of products and the segment to which it was aimed. Among the formats used by these were outlets with a very limited assortment to meet the daily demands of basic consumer goods and others which responded to a higher standard with a more specialized sale proposal to the consumer.

1.1 Issues addressed in the Investigation

6. Assessing the existence of anti-competitive behavior, it was identified that the relevant market included the commercial relationship between the Supermarket Chain and their suppliers, being this a market for purchase of goods or market suppliers, having established that relations between the supermarket and the end consumer obeyed to a different relevant market, which was not included in the investigation.

7. The investigation was based on the fact that the conditions established were directed at a group of providers of one of the formats of the sales points of this Chain, therefore it was also determined that the investigation should be responsive to a group of specific products pertaining to the format used.

8. Once the product categories were determined which comprised the relevant market they proceeded to identify the suppliers and other aspects associated to the existence of substitute buyers for the chain, valuing the existing disproportions in the market in relation to the level of purchases, business size and geographical coverage.

9. As part of the study, it is concluded that the relevant product was composed by the market supply to chain supermarkets, of basic consumer products consisting of food, beverages, cleaning, personal care and other household non-food products of everyday use, which are offered by those supermarkets to consumers.

10. Another important fact is that the Supermarket Chain had more than 50% market purchase of products in relation to other existing supermarket chains in the country involvement. With the above it was determined that there were significant differences between the Chain and the rest of competitors including the closest. This added to the preferences of this chain by consumers, being the most important purchasing chain of retail products.

11. From the point of view of retail trade there were identified strategic barriers seen as the aggressive growth experienced by existing selling retail chains, allowing different formats to increase the purchasing power against their suppliers. Likewise, the investment in advertising added to high investments in commercial installations, strategic alliances, changing the format which posed obstacles to the emergence of new competitors.

12. It was also verified that the chain obtains bigger discounts than other chains in the country, and this for the reason that the more dependency there is between a supplier and the chain, the greater the discount the latter could obtain, precisely because the power of negotiation of the chain would increase.

13. In this case, the infringement committed by the chain, typified as the imposition of price or other conditions to be observed by a dealer or vendor, selling or distributing goods or providing services, which in the Law for the Promotion of Competition and Effective Consumer Protection Law No. 7472, Article 12, paragraph b) constitutes a relative monopolistic practice and punishable, being necessary to verify that the company has substantial power in the market, resulting in pressure It is exerted on a distributor to exercise a certain behavior. Other behaviors derived from the power of the chain consisted of changes in the deadlines for the payment of bills, however, was determined as a punishable practice because changes

in the period were communicated promptly to suppliers, with an anticipation that they allowed to adapt to change. Also, changes in prices, discounts and others were generated because of the power of the chain.

14. Finally, the chain was sanctioned with a heavy fine because the infringements were particularly serious, however, the sanctioned chain presented an appeal against the administrative decision which imposed the fine and this is still in the assessment of the Authorities of the court.

2. Current market situation involving Supermarkets

15. The subject of supermarkets in our country responds to a varied market scheme with various store formats, with the presence of supermarkets with significant participation fees, convenience stores growing and competing to achieve significant participation fees, grocery stores, suppliers, and distributors nationwide. This sector is identified as a form of retail trade linked to the retailer where agents buy large quantities of products to importers, producers, manufacturers however the products they buy are destined for the end consumer, with the implementation of various forms of points of sale. Hereinafter the table that collects the details about the commercial activity in which the contribution is included in Gross Domestic Product (GDP).¹

Contribution to GDP of the five main productive activities. 2000, 2005, 2010 and 2013

Branch of Activity	2000	2005	2010	2013
<i>Manufacturing Industry</i>	24,1	23,2	21,1	21,2
<i>Transportation, warehousing and communications</i>	9,7	13,6	15,6	16,5
<i>Trade, restaurants and hotels</i>	17,8	16,8	15,2	14,9
<i>Community services, social and personal</i>	10,5	9,8	9,5	9,2
<i>Agriculture, forestry and fishing</i>	10,7	9,7	9,2	8,6

Source: SOURCE: OWN PREPARATION WITH DATA FROM BCCR

16. However, given the plurality of formats of points of sale at nationwide market level, there arises a series of trade talks set for suppliers and their business relationship with large retailers such as supermarket chains, small grocery stores, grocery stores meaning, these buyers have a series of policies originating in their bargaining power as well as the acquisition of large volumes of various products.

17. Some supermarket chains have a presence in almost all the national territory and some have set specific formats for rural areas, in response to specific market niches, with a variety of products that meets the tastes and preferences the consumers. In short in the market have reaffirmed some of the supermarket chains on the other hand, have entered other industries, however, the competition is led by convenience stores also belonging to major chain, have an important struggle to get a better market position, offering a wide range of products, convenient geographical location, hours of extensive attention, however, prices are higher than those of a traditional supermarket.

¹ Chapter 3 State of the Nation, page 129.

18. Another innovative figure in these activities, are the distribution centers as an alternative for producers, manufacturers regarding the placement of their products, offering various facilities regarding the purchase and distribution of products, but is necessary to conduct a market study to determine elements such as the bargaining power which operates between the center and the parties, benefits or damages associated with this option, risks assumed by the parties, costs, and follow up it can operate around the product tour from downtown to the final destination. Currently, the effects that may arise regarding the negotiations between these distribution centers and the interested parties are unknown.

19. Currently, traditional sales channels such as is the case of local stores the tendency is aimed at reducing these points, however, with these comes a series of negotiations between retailer agents with conditions associated to the transport costs, handling of product, volume purchases and other negotiations that could generate anticompetitive practices. Additionally, certain constraints may arise as to the negotiations relating to the exhibition and preservation of the product to the consumer and how the "pulpero" should manage the "benefits".

20. In recent years the retail market has experienced a growth of 83%², led to the search of tastes and preferences of consumers, meaning, from a more wise profile of the consumer through the assessment of purchasing behaviors, covering the needs existing in the market. This is to establish the presence of products and services that make up the market.

21. Recently, in an article published in a national newspaper about retailing market, noted: (...) The businesses follow a strategy based largely on price competition and opening new outlets to increase convenience of its offer and attract consumers to stores located near their homes. (...)³

22. In general the market that integrates retail sales, is very tight to the fundamentals of price variables, volume of offer and demand, with multiple participants in a variety of conditions with the interference of big chains, with decreases in the traditional channels with modern channels trends. However, it is a fact that even though the market has different suppliers, there is a significant growth of large buyers reflected in their high bargaining power caused by high volumes of purchases, allowing them a position of weight in relation to its suppliers and distributors, and other aspects associated with the business, as is the inclusion of other retail formats with better prices, customer service specialization, location, appearance, and prolonged use of promotions that could cause market distortions.

23. The Chamber of Commerce of Costa Rica noted in the study entitled "Study on distribution channels in Costa Rica, that because it is a small country in size and with a significant geographical concentration of the economy in the Greater Metropolitan Area (GAM)⁴ the distribution channels are short, which makes it easier for companies to getting the most products to the end consumer.⁵

² Rodríguez Raquel, Ventas al detalle se consolidan en Mercado Nacional periódico La República, año 2015.

³ Monge Federico, Ventas al detalle se consolidan en Mercado Nacional, periódico La República, año 2015.

⁴ Directorio de Unidades Institucionales y Establecimientos 2012 del Instituto Nacional de Estadísticas y Censos (INEC), demuestra la existencia de una importante concentración de la economía costarricense en el Gran Área Metropolitana (GAM). Según datos del INEC, para el 2012, del total de 48.981 empresas registradas, un 41,9% (20.515) se encuentran establecidas en San José, un 20,9% (10.247) en Alajuela, un 10,6% (5.194) en Cartago, un 10% (4.921) en Heredia, un 4,3% (2.088) en Guanacaste, un 6,1% (2.983) en Puntarenas, 3,9% (1.901) en Limón y un 2,3% (1.132) con ubicación no definida. Fuente: www.inec.go.cr

⁵ Cámara de Comercio. Estudio sobre los Canales de Distribución en Costa Rica, año 2013.

24. Another aspect mentioned in the report lies in those situations in which economic agents play a dual role, that is, that the agent is an importer and retailer distributor, which affects the specialization of the importer given that the market is very small and therefore they can not specialize in a single product.

25. In reference to the distribution channels, it is mentioned that the supermarket industry, obeys to a complex sector, competitive and rapidly changing. The occurrence of large supermarket chains, hypermarkets, department stores have caused the spread of sets of independent supermarkets and smaller chains and other type of stores. The advantages of these sales points are that the products found in them are better and with lower prices for consumers.⁶

26. Among the major supermarket chains are Walmart formerly known as Corporación de Supermercados Unidos, which is the main chain, with its hypermarket formats (Walmart); supermarkets (Más x Menos and Maxi Pali) and its chains targeting lower socioeconomic strata (Pali); Grupo Z (Megasuper Corporation) with its store formats and discount Megasuper (Mi Mercado); Auto Mercado with supermarkets under the same name; Gessa Group with its supermarkets Perimercados and Pricesmart under a warehouse scheme.⁷

27. Another figure present in the commercial relationship between large buyers such as supermarkets, is the distributor seen as a company or individual who buys goods directly from the manufacturer in order to resell them.⁸ However, distributors are also part of the negotiations that operate between producers and retailers, as these as intermediaries can take advantage in order to manage certain negotiations that could affect consumers, such as the increase in prices among other topics.

3. Arrangements implemented by the competent authorities

28. As part of the work done by the competent authorities, in 2012 the reform to Article 12 of the Law on Promotion of Competition was promoted which protects relative monopolistic practices, expanding the definition of the behaviors that may arise as part versus negotiations between buyers and suppliers that could be considered anti-competitive. If the behaviors derive from an act, contract, agreement, arrangement or combinations with the purpose or effect of displacing an economic agent, or prevent access or the establishment of advantages in favor of one or more people, a punishable behavior can be established. However, the above is subject to verification of substantial power that the agent can exercise on the market practice.

29. Another effort led to manage a "Code of Responsible Practices of Enterprises with its Value Chain", making an important group of economic operators submit to self-regulation by the actors of the chain, in this case it is about producers, suppliers and consumers, achieving monitoring of the relationships between them.

30. With these actions wider guardianship of anticompetitive behavior that could arise as part of business relationships that operate between the agents, and to a significant increase in the chains that have higher levels of participation and exercise could be achieved set various constraints through actions such as: inclusion of contractual clauses, pricing, product placement and categorization, specialized application requirements to its suppliers, granting of discounts, tied sales, exclusive contract as well as barriers that could hamper a provider part of the group that distributes to a supermarket.

⁶ Cámara de Comercio. Estudio sobre los Canales de Distribución en Costa Rica, año 2013.

⁷ Cámara de Comercio. Estudio sobre los Canales de Distribución en Costa Rica, año 2013.

⁸ Cámara de Comercio. Estudio sobre los Canales de Distribución v en Costa Rica, año 2013.

31. In the case of small suppliers of products and its relationship with the large purchasing goods chains, could be in the presence of any of the anticompetitive practices highlighted in the previous paragraph, however, associated with these behaviors is necessary to consider that aspects such as quality, price and service are key components for product placement. However, the authority must consider in these situations, what are the variables that are in play with a practice of this kind, without compromising the protection of competition as an alternative, that far from creating a competitive market with more participants and products quality differences which should not be paid for by a law on competition but rather by another policy that respects the participation of small suppliers by designating a certain percentage to purchase their products from supermarkets believe.

32. Finally, in the marketing chain we find the relationships established between a permanent supplier and that can derive an occasional supplier because the first could be vertically integrated, signing supply contracts and other relationships as a result of a lasting business relationship however, these behaviors are part of the protection of competition when they can result in damages to consumers as: decrease in supply, transfer of consumer surplus, deficiencies in the product etc.

4. Final Conclusions

33. This sector is experiencing a number of changes in relation to the mode of existing sales points for the consumer. On one hand, there are the traditional formats such as local stores, grocery stores, smaller supermarkets, smaller installations and on the other hand, are the large retail chains formats that meet specific market niches and various segmentations.

34. Also they enter the convenience store market, while not responding to typical supermarket format in size and product management, if they offer essential products to meet a need or taste quickly. This type of business takes away some customers to large supermarket but at the same time meets the basic needs, since no high volumes of products handled.

35. The market for retail sale is made by various actors between these large supermarket chains to traditional grocery stores with challenges to keep consumers satisfied, creating new services and dabbled in other forms of sale, however, it is a sector that requires study more detailed.

36. The issue of distribution centers is a reality in the country, however, requires a specific knowledge about the scope and limits of negotiation that may have agents who make up the market and offer their products to these centers. This considering the issues of prices, fees, quality, risk capacity, growth, compensation, benefits, damages and other components that define trade relations.

CODE OF RESPONSIBLE PRACTICES WITH THE VALUE CHAIN

TABLE OF CONTENTS

Definitions	9
Introduction	11
What is the Code?	11
Who is the target audience for this Code?	11
I. Strategic Framework	12
Vision	12
Objectives	12
II. Code of Responsible Practices with Value Chain	13
Commitment to SME suppliers and distributors	13
Commitment to the consumer	14
III. Dispute resolution	15
IV. Member companies	16

Definitions

AED: Business Development Association.

Value Chain: Complete sequence of activities or parties that provide or receive value in the form of products or services.¹

Buyer: Organization or individual member of the general public purchasing property, goods or services for commercial, private or public purposes.²

SMEs Condition: Official Recognition by the MEIC to those production units that meet the following requirements, estipulated in Article 21 of Executive Decree No. 37121-MEIC of 18 May 2012:

- To comply with at least two of the following criteria:
 - Compliance with labor obligations;
 - Compliance with tax obligation;
 - The payment of social security.
- They must be registered with the MEIC as micro, small or medium businesses.

Consumer: Any natural person or entity in fact or in law, as final recipient, acquire, use or enjoy goods or services or receives information or suggestions for them. Consumer is also considered small or artisan to industrial purchasing products terminated or inputs to integrate processes to produce, process, sell or provide services to third parties.³

Sustainable development: Integration of social, economic and environmental goals in order to meet present and achieve a high quality of life, health and prosperity with social justice; without compromising the ability of future generations to meet their own needs.⁴

DIGEPYME: General Directorate for Support to Small and Medium Enterprises of the Ministry of Economy, Trade and Industry.

Law No. 8262: Law to Strengthen Small and Medium Enterprises of May 2, 2002, published in the Official Gazette No. 94 of May 17, 2002.

MEIC: Ministry of Economy, Trade and Industry.

¹ Tomado de: Norma Voluntaria Guía de Responsabilidad Social ISO 26000:2010.

² Ídem.

³ Tomado de: Ley N°7472 de Promoción de la Competencia y Defensa Efectiva del Consumidor.

⁴ ISO, op. cit.

Supplier or distributor: Any individual, entity or factual, private or public, in own name or that of others, is engaged on a regular basis to offer, distribute, sell, lease, grant the use or enjoyment of goods or supplying services, without necessarily this is their main activity.⁵

SMEs (PYME): permanent production unit that has stable physical resources and human resources, manage and operate, under the guise of natural person or legal entity, in industrial or service activities. For all purposes the term MSMEs (PYMES) will be contained in the SME (PYME) definition.⁶

Social Responsibility: According to the Volunteer Guide Social Responsibility Standard ISO 26000: 2010 is the responsibility of an organization for the impacts of its decisions and activities cause in society and the environment through transparent and ethical behavior that:

- Take into account the expectations of interested parties;
- Contributes to sustainable development, including health and the welfare of society;
- Complies with applicable law and consistent with international norms of behavior; and
- Is integrated throughout the organization and put into practice in their relationships.

SIEC: Costa Rican Business Information System.

⁵ Ídem.

⁶ Tomado de: Decreto Ejecutivo N° 37121-MEIC, Reglamento General a la Ley No. 8262 de Fortalecimiento de las Pequeñas y Medianas Empresas.

Introduction

What is the Code?

It is a voluntary self-regulatory initiative for the relationship with the players in the value chain of a business: suppliers, distributors and consumers. This initiative has great potential impact on the Costa Rican society, as it promotes transparency, inclusion of SMEs in the Value Chain and fair treatment to all stakeholders. All these topics are aligned with the pillars of the Rescue Plan Solis Rivera Administration and are part of the goal of Inclusive Growth Architecture Post 2015 of the United Nations Organization.

The companies that sign the Code undertake voluntarily to implement public and responsible practices in the relationship with the different actors of the Value Chain.

The practices included in the Code are based on the expectations of the core subjects of Consumer Affairs and Fair operating practices of ISO 26000 Social Responsibility. Also, they make reference to the best practices identified at the international and national level.

Both the MEIC as the AED in public-private alliance, value the construction of the Code as a self-regulatory initiative. Such initiatives promote collaboration in an atmosphere of mutual trust that accelerates efforts to appropriately manage the risks and opportunities of sustainability, increase the impact of best practice and contribute to make learning more efficient. Both organizations are convinced that without collective action, the fundamental challenges the country will not be achieved.

Who is the target audience for this Code?

This code applies only to SMEs established in Costa Rica and their transactions with their customers.

SMEs are subject to the benefits of these responsible practices are those that:

1. Comply with the requirements for SMEs condition, as defined in Article 3 of the 8262 Act and Article 21 of Executive Decree No. 37121-MEIC.
2. They are formally registered as SMEs and company are listed on the SIEC MEIC system.
3. If required, part of the registration of suppliers of the client company.
4. Know the Code of Ethics, or similar, of the client company, if required.
5. They report on the sustainability of their business through the following practices:
 - a. They act with transparency in reporting how they dealt with their environmental, social and economic impacts.
 - b. Meet the economic, environmental and labor legislation applicable and relevant.
 - c. Communicate changes in its raw materials, processes or staff, always impacting the goods or services acquired by the client company.
 - d. Take the transfer of knowledge that makes the company the customer and apply what they have learned.
 - e. They do not engage in bribery or conflict of interest in promoting business relations.

I. Strategic Framework

Vision

Promote and encourage compliance with responsible practices applicable to their value chain, by promoting fair and transparent business environment.

Objectives

- To Promote responsible with the value chain of the member companies of this instrument practices.
- To promote trade with reciprocity of responsibility among the different parts of the value chain.
- Encourage the accession of new businesses to this Code.
- Promote the inclusion of responsible practices in contractual instruments governing the relations between the parties.
- Promote the integration of responsible practices in the business model of companies.

II. Code of Responsible Practices with Value Chain

Commitment to SME suppliers and distributors

1. Meets applicable and relevant legislation in the different subjects that matches your business.
2. Complies strictly with the terms of the deal agreed between the parties. If such terms are modified, it will be done with the knowledge and consent of both parties.
3. Respect the company procedure for resolving conflicts and communicates to SMEs
4. Respect the confidentiality between the parties. Also, any information that is shared is true, accurate and timely, without any manipulation by the parties, or otherwise mislead or deceive.
5. It has a formal feedback process to ensure continuous improvement of the services or products received from the SMEs.
6. Share expertise and encourages best practices in the three dimensions of sustainable development.
7. Committed to fair practices and meets the applicable and relevant legislation, with regard to the form of payment to suppliers and distributors.⁷
8. Encourages linking with local suppliers and distributors.
9. Prima the value of ethics and transparency in all transactions and rules are explicit maintained preventing bribery by both parties.
10. Promotes fair competition and does not take advantage of the social conditions for unfair competitive advantage.
11. Empower all staff involved in the procurement process and execution, acquisitions and/or Storehouse for supplies in relation to social responsibility commitments acquired.
12. It includes, additionally, social responsibility criteria in the selection of goods and services.
13. Implement and applied in the company the same requirements as demand for their Value Chain.
14. Do not resort to the threat or coercion by either side to take advantage of any of the members of the Value Chain.

⁷

Para empresas estatales, aplica el Reglamento Especial para la Promoción de las PYMES en las Compras de Bienes y Servicios de la Administración, de acuerdo con el Decreto Ejecutivo N° 33305, publicado en La Gaceta N° 168 del 1 de Setiembre de 2006.

Commitment to the consumer

1. Provides accurate and timely information about their products and/or services to the consumer to allow them to make informed decisions. Informs particularly about the dangers and risks that their products and/or services provoke.
2. Clearly informs the procedures required for its products and/or services.
3. The advertising information is clear and does not mislead or deceives the consumer.
4. Tries to offer products and/or safe services, that do not create an unacceptable risk when used or consumed, even when used incorrectly.
5. Protects the privacy of consumer data under applicable law.
6. Tries to innovate in products and/or services considering sustainability criteria.
7. It has a formal process for receiving feedback from the consumer and takes corrective or preventive actions in this regard.
8. Establishes contracts and / or clear procedures of relationship with the consumer, avoiding unfair terms and including alternative dispute resolution.
9. Considers economic, social and environmental impacts throughout the life cycle of their products and/or services.

III. Dispute resolution

The signatories of this Code, seek to conduct avoiding commitments, when it is in their power, conflicts with their value chain. To do this, they endeavor to take appropriate timely communication, so that they can solve any mishap that occurs.

In this sense, the companies adhering to this Code will attempt to resolve differences without third party mediation, applying the mechanism that the company has initially established and has been knowledge of SMEs and of consumers.

If, despite this, the conflict fails to be resolved, the parties may establish a peaceful conflict resolution mechanism in which they can obtain the intervention of an expert and neutral third party.

Once all the above alternatives have been exhausted, in this Code no restrictions are established that differences be resolved in judicial or administrative body, whichever the parties deem appropriate.

IV. Member companies

The following companies publicly and voluntarily adhere to the Code of Responsible Practices with the Value Chain way, while we are committed to annually review the practices set forth herein in order to evaluate our management, to increase the impact of good practices and ensure a process of continuous improvement.