

COFECE releases market study on food and beverage sector

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Introduction

On 4 November 2020 the Federal Economic Competition Commission (COFECE) released a market study on the food and beverage sector (specifically, focusing on the 'modern channel' – that is, self-service stores). COFECE considered the study relevant since:

- Mexican families spend 27% of their expenses on food and beverages; and
- this sector employs 9.3 million people in Mexico.

Through the study, COFECE:

- noted that few self-service chains have a national presence;
- warned of regulatory barriers that harm competitive conditions and favour market concentration; and
- issued recommendations to address these identified problems.

COFECE's concerns

COFECE identified the following main concerns:

- The structure of the modern channel is concentrated among a few players:
 - In the warehouse, supermarket, hypermarket and megamarket (WSHM) formats, only three companies have a national presence.
 - In the areas which have only one company present, Walmart is the brand present 87% of the time.
- In some regions, there is not enough competitive pressure for WSHM format stores:
 - Consumers buy from the closest stores to reduce costs and travel time, so competition in the modern channel is local.
 - Two out of 10 Walmart WSHM stores have no competitors in their area of influence. Moreover, in undeveloped areas, almost half of Walmart's WSHM stores have no competitors.
- High concentration favours the bargaining power of large retail chains versus their smaller suppliers, which could damage market efficiency in the long run:
 - Some retail chains have business practices that cause uncertainty and unforeseen costs for their suppliers and transfer to them the risk that products the retailer has already purchased will not be sold. Such practices include paying late, applying non-negotiated charges and returning merchandise without prior agreement.
 - Large retail chains can impose conditions that affect the profits of their suppliers to the extent of reducing their availability of resources to invest and innovate or even precipitate their exit from the market.
 - To prevent abuse by large chains, in 2009 retailers and suppliers executed an agreement that includes the Code of Competitive Business Practices. However, this code has not been effective in Mexico, mainly because it is unknown to small suppliers, its subscription is voluntary and it fails to include some abusive practices.
- Regulatory barriers at the local level harm competition in the modern channel and favour concentration:
 - The study identified legal and regulatory provisions that, if repealed or amended, would reduce the barriers to entry faced by physical stores.
 - The requirements imposed in several states hinder the entry or expansion of businesses. For example,

AUTHORS

[Lucía Ojeda Cárdenas](#)



[Felipe García Cuevas](#)



[Diego Hernández Aello](#)



six state regulations favour the distribution and commercialisation of local products with respect to those coming from other entities or those that are imported, making it difficult for potential competitors to enter the market.

- Regional or local commercial chains generally have fewer resources than national chains to overcome the regulation barriers:
 - Large national chains have sufficient experience and resources to form legal teams specialised in procedures. On the other hand, regional and local chains generally have fewer resources to do so.
- Regulatory barriers generate a bias that favours the opening of smaller format establishments that have reduced inventories:
 - The fulfilment of the procedures for the opening of establishments implies administrative costs, which are payments to process the permits.
 - The delay in the procedures represents a high opportunity cost that commercial chains must face in order to enter local markets. The average time that it takes to open a WSHM store is 351 working days, 2.4 times more than for discount stores and express stores (DSES), and the administrative cost of opening a WSHM store is 6.9 times greater than that of DSES stores.
 - It is estimated that WSHM agents lose approximately Ps1 million for each day that it takes to receive authorisation to start operations, while the administrative cost of the procedures is estimated at approximately Ps1,860 for each day that it takes to open an establishment of the same format.

COFECE's recommendations

Considering the concerns described above, COFECE issued the following recommendations:

- The implementation of the code should be improved through greater promotion among business bodies and the incorporation of commercial practices not currently contemplated, in addition to greater and better use of its monitoring, evaluation, penalising and dispute resolution mechanisms.
- State and municipal authorities should modify or eliminate provisions that limit businesses' ability to compete or that limit the number and variety of competitors. In particular, these authorities could establish one-stop counters to authorise the establishment and operation of self-service stores, collaborating with the federal executive by designing an assistance or best practices programme.

Comment

COFECE's study identifies several relevant competition concerns in the food and beverages retail market. As stated before, this market has a lot of impact in the Mexican economy, given the portion of income that families spend on food and beverages and the number of jobs that the sector produces. Therefore, it is positive that COFECE has highlighted the main competition problems that this market experiences.

With regard to the market power that certain players might have, given that COFECE has already identified high market concentrations in certain regions of the country, it would be expected that the study would serve as a warning to the big players and that they would be particularly cautious in their conduct and with the type of contractual terms and conditions that they enter into in order to avoid potential complaints from suppliers or competitors and investigations by COFECE that could lead to penalties due to market dominance abuse.

With regard to the asymmetric power relationship between retailers and suppliers, it would be expected that efforts would be made to promote and improve the code, so that it would be an effective tool to prevent abuse by players with greater negotiating power.

Finally, in connection with the regulatory barriers noted by COFECE, it would be convenient if state and local authorities review their regulatory frameworks so that they generate better competitive conditions for the benefit of consumers and the public as a whole.

For further information on this topic please contact [Lucía Ojeda Cárdenas](mailto:Lucia.Ojeda@sai.com.mx), [Felipe García Cuevas](mailto:Felipe.Garcia@sai.com.mx) or [Diego Hernández Aello](mailto:Diego.Hernandez@sai.com.mx) at SAI Consultores SC by telephone (+52 55 59 85 6618) or email (loc@sai.com.mx, fjc@sai.com.mx or dha@sai.com.mx). The SAI Consultores website can be accessed at www.sai.com.mx.

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