Regional Competition Center for Latin America Presents:

Competition Challenges in the Supermarket Sector

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Prof. Basker and Dr. Noel recently released a report on the distinguishing features of the supermarket sector, which present unique challenges for competition authorities monitoring this industry. The report details the experiences of other jurisdictions that may be relevant for Latin American agencies as the sector in these countries continues to evolve.

The first chapter of the report provides an introduction and highlights the supermarket sector's unique features. First and most important is the universal nature of the demand for food. With few exceptions – generally extremely rural populations without access to markets and who consume a very limited variety of food items – everyone shops for food. The universality of food shopping implies that virtually all consumers are affected by competitive behavior in the sector and thus any anticompetitive behaviors can have wide reaching impacts. The universal nature of food consumption has also created specialized regulations in many countries related to food safety, which in turn have implications for competition policy since they potentially create barriers to entry. They further create incentives for supermarkets to integrate vertically to improve inventory management and control over the supply chain.

Second, the vast majority of consumers who visit a supermarket do not buy a single item or two but rather a basket of food items, a basket that changes from visit to visit. Moreover, supermarkets provide not only a varying basket of a goods but an intermediary service: the arrangement of a large number of products available for sale together in a convenient setting and location, with emphasis on quality, service, one-stop shopping ability, and an overall shopping experience. The nature of this service is that it is highly differentiated, and no two supermarkets provide the same combination of location, prices, selection, quality, and other amenities, all of which affect consumers' choices. Both the differentiation of stores and the mix of products in one's basket matter for a consumer's choice of supermarket. These factors complicate competition analysis because different consumers may treat different stores, at different times, as either close or distant substitutes to one another. Market definition, the first step in many competition investigations, becomes more complex in this setting. In addition, supermarkets' large array of products for sale is often associated with complex pricing schemes.

Third, the sector is relatively unique because many food products tend to be perishable, with implications for both the organization of firms and the shopping behavior of consumers. For consumers, perishability means two things: they shop often and in many cases shop locally. The latter means that much of the competition between supermarkets occurs at a local level, because most consumers do not travel more than a few kilometers to buy their food. Barriers to entry at this local level can affect competition in certain areas even if national markets are generally competitive. Consequently, both mergers and anti-competitive conduct by supermarkets can negatively affect subsets of consumers in specific geographic markets.

For firms, the perishable nature of their product means that inventory control is of central importance. Supermarkets make much larger investments than other types of retailers in logistics, distribution, and inventory maintenance. This includes refrigeration (often with back-up generators), distribution centers, and trucking networks. Power outages and disruptions to supply routes can have devastating effects on a supermarket's costs. The investments in logistics and other technologies have made supermarkets into some of the largest, most technologically advanced, retailers in the world, and may create barriers to entry to smaller operators that cannot make these large investments. At the same time, the local nature of competition, combined with the differentiation inherent in this sector, has left opportunities for smaller stores to compete in local markets against large chains.

Chapter 2 in the report gives more background on the supermarket sector, including definitions of different food-selling retail formats, the history of the transformation of the sector from small stores to chain supermarkets, a listing of the major players in the Latin American supermarket sector, and a discussion of common pricing strategies by supermarkets. The latter include "focused" pricing that emphasizes so-called key-value items (KVIs), which consumers are believed to pay disproportionate attention to; promotional ("high-low") pricing, which involves frequent sales and discounts; "everyday low pricing," which relies on price stability to attract consumers; uniform pricing, which provides consistent pricing across a chain's stores over a wide region; and private label sales, which provide less expensive, non-branded, alternatives to many national products.

Chapter 3 provides a detailed discussion of the challenges of market definition given the unique features of the supermarket sector, including the proliferation of store formats and the local nature of competition. The complexities of market definition are illustrated with several recent cases from the U.S. and Colombia.

Chapter 4 discusses competition issues in the supermarket sector, including horizontal collusion, abuse of dominance, vertical contracts, and buyer power. Special features of the supermarket sector are highlighted throughout, with recent cases from Argentina, Brazil, Canada, Chile, Costa Rica, Germany, Mexico, the U.K., and the U.S.

Supermarket mergers and acquisitions are discussed in Chapter 5, as are vertical mergers between supermarkets and suppliers. The chapter discusses the ways in which direct evidence has been used to supplement "hypothetical monopolist" market-definition exercises in the U.S. and elsewhere in supermarket merger cases. One example discussed is cross-sectional benchmarking, in which prices in markets with multiple supermarkets are compared with prices in markets with monopolist supermarkets to determine the impact of competition on prices. Direct evidence can also be obtained by studying prior mergers and the impact of supermarket entry and exit on prices. Available data in each case dictates the feasible types of analysis, which complement one another as well as more traditional approaches. The analyses used in the Staples/Office Depot and Whole Foods/Wild Oats merger cases in the U.S. are discussed in detail, as are other cases from Australia, Chile, Mexico, the U.K., and the U.S.

Chapter 6 provides a discussion of some other concerns that apply to the supermarket sector and which may concern competition authorities either because they impact competition or because they may interact or interfere with certain remedies competition authorities attempt to implement. These include the internationalization of the supermarket sector with the rise of regional and international chains; regulation, including food-safety regulation and zoning regulation; deceptive trade practices; and consumer resistance to market change.

The report concludes, in Chapter 7, with a discussion of the myriad of data sources used in competition cases in the supermarket sector and the need for a unified approach to competition policy that recognizes the sector's special features. The very force that underpins the sector's promise of better quality at lower prices – economies of scale and investments in technology – naturally leads to some market concentration and the possibility of anti-competitive behavior. Competition authorities in Latin America as around the world should continue to monitor the industry carefully, and ensure the competitive balance among competitors is always maintained.