Final Report on Commercial Relations Between the Large Retail Groups and their Suppliers

(Abridged English Version)

Portuguese Competition Authority

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Portuguese Competition Authority (PCA)

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EXECUTIVE SUMMARY

The commercial relations between the large retail groups (LRGs) and their suppliers have been the subject of debate in Portugal for a number of years now, as they have been in many countries across Europe.

The issue has surfaced again recently with many factors coming together: the growth of LRGs; the imbalance in bargaining power, with suppliers on the downside; the reform of the Common Agricultural Policy (CAP); and the volatility of prices for certain foodstuff on international markets. It was against this backdrop that the Portuguese Competition Authority (PCA) decided to undertake this market study. This report is the result.

The aim of this market study was to give as detailed a picture as possible of the food supply chain in Portugal as the LRGs are concerned. The market study required the collection and treatment of a vast amount of data requested from nearly 50 organisations.

The report analyses the behaviour of the nine LRGs operating in Portugal, covering a representative sample of what are generally referred to as “fast moving consumer goods” (FMCG). This includes dairy products (UHT milk, yoghurts, cheese and butter), rice, pastas, flour, breakfast cereals, biscuits, vegetable oils (seed-oils, olive oil and margarine), fruit and vegetables, and soft drinks, coffee and substitutes.

The nine LRGs held a market share of around 85% of foodstuff in 2008, with the two biggest groups coming in with around half of that market share. FMCGs account for around three-quarters of spending in supermarkets.
A major finding of this market study concerns the competition assessment of buyer power. In spite of the fact that the new EC guidelines on vertical restraints give greater emphasis to the seller power of suppliers as against the buyer power of the big retailers, the latter could increase so much in the years ahead that it may not be seen automatically as being pro-competition, as it is now.

The PCA has identified four areas where the increase in buyer power would seem to have been more acute: (i) the unilateral imposition of terms and conditions (i.e., negotiations around a standard contract) (ii) discounts and related mechanisms; (iii) penalties; and (iv) payment terms.

The concerns identified by the PCA on the basis of this market study do not come strictly within the scope of prohibited practices as per competition law, a finding that is in line with similar studies undertaken in other countries of the European Union. Specifically:

(i) The provisions of the contracts between the two sides do not impede, distort or restrict competition in any substantial way (Article 4 of the Portuguese Competition Law or Article 101 TFEU);

(ii) There is no evidence of abuse of a dominant position, bearing in mind that none of the LRGs has such a dominant position (Article 6 of the Portuguese Competition Law or Article 102 TFEU); and

(iii) Even though some suppliers only work with one of the LRGs, there is no evidence that equivalent alternatives do not exist meaning that there is no evidence of abuse of suppliers in terms of economic dependency (Article 7 of the Portuguese Competition Law).

Some issues, however, may fall within the provisions of legislation on (individual) unfair trade practices and therefore warrant continued rigorous scrutiny.
This point, however, does not detract from the fact that a detailed analysis of the many contracts signed between distributors and suppliers reveals an imbalance in bargaining power, generally to the detriment of the suppliers.

On the basis of the market study carried out, and the legal framework, both domestic and European, the PCA believes that it would be helpful to put forward a raft of recommendations geared to promoting a culture of competition, which contributes to a more balanced and transparent bargaining power and an effective proactive position taken by the authorities that have jurisdiction in the matter.

All the recommendations should be duly framed within the scope of the discussion on the food supply chain issues which have been taking place in the European Union, specifically within the context of the work undertaken by the European Council, the European Commission and the European Parliament.

The recommendations cover a range of topics, specifically

1. Promotion of a culture of competition through self-regulation based on a code of conduct acceptable to all parties;

2. An analysis of the opportunity to draw up regulations on debatable trade practices that do not fall within the existing competition legislation or the legal framework covering restrictive practices, and where there is no possibility of agreement through self-regulation;

3. Reinforcement of the collection, treatment and dissemination of statistical data for prices and quantities along the food supply chain;

4. Additional recommendations:
   (i) Greater emphasis on supervising compliance with legislation covering restrictive trade practices;
   (ii) Measures that encourage the creation of small/medium-sized commercial units in local markets;
(iii) Analysis by an independent consultant financed on the impact on consumer welfare of “look alike” and “copycat” products;

(iv) Priority to transposing to domestic legislation the next directive from the European Commission and the European Parliament on payment terms for commercial transactions; and

(v) Proactive participation by the competent Portuguese authorities on the work undertaken by European institutions that deal with issues related to the food supply chain and the large retail sector.
1. Main conclusions

International framework

1. Since the second half of 2006, the world has witnessed widespread volatility in commodity prices affecting foodstuff, both in Europe and across the globe. This has led to greater concern about relations between food distribution groups and their suppliers, a concern that has in turn spilled over into a related issue, which is the alleged imbalance in the bargaining power of the two sides.

2. A considerable part of the current discussion (at the European Commission level and between member states) has centered on the commercial relations between food distributors and their suppliers consequent on the prospects generated by the 2003 reform of the Common Agricultural Policy (CAP), to be in force by 2013. This has been aggravated in part by events in the three-year period 2006 to 2008, when there was great volatility in international prices for commodities in the food sector. Against this backdrop, there has been a fall-off in production incentives, with concern being expressed in a variety of quarters.

3. The aim of the 2003 CAP reform was to conclude the process of liberalizing the agricultural sector in the EU, with the final abolition of quotas and intervention prices and with gradual cut backs in direct aid to come into force by 2013. As a result of this ongoing market liberalization, there are some agricultural markets, specific to certain member states, which may become more vulnerable to the growing buyer power of distributors and the way they can influence supply structures. This vulnerability could affect prices, productive capacity, incentives for producers and/or sales conditions.

4. In tandem, there has been growing concern in many community institutions, among them the European Parliament and the European Commission, regarding moves in prices for foodstuff, and the differential between prices paid to the producer and prices charged to the consumer, tied in with an array of trade practices used in the food distribution sector,
along with a range of issues relating to production, supply and distribution of foodstuffs.

5. As a result, the European Commission published an interim report in December 2008, on the subject of “Food prices in Europe”\(^1\), along with a road map detailing the key guidelines for the political actions to be taken. In October 2009 the European Commission published a communication entitled “A better functioning food supply chain in Europe”\(^2\), where the Commission outlined specific political initiatives in line with the road map. More recently, in July 2010, the Commission published the “Retail market monitoring report”\(^3\), in accordance with the new approach to monitoring the market set out in the 2007 document on “A single market for 21\(^{st}\) century Europe”.\(^4\)

6. The Commission identified three priorities, common to the whole food supply chain, to be followed by member states. These relate to (i) fostering sustainable market-based relations between all stakeholders in the food distribution chain, (ii) increasing transparency along the chain so as to provide an incentive for competition and resilience to price volatility, and (iii) encouraging integration and competitiveness in the chain in all member states.

7. In this context, the issues relating to growing buyer power of large retailing groups (LRGs) vis-à-vis their suppliers have warranted special focus. It has been the subject of several studies, carried out not only by the European Commission, including the General Directorate for Competition (DG COMP) and the General Directorate for Agriculture and Rural Development (DG AGRI), but also by member states, either through their competition

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authorities or their agriculture ministries. This work has attempted to mesh a range of solutions into the process of European integration and the creation of the single market, as envisaged in the CAP reform of 2003.

8. The Portuguese Competition Authority (PCA) as an active member of the “European Competition Network” (ECN), has been following the analyses undertaken by the EC and by member states and has been participating in the ECN working groups on these subjects.

Applicable legislation and code of conduct

9. The major expansion of the LRGs compared with traditional retailers and suppliers has led to a series of regulations geared to returning some degree of balance to the market where these players operate.

10. There are, for example, restrictions on the licensing of stores run by the LRGs and on their opening hours (until recently, hypermarkets had to close on Sunday afternoon, though new legislation has recently been approved allowing them to open on Sundays all day if local authority approval is obtained). The aim of these restrictions is to provide some protection for traditional retailers, but there is no clear indication as to whether the opening hour restriction has in fact done so.

11. The commercial relations between big retailers and their suppliers are regulated in part by domestic legislation relating to (individual) unfair trade practices (Decree Law 370/93, of 29 October 1993, subsequently amended by Decree Law 140/98, of 18 May 1998), in particular as regards the norms for “below cost sales” and “abusive negotiating practices”.

12. When looking at the practices stemming from the commercial relations between the big retailers and their suppliers, a distinction has to be made between:

   (a) Those that fall within the scope of Portuguese Competition Law (as for example in articles 4, 6, and 7 of Law 18/2003, of 11 June 2003) and/or in the Lisbon Treaty (TFEU)\(^5\) (articles 101 and 102), if

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\(^5\) The TFEU—also known as the Lisbon Treaty—replaces what was EC Treaty that set up the Community, also known as the Treaty of Rome.
it can be shown that they have an appreciable effect on competition;

(b) Those that fall within the scope of (individual) unfair trade practices; or

(c) Those that may on the surface indicate (for example) an imbalance between the bargaining power of each side, but do not show per se any infringement under the terms of the Portuguese Competition Law, or the TFEU, or the legislation on unfair practices.

13. It is difficult to fit a large part of the type of practices analysed here in this competitive assessment framework. This is above all true if we compare agreements on purchases (a priori pro-competition) with agreements on sales (a priori anti-competition) (see for example article 5 of the Portuguese Competition Law and/or article 101, 3 of the TFEU).

14. There are two points that should be borne in mind here:

(a) Portuguese legislation does not have a redistributive purpose, so certain trade practices between suppliers and distributors cannot be seen within the terms of the competition law, among them the increasing buyer power arising from a certain degree of concentration, and the expansion of specific private labels; and

(b) The legislation relating to (individual) unfair trade practices\(^6\) aims to protect competitors and/or consumers, and can be applied whether or not there seems to have an appreciable effect on competition. Specifically, the law seeks to bring about equilibrium and transparency in the relations between economic agents.\(^7\)

\(^6\) In particular, as this relates to the use of discriminatory prices or conditions, to below cost sales, to a refusal to sell products or provide services and to abusive negotiating practices.

\(^7\) The law as it stands means that the Portuguese Authority for Food Safety and Business Affairs (ASAE) has the task of supervising compliance relating to unfair practices, while the Portuguese Competition Authority is responsible for instructing the cases detected and referred to the PCA by ASAE and levying fines. It should be mentioned that «The purpose of ASAE is to assess risks in the food supply chain and make the information on this public, along with supervising and ensuring compliance with legislation regarding business operations in the food and non-food sectors», specifically, «To supervise economic agents’ compliance with their legal obligations», under the provisions of Decree Law 274/2007, of 30 July 2007, article 3, clause 1 and clause 2, paragraph s).
15. This then raises the issue of whether practices not covered by Portuguese competition law can be considered as unfair practices and, if they are not, whether they should be covered by regulatory and/or legal measures.

16. Finally, there is the possibility that relations between the LRGs and their suppliers could be subject to self-regulation, as with the Code of Fair Trade Practices drawn up by the Confederation of Portuguese Industry (CIP) and the Portuguese Large Retailers’ Association (APED) in July 1997.

**The focus of this report**

17. The main focus of this report covers basic food consumed in large quantities and the “commercial relations between the large retailing groups and their suppliers” in the food distribution sector.

18. The comparison between the characteristics of distribution and supply provides an opportunity to check on the relative market powers of the big chains in the market and their suppliers, particularly in light of the major expansion of the former. This analysis will be supplemented by a description and appraisal, within the terms of the PCA remit, of the main types of trade practices (contractual and extra contractual) prevalent in the relations between the big distributors and their suppliers.

19. The term “distribution” is taken to include a range of functions relating to the acquisition of foodstuff from suppliers (fundamentally upstream in the production chain) in order to sell the goods to the consumer. It is made up, in general terms, by two sets of operations: (i) one which is upstream of the ‘wholesale activity’ – and this includes cooperatives acting as wholesalers, along with smaller scale operators and wholesale chains (in some cases very small indeed). These are the traditional suppliers for small retail outlets (such as grocers’, hardware stores, bakers’ and confectioners’, butchers’, fishmongers’ and local markets), as well as a large part of the hotel, restaurant and café trade; and (ii) that part of the market which is downstream, known as the ‘retail trade’.

20. The retail trade includes: (i) hotels, restaurants and cafés, as already mentioned, which pick up supplies through the wholesale trade, and more
and more directly from the supplier, in the agro-food supply sector; (ii) the traditional, atomized, retail trade; (iii) smaller and regional based retail chains; and (iv) large retailing groups (LRG), defined here as the main retail chains with a network of outlets, both small and large (mini-markets, supermarkets and hypermarkets), extending (in fact or potentially) nationwide.

21. Currently, there are nine of these LRGs in mainland Portugal (this being the geographical scope of the present report), operating in foodstuffs under the banners:

(1) Aldi;
(2) Auchan (using the banner names “Pão de Açúcar” and “Jumbo”);
(3) Dia%/Minipreço (Dia), part of the Carrefour group, operating through a network of small stores with the banners “Dia” and “Minipreço”;
(4) El Corte Inglés (hereafter referred to as “ECI”, part of the “Supercor” brand);
(5) E. Leclerc;
(6) ITMI or “Os Mosqueteiros” operating under the brands “Ecomarché” and “Intermarché” and using the banner name Netto for the so-called “hard discount” or “discount” sector;
(7) Jerónimo Martins (hereafter referred to as “JM”, using the wholesale banner name “Recheio” and the retail banner “Pingo Doce” (supermarket size), in the process of taking over from what was the hypermarket brand “Feira Nova;”
(8) Modelo Continente, formerly of the Grupo Sonae Distribuição (hereafter referred to as “MC”, using the hypermarket brand “Continente” and the supermarket or smaller scale shops “Modelo”,

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The term “discount” is taken to be retail distribution characterized by the sale of low price products, many of which are private labels, also called in Portugal “marcas brancas” - white brands, i.e., products manufactured or supplied by one company and sold under the banner of another. The term “hard discount” is normally used for shops which sell exclusively private label goods, such as the Aldi Group in Portugal. Bearing in mind the fact that the two terms are sometimes confused, we shall use the single term “discount” in this report.
“Modelo Bonjour” and “Modelo 24”–M24–the last of these being mainly found on service station sites run by the oil company Galp);

(9) Lidl (Schwarz group).

22. The groceries market share of these nine LRGs amounted to 85% in 2008. The share of the two biggest LRGs (MC and JM) represented almost 45%. The total value of retail sales in foodstuff, according to estimates made by this authority, stands at around 12,154.0 M€ (million euros) in 2008, amounting to around 7.3% of GDP. This was around 30% higher than the figure for 2004, when it stood at 9,345.6 M€ (around 6.5% of the GDP for that year). In 2008, the nine LRGs employed around 57,000 staff–of which around 39,000 was in the two biggest retail chains–and this was an increase of around 63% compared with 2004, when the figure was around 35,000.⁹

23. The main products covered here by what is termed “distribution” are those known as mass market consumer goods and these can be divided into: (i) fast-moving non-durable consumer goods, usually referred to as “fast moving consumer goods” (FMCG)¹⁰, in retail sales and in the supply sector, and these make up the main basket of purchases in supermarkets (outlets between 400 m² and 2,500 m²), including everyday food and beverages (groceries, dairy products, meat, fish, vegetables and fruit), along with toiletries, household and cleaning products; and (ii) “widely used durable consumer goods”, including, for example, household appliances, products

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⁹ Cf. Newsletter of the APED, no. 57 “Ranking 2008”, May-June 2009, available on http://www.aped.pt/Media/content/182_1_G.pdf. It should be mentioned that these figures relating to the number of employees are conservative estimates, bearing in mind that they do not include the ITMI, E. Leclerc and Aldi groups. To come to a general overall figure of staff numbers, examples could be given from the JM group, with around 25,000 employees (2009), Auchan, with around 8,000 (2008) and Dia%/Minipreço with around 4,000 (2009).

¹⁰ The term “groceries” is used to describe a basket of goods in the food distribution chain. The Portuguese institutions INE (the National Statistical Institute) and IAPMEI (the SME Agency) include toiletries and cleaning or household goods in this basket. This represents the main basket of goods sold in supermarkets. The alternative designation, “FMCG”, is used in this report, as it is by a number of organisations in the sector, including Centromarca (the Portuguese Association of Brand Products Manufacturers) and Nielsen (e.g. Scan Trends, Nielsen, no. 6, September 2009, p. 3).
for house and garden, sports equipment and clothing.\textsuperscript{11} FMCGs account for around two-thirds of expenditure on consumption goods in supermarkets.

24. As already mentioned, the main focus of this report is widely consumed food products. However, given the big number of items this could include, and the variety of food sold by the LRGs, this analysis will be limited to a selection of these goods, made up of dairy products (UHT milk, yogurts, cheese and butter), rice, pastas, milk, flour for culinary use, breakfast cereals, biscuits, vegetable fat products (cooking oil, olive oil and margarine), fruit and vegetable and big turnover non-alcoholic drinks (bottled water, soft drinks, fruit juices but not alcohol-free beer), and coffee and related products.

25. Focus on these products can be justified: (i) by the importance they have in family budgets, given that this selection represents around 40\% of household consumption of fast-moving non-durable consumer goods (that is, in the main basket of products sold in supermarkets); (ii) by other studies of food and beverages being undertaken in various member states, in the wake of the effects stemming from the crisis that affected the sector in the three-year period 2006 to 2008; and (iii) by the fact that a large part of these products or the raw materials from which they derive are covered by intervention through the CAP.

Specific issues raised by the development of LRGs

26. The LRGs act in effect as gatekeepers in the chain that runs from manufacturing—as pertaining to foodstuff—to the consumer. Their growing market power in the retail business and as clients of the suppliers has played a part in the progressive loss of clout on the industry side, given the buyer power of LRGs in determining price levels along the value chain, from production to supply and in sales to the consumer.\textsuperscript{12}

\textsuperscript{11} In fact, LRG business extends beyond the sale of these products and can cover, for instance, repairs to cars and retail sales of fuel (petrol and diesel) at service stations.

\textsuperscript{12} The recent EC Working Document from the European Commission is recommended reading on this issue. It is entitled: “On Retail Services in the Internal Market – Accompanying document to the Report on Retail Market Monitoring: “Towards more efficient and fairer retail services in the
27. This new pattern is characterised by the growing buyer power of the major retailers compared with a situation where there was a bigger degree of relative concentration of suppliers and this has led to tensions in the commercial relations between suppliers and distributors.

28. Earlier studies have shown that centralized purchasing and vertical integration in some LRGs have led to lower prices in a range of goods purchased by these groups, and consumers have tended to feel the benefits with the pass-through of the results of their buyer power, even tough the pass-through may be only partial.

29. As these groups have expanded in the retail sector, there has been a considerable increase in their needs for FMCG compared with other clients, especially the wholesale channels and the hotel, restaurant and café sectors. In addition, the LRGs have developed different strategies to improve their purchasing conditions—i.e., in such a way as to increase their buyer power over their suppliers—and thus gain a competitive edge (between each other and over the remainder of the trade), boosting their sales to the public and pushing up their margins.

30. Their expansion has in fact, as already mentioned, turned them into real gatekeepers giving access to the market (final consumers) for branded labels. The exception is non-alcoholic drinks, where hotels, restaurants and cafés provide an important channel for getting their products to the market. An analysis from the economic and legal angle, however, does not lead to the conclusion that LRG network can be considered an “essential infrastructure,” needed to get suppliers’ branded labels to the market, even when there is competition with private labels.

31. Notwithstanding these points, it is worth looking at the current expansion of private labels, and the growing trend towards concentration among the retailers in obtaining supplies and in selling their products. Highlighting what is happening could well raise concern about the possible future effects of the expansion of the retailers and their private labels, both on the supply industry, and on the effects of the pass-through to the consumer.

Currently, private labels account for 29% of sales of FMCGs (in value terms), with only 2.2% corresponding to own production.

32. In spite of the fact that the new EC guidelines on vertical restraints give greater emphasis to the seller power of suppliers as against the buyer power of the big retailers, if the issue is seen in the terms outlined above, the LRGs buyer power could increase so much that they will not be seen automatically as being pro-competition, as they are now.

33. The analysis made in this report suggests that the possibility of a balance to be reached over time between the buyer power of the LRGs and the seller power of suppliers depends fundamentally on various factors: whether there is an alternative channel for suppliers to get their products to the market; the degree of concentration of the big retailers on the demand side; the expansion of their private labels (actual or potential); and the degree to which the LRGs have recourse to purchases abroad, especially for their private labels.

34. The measure of relative buyer power used in this report is given by the ratio between the degree of concentration of suppliers’ sales of their brands—thus excluding LRGs’ private labels—and the degree of concentration of LRGs’ purchases. In case this ratio is lower than one, it suggests that LRGs have a relatively higher buyer power than the seller power of their suppliers. Considering this measure of buyer power and looking at the food products under review, leaving aside soft drinks, coffee and related products—where suppliers have alternative channels to LRGs—it can be seen that LRGs indeed act as gatekeepers, controlling the availability of these products to consumers. They account for over two-thirds of the demand for most of these products. Moreover, there exists a clear tendency for the LRGs’ buyer power to become larger than the relative seller power of their suppliers i.e., there is a clear tendency for the ratio of relative buyer power referred above to become smaller than one. In fact, this was already observed in the fruit and vegetables sector during the period 2004 to 2008.

35. From this it can be seen, as already mentioned, that the buyer power of the LRGs can act as a counterweight to the seller power of suppliers, to the
apparent benefit of consumers—at least where there is a pass-through effect—but the increase in this buyer power over time is likely to rack up tension in the commercial relations between these groups and their suppliers where there are few alternative channels for the suppliers to get their own products to the market.

36. In turn, there has been a growing move among retailers to provide their own brand of certain products (private labels), available exclusively in their stores and competing against branded labels. This has knocked on to issues of competition, economic efficiency and the effects on consumers’ welfare.

37. The growth of private label sales can be seen as the result of a competitive strategy from the LRGs with two main aims: (i) to improve their competitive position in purchases and sales; and (ii) to increase customer loyalty. The results of the studies undertaken to date show that the expansion of private labels tends to cause the market to expand, either by bringing “a democratic bias” to the consumption of products which can be close substitutes for branded labels, or by offering a product with a price that is lower than the comparable branded labels.

Main concerns

38. As already mentioned, some of the trade practices of LRGs may seem to raise problems in terms of the contractual relations between distributors and suppliers, but they may not fall within the scope of legislation designed to foster and protect competition, or within legislation that is geared to protecting or encouraging good trade practices. There are practices that may be deemed unfair, in particular as regards the norms for “below cost sales” and “abusive negotiating practices.” These must continue to warrant special attention from the authorities, as they may be illegal, though there are also practices that fall within the purview of other entities in the social sphere.

39. In fact, the analysis undertaken by the PCA found that the concerns expressed did not come strictly within the provisions of Portuguese Competition Law (articles 4, 6 or 7).
40. The PCA did not find any elements in the contracts between distributors and suppliers which have the effect of impeding, distorting or restricting competition in any substantive way (article 4).

41. There is, moreover, no evidence that a dominant position is being abused, since none of the LRGs would seem to have such a dominant position (article 6).

42. In addition, even if some suppliers only sell to one LRG there is no evidence that there are not equivalent alternatives. Despite the importance of the LRGs for the distribution of certain categories of products, those suppliers can reach consumers by switching between LRGs or going through the hotel, restaurant and café sector, or directly to traditional shops and/or their own outlets. There is also, in certain cases, the possibility of exporting their products abroad. There is thus no evidence of economic dependence of suppliers vis-à-vis LRGs (article 7).

43. This does not, however, detract from the point that an analysis of many contracts between distributors and suppliers clearly show imbalance between the two parties, with increasing buyer power.

44. There are overall four areas where the imbalance would seem to be more acute: (i) the unilateral imposition of contract conditions (that is, negotiations within a pre-set purchasing agreement); (ii) discounts and related mechanisms; (iii) penalties; and (iv) payment terms.

45. In terms of unilateral imposition of contract conditions, there are two points that make the distributor the party that “calls the tune”: one is the prior definition of general conditions; the other is the supplier’s limited room for manoeuvre when it comes to negotiating.

46. In terms of discounts and related mechanisms, their use is common in the trade, so if they are included as such, there is no reason for any concern. There are, however, issues to be looked at regarding the value of the discount in any one commercial transaction and also the justifications given for applying the discount or for the effects that might result from it.

47. The field of penalties has implications in some form or another in all aspects of the commercial relations involved. From the analysis of the wide
range of contracts carried out, only one of the parties—\textit{in casu}, the supplier—is subject to penalties stemming from the contract.

48. As regards the final point (payment terms), this has been a concern across the EU and in European institutions. This point raises essentially two kinds of problem: (i) contracts which set long time spans between the date of invoicing and the date when payment is due, above all for products that only have a limited shelf space time period; and (ii) delays in payment (most frequently, delays beyond the date when payment is due, but also breaches of contractual payment terms). New legislation recently approved places stricter conditions on this point and should resolve many of the outstanding issues (Decree Law 118/2010, of 25 October 2010).

**Repercussions from the increase in VAT rates**

49. This report also includes a brief summary of the effects of the recent one percent increase in VAT rates, moving in the three rates to what are now 6%, 13% and 21%. The specific point here is the intention proclaimed by some of the LRGs not to pass on the increase to the consumer; and the concern was that the increase in VAT rates would be absorbed in the form of an extra discount that the supplier would be required to accept.

50. Based on the information reported by the LRGs and a representative sample of suppliers, the PCA has in fact not detected (up to the date of this report) any clear evidence that the LRGs have passed on the effect of the VAT rates increase to the suppliers from the date the change came into force on 30 June 2010.

**Recommendations**

51. On the basis of the analysis in this report, covering a it does a subject that is so complex, and bearing in mind the domestic and European legal framework, the PCA is setting out a series of recommendations aimed at promoting a culture of competition and a more transparent and balanced
relationship between economic agents, with effective action from the authorities that have responsibilities in this area.

52. All the recommendations should be duly framed within the debate on issues relating to the food supply chain and to large retailers that have been taking place in the European Union, specifically in the context of work undertaken by the European Council, the European Commission and the European Parliament.

53. The recommendations, set out in more detail in the following chapter, cover various areas, among them the following:

(a) Promoting a culture of competition that makes it possible to strengthen the self-regulation process through the reinstatement of the 1997 CIP/APED Code Fair Trade Practices, or the implementation of a new code which can play a part in improving contractual and/or extra-contractual conditions that govern the commercial relations between producers and distributors.

(b) Looking at the possibility of regulating contentious trade practices involving contracts between suppliers and distributors that do not fall within the scope of competition law or the legal framework covering (individual) unfair trade practices yet also do not seem amenable to resolution through self regulation between suppliers and distributors.

(c) Collecting, treating and disseminating more statistical information on prices along the food supply chain, along with related statistical information on quantities, allowing for a better understanding of the issue among all the interested parties and for timely intervention by the authorities, if necessary, to detect possible distortions to competition and/or to price formation along the food supply chain.
2. RECOMMENDATIONS

54. Commercial relations between the LRGs and their suppliers raise three separate issues pertaining to the Portuguese competition legal framework:

(a) Those that can be seen as falling within the definition of “restrictive practices” as set down in the Portuguese Competition Law (articles 4, 6, and 7 of Law 18/2003, of 11 June 2003), and/or in Treaty on the Functioning of the European Union (TFEU,\(^1\) articles 101 and 102), if there can be shown that they have an appreciable effect on competition;

(b) Those that can be seen as falling within the definition of (individual) unfair trade practices (Decree Law 370/93, of 29 October, with the amendments introduced through Decree Law 140/98, of 16 May); and

(c) Those that may appear to reflect (for example) an imbalance in the bargaining power of the two parties, but do not per se infringe legal or competition strictures under the terms of Portuguese or EU legislation or the (individual) unfair trade practices mentioned above.

55. It must be remembered that Portuguese Competition Law does not have a redistributive purpose, so certain supplier/distributor practices cannot be seen to fall within its remit, among them those that stem from increased buyer power associated with a certain level of concentration or from growing sales of private labels.

56. As for legislation on (individual) unfair trade practices,\(^1\) the aim here is to protect competitors and/or consumers, and the law is applied whether there is a material effect on competition or not. The legislation aims, in

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\(^{1}\) The TFEU replaces what was the EC Treaty that set up the Community, also known as the Treaty of Rome.

\(^{1}\) In particular, as it relates to the use of discriminatory prices or conditions, below cost sales, refusal to sell products or provide services and the abusive negotiating practices.
particular, to bring about equilibrium and transparency in relations between economic agents.\textsuperscript{15}

57. There is thus an issue concerning practices that are not covered by competition law or (individual) unfair trade practices, but do nonetheless raise concern over the balance between the parties involved. These need to be looked at carefully and it may be deemed necessary to put forward regulations or legal statutes or have recourse to self-regulation.

58. The PCA, therefore, following the analysis set out in this report, and under the powers vested in it through article 6, clause 1, paragraphs b) and f) and article 7, clause 4, paragraph b) of its statutes (Decree Law 10/2003, of 18 January 2003), hereby puts forward a series of recommendations geared to promote a culture of competition and equilibrium and transparency in the relations between economic agents\textsuperscript{16} and effective oversight by the authorities responsible for these issues.

59. All the recommendations should be duly framed within the debate on issues relating to the food supply chain and to large retailers that have been taking place in the European Union, specifically in the context of work undertaken by the European Council, the European Commission and the European Parliament.

60. More specifically, three recommendations stand out:

(1) Promoting a culture of competition that makes it possible to strengthen the self-regulation process through the reinstatement of the 1997 CIP/APED Code of Fair Trade Practices, or the implementation of a new code which can play a part in improving contractual and/or extra-contractual conditions that govern the commercial relations between producers and distributors (section 1.1);

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\textsuperscript{15} The law as it stands places the task of supervising compliance on restrictive practices to the Portuguese Authority for Food Safety and Business Activity (ASAE) while the Portuguese Competition Authority is responsible for instructing the cases referred to the PCA by ASAE and levying fines. It should be mentioned that «The purpose of ASAE is to assess risks in the food supply chain and make them public, along with supervising and ensuring compliance with legislation regarding business operations in the food and non-food sectors», specifically, «To supervise compliance of economic agents with their legal obligations», under the provisions of Decree Law 274/2007, of 30 July 2003, article 3, clause 1 and clause 2, paragraph s).

\textsuperscript{16} Vide Preamble to Decree Law 140/98, of 16 May, amending Decree Law 370/93, of 29 October.
(2) Looking at the possibility of regulating contentious trade practices involving contracts between suppliers and distributors that do not fall within the scope of competition law or the legal framework covering unfair practices yet also do not seem amenable to resolution through self-regulation between suppliers and distributors (section 1.2); and

(3) Collecting, treating and disseminating more statistical information on prices along the food supply chain, along with related statistical information on quantities, allowing for a better understanding of the issue among all the interested parties and timely intervention, if necessary, to detect possible distortions to competition and/or the formation of prices along the value chain (Section 1.4).

2.1. **Recommendation on a Code of Conduct**

61. The first type of recommendations is directed to the CIP, APED and Centromarca as the most representative associations of those involved. It relates to the need to reinstate the 1997 CIP/APED code of good practices.

62. The aim would be to promote a culture of competition through an effective process of self-regulation which makes it possible to improve the contractual and/or extra-contractual conditions that govern the commercial relations between producers and distributors. This code would include, among other points, a conflict resolution mechanism, the possibility of creating an ombudsman, the principles to be borne in mind when putting forward a standard contract, the non-applicability of retroactive penalties, shelf space management and payment periods.

63. Problems in the relations between the producer/supplier on one side and major distributors on the other, led the CIP and APED to draw up a code of fair trade practices (in Portuguese, *Código de Boas Práticas Comerciais*), signed on 17 July 1997. A set of principles, rules and procedures was laid down in the document, to be observed by the associates in their commercial relations, without prejudice, of course, to the freedom they have in terms of the contracts they work under.

64. This self-regulation needed to be fostered and overseen, and to do so, the CIP and APED created a permanent committee to assess and monitor the
situation (in Portuguese, the CPAA—Comissão Permanente de Avaliação e Acompanhamento). This was made up of two representatives from each party entering into the agreement and by an independent figure to chair the committee, chosen by mutual accord.

65. This code actually exists, but the truth is that it has not lived up to expectations and needs therefore either to be reinstated or replaced by a new code.

### 2.1.1. Creation of a dispute resolution mechanism

66. A code of conduct is not binding and adherence to its contractual and extra-contractual practices depends on the will of the parties and their negotiating powers.

67. Given this, and notwithstanding the importance of the principle of contractual freedom between the parties, the issue arises as to the credibility and effectiveness of a code of good trade practices that depends not only on continued assessment of its terms but also on the creation of a dispute resolution mechanism where decisions are binding on the parties.

### 2.1.2. The possibility of instituting an ombudsman

68. Moreover, the monitoring of the code should be grounded on real powers to collect information from the parties on how it is applied, above all in issues relating to conflict resolution.

69. A strengthened CPAA or an ombudsman would need to have the wherewithal to ensure effective supervision over whether the rules of the code were being observed, along with recommendations and decisions adopted within its scope. These would include among the most important:

(a) Payment terms fulfilled according to contract terms and ratios,\(^\text{17}\) as used by each LRG for each of its suppliers;

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\(^{17}\) Payment ratio is the ratio between (a) the actual number of days between the date of invoicing and the payment date, and (b) the number of days stipulated in the contractual payment terms. If, for instance, the latter is 30 days and the former 45 days, the ratio equals 1.5. Ratios higher than 1 should be the exception.
(b) Discounts offered by each LRG to its suppliers every year, the amount they involve and how they are justified, in particular retroactive discounts;

(c) Penalties for suppliers, either in cash or in kind (the latter, for instance, in the withdrawal of product lines, revoking of contracts and so on).

70. A strengthened CPAA or an ombudsman should also be responsible for publishing an annual list detailing compliance with the code, both by the LRGs and the suppliers. This would be based on the contractual and extra-contractual practices observed, the reporting of terms and conditions being mandatory.

71. A strengthened CPAA or an ombudsman should ensure that the confidential nature of information would be respected, and greater independence for members of the CPAA guaranteed when carrying out their duties.

2.1.3. Drawing up guidelines for standard contracts

72. It would also be useful to consider drawing up and adopting guidelines for standard contracts defining basic conditions for all contracts covering the supply of products.

73. These guidelines for standard contracts would bring together the terms that are common to the commercial relations between LRGs and the industry. The aim would be to foster equilibrium and transparency in the negotiations of contractual conditions between the economic agents involved, in casu, suppliers and distributors.

74. The definition of specific conditions inherent to each supply relationship should be the prerogative of the parties involved, as should be the case, given the principle of freedom to enter into a contract.

75. Even so, when a contract is signed, fundamental rules should be observed, on the basis of prior acceptance as defined by both parties as being the most suitable and equitable.
76. The standard document or contract will include a definition of the rights and duties of each of the signatories, the period during which the contract is valid, general terms regarding invoicing, discounts, non-fulfilment, returns, packaging, penalties, periods for and conditions of delivery, the level of service and termination of the contract.

2.1.4. Non-applicability of retroactive penalties

77. Retroactive penalties should be forbidden, and the CPAA or ombudsman should have the right to see whether such penalties have been applied.

2.1.5. Shelf space

78. The manufacturer should have the right to know in due time if the LRG takes an industry label off the shelf or reduces shelf space to a significant degree. The CPAA or ombudsman must be informed of the decision and the justification advanced for the action.

2.1.6. Payment terms

79. There should be an agreed definition of the rules for payment terms, some of the possible alternatives being:

(i) Definition of any replacement date when payment is due;

(ii) The setting of a maximum time span between the date of invoicing and the date when payment is due;

(iii) The setting of intervals for minimum and maximum payment terms. If a distributor goes beyond the contract dates to any significant extent, a number of suppliers could find themselves in difficult financial circumstances, especially when a supplier is under an obligation to pay his own suppliers (for instances those who supply raw materials).

80. Moreover, in the case of fruit and vegetables, the perishable nature of the products means that they have to be cleared more quickly by the retailer, and is likely to be less compatible with payment timings that relate to less
perishable products. The issue of the sell-by date is above all important here and quick sale by the retailer (with payment by customers at the point of sale) needs to be borne in mind.

81. A legislative initiative recently approved (Decree Law 118/2010, of 25 October 2010) sets maximum payment terms in contracts with micro and small enterprises or involving the supply of agro-food products for human consumption. It goes some way to addressing the point at issue. It also fits in with EU guidelines for taking measures to combat late payment in commercial transactions (Directive 2000/35/CE).

82. As a final point, it should be noted that the Portuguese Authority for Food Safety and Business Affairs (ASAE) is responsible for supervising compliance with the new legislation, and to presents an annual report on the controls it will carry.

### 2.2. Recommendation on regulating trade practices

83. The second type of recommendation is directed to government and regards the regulating of trade practices in contracts, cited as contentious by economic agents. The problems arise above all between suppliers and distributors, yet do not fall within competition law, neither do they constitute unfair practices nor are they amenable to resolution under the terms of a code of conduct.

84. In order to cover this, the government should consider setting up a committee composed of representatives from the ministries responsible for the economy and for agriculture and fisheries, the most representative associations in the sector (taken here as the CIP, APED and Centromarca) and ASAE. Their mandate should be to draw up and present proposals for regulations. The ensuing proposals would gain much from joint work carried out by the kind of organisations mentioned here.

85. The purpose of this recommendation is to (a) stimulate analysis and discussion between those involved, i.e. those entities that have responsibilities and/or know-how in the sector. They should look at the
various options that could improve the current state of a situation that is as complex as the one detailed in this report, and (b) propose what they consider the most viable solutions. The reality at issue cannot be tackled through regulation that is not grounded on a complete knowledge of the field, or through regulation that is very likely to offset the expected results. Rather does it require proposals that have been thought through and are likely to produce successful results in the medium to long term.

86. The more detailed analysis of a wide range of contracts between suppliers and distributors made it possible to identify four areas where practices have been detected illustrating in a very salient way the imbalance between the parties in their commercial relations. These are: (i) the unilateral imposition of terms and conditions (i.e., negotiations within a pre-set purchasing agreement); (ii) discounts and related mechanisms; (iii) penalties; and (iv) payment terms.

87. It may be that the practices in these four areas do not constitute unfair trade practices as set down in Decree Law 370/93, of 29 October 1993, amended in Decree Law 140/98, of 16 May 1998, but they could well be seen as questionable in the light of principles governing good trade practices. Improvements to this legal regime could therefore in the first instance broaden or clarify where such practices should be scrutinised--while always safeguarding the principles of contractual freedom and private initiative.

88. Subsequently--and again while always safeguarding the principles of contractual freedom and free economic initiative--one of the options to be looked into is to structure a new legal framework to govern the relations between the LRGs and their suppliers. This could be undertaken within a timetable that is realistic but strictly adhered to so as not to take up time that would inhibit investment in innovation and in a sound economic development for all the players in the food supply chain.
2.3. Recommendation regarding price statistics

89. The third type of recommendation is directed to the government, and it relates to the need to enhance the statistical information about prices along the food supply chain, complemented by statistical information on quantities.

90. An analysis of moves in retail prices for fast-moving consumer goods is made difficult by the shortage of information relating to the prices charged by the LRGs and, specifically, by traditional retailers, who are in a highly atomised section of the industry, and where there is an even greater shortage of statistical information.

91. The lack of regular, wide-ranging and detailed statistics is one of the biggest obstacles in the way of monitoring and then possibly bringing in the competent public bodies. It is essential to ensure better statistical information on FMCG prices along the food supply chain. Only then will effective monitoring of the sector be possible.

92. There was in fact a body that provided regular monthly monitoring of prices, the General Directorate for Trade and Competition (ex-DGCC),\(^\text{18}\) now extinct. Indeed, the work actually ceased in May 2005, in what was before that the General Directorate for Companies (DGE),\(^\text{19}\) now the General Directorate for Economic Affairs (DGAE).

93. Now the Portuguese Consumers’ Association (DECO) is the only body that monitors food prices (on a half-yearly basis). The information they provide is only produced in the form of indices comparing prices between retail chains \textit{inter-} and \textit{intra}-city, though it has also included some cities in Spain since 2008).\(^\text{20}\)

\(^{18}\) \textit{Cf.} Bens de Consumo Corrente, Boletim Preços, DGCC (\textit{Fast-moving consumer goods, Price Bulletin}).

\(^{19}\) The DGE replaced the DGCC when the Portuguese Competition Authority was created in March 2003, and was itself replaced by the DGAE in April 2007 (\textit{cf.} Regulatory Decree 56/2007, of 27 April).

\(^{20}\) For example, DECO Proteste no. 294, of September 2008, and information issued by DECO \texttt{http://www.deco.proteste.pt/supermercados/supermercados-poupe-ate-940-euros-no-carrinho-}
94. Apart from the surveys carried out by DECO, there are consumer price statistics published by the Portuguese Statistical Office (INE), broken down by products and product categories, such as those detailed above. However, these indices bring together different types of retail trade and do not provide any separation between LRGs and traditional trade and/or between the different LRGs.\(^{21}\) The only breakdown is geographical and relates to Portugal mainland (NUT II—North, Centre, Lisboa, the Alentejo, and the Algarve);\(^ {22}\) the Atlantic islands of Azores and Madeira are not include.

95. Given all of this, it is very important to weigh up the possibility of creating an observatory to detail retail prices. This would have a remit to include the collection, treatment and dissemination of statistical data, including prices and quantities as per EC norms. It would include functions similar to those carried out by what was the General Directorate for Trade and Competition. It would separate out the various LRG banners and distinguish between these and traditional trade.

96. As the EC has emphasised recently (see above), transparency will be enhanced from setting up these observatories in various member states, widening the brief to include the monitoring of prices along the value chain from production, through supply to retail outlets.

97. The main purpose of collecting, treating and disseminating this kind of statistical information is not only to allow for all stakeholders to obtain clear knowledge of these activities through good statistical data, but also to detect any possible distortions in prices along the value chain, making it possible for competent authorities to take timely action (\textit{cf.} EC Communication, of 28.10.2009, \textit{cit.}).

\(^{21}\) The way information is obtained and collected is not known, nor the number and type of shops, nor the geographical coverage.

\(^{22}\) The NUT are the country’s regions (in Portuguese, \textit{Nomenclaturas de Unidades Territoriais}) used for statistical purposes. They designate the areas in which the territory of all the member states of the Union is divided. This includes Portugal (Decree Law 204/2002, of 5 November 2002, and EC Regulation 1059/2003, of 26 May).
98. The decision to give the mission of price observatory to a specific institution to work within EC strictures is a political one. It should be based on relevant criteria and the need to provide adequate funding.

2.4. Additional recommendations

99. The Portuguese Competition Authority considers that the following recommendations should also be put forward:

   (i) That renewed importance should be given to the inspection and application of legislation on (individual) unfair trade practices (above all, article 3, “Below cost sales,” and article 4, “Abusive negotiating practices”), as well as to new legislation on payment deadlines, building on the work that ASAE and this authority have been doing on the issue;

   (ii) That the government consider measures that encourage the creation of small/medium-sized firms in local markets, especially focused on the retail trade in foodstuff, and on the protection of certain products such as those with designation of origin and/or geographical indication in the light of legislation on industrial property, specifically as set down in Decree Law 36/2003, of 5 March 2003 (approving the Code of Industrial Property), amended in Law 16/2008, of 1 April 2008;

   (iii) That an analysis be undertaken by an independent consultant financed by the parties involved, to look into the impact on

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23 The big difference between designation of origin and geographical indication lies in the kind of link that has to exist between the qualities or characteristics of a product and its natural environment. The relationship is closer in the first than in the second. In the case of the first, the typical nature of the product is a consequence of the geographical location. This means that the specific features should not just be the result of human action but also the natural features of its environment. The production, manufacture and preparation of the product must be carried out in the region of the product’s origin. Where the geographical indication is concerned, such a link between the qualities of the product and the local environment are not so important. It is enough that the product is seen as typical or the reputation can be attributed to its origin. The production, manufacture and preparation of the product should be carried out in the region of its origin. For more information, see: http://www.marcasepatentes.pt/index.php?section=1.

24 Administrative procedures that may lead to a fine are instigated by ASAE, as set down in the Code of Industrial Practice. It is the responsibility of the National Institute for Industrial Property (INPI) to decide on and levy the fine and other sanctions set out in the Code, within the scope of its remit as set down in Decree Law 132/2007, of 27 April.
consumer welfare of “look alike” and “copycat” products in the retail trade, without prejudice to any analysis that made be applied under the terms of Decree Law 57/2008, of 26 March 2008, relating to disloyal trade practices;

(iv) That the trade practices related with these products should be the subject of special checks and monitoring, possibly within the terms of Decree Law 57/2008, of 26 March 2008, relating to disloyal trade practices, and/or under the law on industrial property, specifically to avoid situations which could come under competition law relating to disloyal practices of LRGs towards their suppliers of branded products;

(v) That the government should look at the possibility of giving priority—as soon as there is approval of the proposal being debated in European institutions—to transposing to domestic legislation the next directive from the European Commission and the European Parliament on payment terms for commercial transactions, set to replace Directive 2000/35/CE, of 29 June; and

(vi) Finally, and in line with the need to duly frame domestic solutions within a European context, this authority recommends that a proactive stance should be adopted at parliamentary, inter-ministerial and public authority level regarding the work of institutions in the European Union which deal with issues related to the food supply chain and the large retail sector.
3. STRUCTURE OF THE REPORT

Chapter contents

100. The report is structured as follows: the main conclusions are presented first, followed by Chapter 1 on the recommendations drawn up by the PCA. An introduction to and a framework for the report, with an overview of how the modern retail sector has developed in Portugal since the 1970s is provided in Chapter 2. The Portuguese retail sector as it is today is the subject of Chapter 3.

101. The report then provides a detailed analysis of the food distribution sector as a whole (without calling into question the fact that the report’s main focus is the basket of groceries that are highly important for family consumption). This makes up Chapter 4, where the position of the LRGs is highlighted, both as regards grocery supplies and retail sales.

102. Chapter 5 details the main features of the value chains involved in the “production – supply – LRG” circuit, with Chapter 6 looking into the effects of private label expansion.

103. The report then looks at the main trade practices involving the LRGs and their suppliers (contractual and extra-contractual), and this includes the various types of discounts and the payment terms agreed between the parties (Chapter 7).

104. The final chapter looks at how the LRGs have approached the recent increase in VAT rates (Chapter 8).

105. There are five appendices to the report. Appendix 1 describes the data collected for the study. Appendix 2 provides a survey of the economic literature on the main concepts under review, among them “buyer power” (of the LRGs), the “pass-through” effect (the impact on the consumer’s purchasing power), and the associated collateral effect known in the literature as the “waterbed” effect. Appendix 3 analyses the problem of brands, looking at conceptual issues and the LRGs’ strategies. Appendix 4 looks at the strategies of two LRGs with regard to their own private label.
products. Appendix 5 takes in the moves in prices for the raw materials used to make the goods analysed in this report. There is also a glossary of the main terms and acronyms used in the text.

**Database**

106. In order to work out this report, around 50 organisations were contacted, including a number of suppliers, the nine LRGs that currently operate in the country, sector associations (APED, CIP, Centromarca), and a number of public entities—the planning bureau of the Ministry of Agriculture (Gabinete de Planeamento e Política-GPP), the central bank of Portugal (Banco de Portugal), the Portuguese Statistical Institute (INE) and the Portuguese Observatory of Agricultural Markets and Foodstuff Imports (OMAIAA). A number of meetings took place with several of these organizations.

107. The report is based on the information collected in a tailor-made data base, covering the years 2000 to 2008 for part of the study.

108. This kind of information is extremely complex—and it was broken down into a sample which was considered to be representative of the range of suppliers used by the LRGs, with separation into products and categories. In addition, the data treatment took a long time\(^\text{25}\) and there were some LRGs that could not supply information for 2009, so it was not possible to provide up-to-date information for the large retailers as a whole for that year.

109. The study detailed in Chapters 4 and 5 covers the period 2004 to 2008 (and in some cases from 2002 to 2008) and does not go farther back because of the lack of statistical data on electronic support available from some of the LRGs and suppliers for the period from 2000 to 2002 and in some cases from 2000 to 2004. In many cases, they themselves did not have the resources needed to update their data bases for these years. The analysis therefore is of necessity limited to the information that the companies made available to the PCA.

\(^{25}\) Vide Appendix 1 for details.
110. It should also be noted that the most recent data supplied by the market intelligence company Nielsen only relate to 2008, as is the information provided by the Banco de Portugal relating to actual payment terms applied by the LRGs—including three wholesale chains—and the annual accounts for these groups.

111. It was, however, possible to obtain data for the wider period from 2000 to 2009 in terms of the analysis relating to private labels and industry brands, and the pricing strategies adopted by the main LRGs (Chapter 6). This provided statistics on value and volume data for purchases from suppliers and retail turnover for the wider 2000 to 2009 period, covering practically all the product categories analysed in this report.