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LATIN AMERICAN COMPETITION FORUM

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

-- Contribution from Brazil --

23-24 September 2015, Montego Bay, Jamaica

The attached document from Brazil 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.

Contact: Ania Thiemann, Global Relations Manager, OECD Competition Division
[Tel: +33 1 45 24 98 87, Email: Ania.Thiemann@oecd.org].

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

STRUCTURAL MATTERS IN THE GROCERIES SECTOR: FOCUSING ON MERGERS

-- CONTRIBUTION FROM BRAZIL --

1. The retail sector in Brazil

1. Since the Law 12.529 entered into force in May 2012, the Administrative Council for Economic Defense analyzed approximately 30 transactions in the retail sector.

2. When analyzing mergers in the retail sector CADE takes into account the scale (size) and scope (product portfolio) of the transaction, which are considered key items to the development of activities in this market, given the sensitivity of demand and supply and price fluctuations.

3. CADE's case law usually views the market product as a "basket of goods" due to the competition between different retail formats. This definition usually takes into consideration the following factors: the importance of some product lines in the gross sales of retail establishments, the acknowledgment by its competitors of its position in the market, possibility of diverting the demand to competitors as a result of any price increase¹. According to the geographic definition, the acquisition of durable goods tends to be done locally, and, as CADE's case law² shows, it is most of the times limited to the municipality in which the consumer resides. In large urban centers, given the increase of mobility difficulties, often, the relevant market is defined within district or limits based on a determined radius, because "in most situations, it is most likely that depending of the product indicated, the consumer is not willing to move more than a few kilometers"³.

¹ File 08012.004168/2010-47, 08700.009587/2012-89.

² Files 08012.009959/2003-34, 08012.004997/2003-09, 08012.003251/2010-07, 08012.007406/2003-47, 08012.004259/2009-49, 08012.010903/2007-56, 08700.004910/2014-90.

³ File 08012.009959/2003-34.

4. A narrower definition suggests that other elements (as, for example, the size of the city and its population density) may influence the propensity of the consumers to shift between cities, as it occurs in the relevant market of supermarkets and hypermarkets⁴. CADE's decisions⁵ consider that supermarkets and hypermarkets are part of the same relevant market in the retail sector due to the high substitutability between these types of establishments.

5. Especially due to the size of Brazil, the retail sector in the country is characterized by local and national influences. Many distribution channels are formed on regional and local levels, and they are influenced by national recommendations (for example, margins and discounts that can be practiced).

6. Companies work under a decentralization logic whereby the regional and local levels are as important as the national one. On the one hand, the everyday life's competition is local; on the other hand, the long-term strategy is national. Thus, it is a market in which companies have national presence and regional operation, competing in a multi-product segment. Therefore, the analysis of the retail sector should take into consideration its national and local dimension.

7. Furthermore, in addition to the location of stores, distribution centers are also an element that affects competitiveness in this market, since the logistics of distribution tend to vary depending on the strategy of the player and the industry size. There are players who have their own distribution centers and others that rent them. Notwithstanding, there are also players that can distribute their products to the whole country, while others are limited to certain regions.

8. Since distribution centers are an important competitive variable in retail market, they should be analyzed within the local and national perspectives. The logistics of distribution takes into account local factors, such as the location of stores and the competitive pressure exercised by online retail, which highlights the national dimension of the sector.

9. Finally, this is an industry that depends on financial strength in order to supply consumers with credit (demand creation) and to conduct the company's own investments (expansion of supply). These are factors that directly affect the ability of the companies to enter and compete in the market.

2. Main case law in mergers in the retail sector

10. Some decisions issued by CADE show how the competition authority has assessed transactions – and has discussed these aforementioned points – in this market.

11. In 2007, the acquisition, by the Brazilian Group *Bompreço Supermercados do Nordeste*, of five supermarkets owned by Carrefour Group was cleared by CADE under certain conditions⁶. After the merger, both supermarkets, located in a city called Petrolina, would be owned by the same Group. To maintain the competition in this market, CADE ordered Bompreço to sell one of its two supermarkets – one was originally under the control of Carrefour and the other belonged to the Bompreço Group.

⁴ File 08012.004168/2010-47, 08700.009587/2012-89.

⁵ Files 08012.009959/2003-34, 08012.007406/2003-47, 08012.004997/2003-09, 08700.004910/2014-90.

⁶ Merger File 08012.003972/2001-18.

12. In 2012, the French company Casino took over the *Companhia Brasileira de Distribuição* (the trade name of *Pão de Açúcar* Group). Since Casino did not hold any shares in any Brazilian company operating in the same market as the Brazilian group, CADE cleared the merger⁷ without any restrictions. The authority understood that the transaction did not result in overlaps or integrations in the markets affected by it.

13. In this sense, two relevant cases highlight CADE's consideration of the market. In 2013, CADE approved with restrictions an association between *Pão de Açúcar* and *Ponto Frio* (merger file no. 08012.004857/2009-18), and *Pão de Açúcar* and *Casas Bahia* (merger file no. 08012.010473/2009-34). The result of both mergers was the creation of the largest retail company in Brazil: *Via Varejo*, a holding company created by *Grupo Pão de Açúcar* to manage *Ponto Frio* and *Casas Bahia* appliance chains and an e-commerce company responsible for sales of all three brands on the internet.

14. The association affected hundreds of local markets – to be precise 117 municipalities – and was approved subjected to restrictions. After a long and thorough analysis, it pointed to a high probability that those firms would exercise their market power. Thus, CADE set the following threshold: in the markets in which *Casas Bahia* and *Ponto Frio* held a market share of 60% or more, the market domination was considered anticompetitive and a remedy was needed to reestablish competition. This threshold was set because the market test developed in this case indicated that some local markets had only two or three competitors, already including the merging companies.

15. To clear this case, which involved more than a hundred local markets throughout the Brazilian territory, *Via Varejo* agreed to sell 74 commercial spots in 54 municipalities: 25 located in the State of São Paulo, 15 in Rio de Janeiro, 6 in Minas Gerais, 5 in the Federal District, 1 in Goiás, 1 in Espírito Santo, and 1 in Mato Grosso. The remedies were negotiated with *Pão de Açúcar*, *Ponto Frio*, and *Casas Bahia*. The companies accepted the divestment order and collaborated in the adoption of a performance agreement in order to better implement the divestment. The case is still under CADE monitoring.

3. Conclusion

16. As shown by CADE's case law, the presence of local markets and national influences raise special considerations in the analyses of mergers in this sector. CADE's case law deals with these aspects by addressing mainly three types of variables:

1. scale and scope to compete in the market: there is a role played by factors such as distribution, portfolio, bargaining power and financial power;
2. consumer preference for physical stores: considering that the product is a service, consumers tend to prefer the physical stores;
3. pricing policies and discounts: the pricing policies often follow a street logic of competition, however, there are some national elements that compose the prices.

⁷ File 08012.005586/2012-13.