Fair Trading Commission

Commissioners' Decision

Case 3794

Super Plus Food Store on Predatory Behaviour

August 13 , 2001

Public Version
Confidential information omitted. The omissions are indicated by a note or by the symbol ✄

1. The Allegation

1.1 On April 9, 2001, the informant, Future Foods Limited (henceforth "Future Foods") lodged a complaint with the Fair Trading Commission (FTC) against the respondent, Super Plus Food Store (henceforth "Super Plus"). The Informant, is of the view that Super Plus is selling merchandise below cost which constitutes predatory pricing.

1.2 The allegation concerns a promotion offered by Super Plus in the form of a coupon scheme advertised in *The Gleaner* and *The Observer*, offering a variety of goods at discounted prices. The particular advertisement brought to the attention of the FTC appeared on page 20 of the *Daily Observer* on Thursday, 29 March, 2001. Goods on offer ranged from canned sausages to rum and cleaning liquid. The offer was for specific brands of items; on the particular advertisement, there were 35 items in the offer. In order to get these discounted prices, the consumer had to cut out the coupons and take them to the Super Plus store. The coupons were redeemable up to a certain date, between one to two weeks of the publication of the advertisement. There were limits on the number of items, ranging between one to twelve, that could be bought at the discounted price on each coupon. Since the complaint was made, it is observed that Super Plus has been and is still running the promotion scheme with similar advertisements being made regularly in the daily tabloids. The goods on offer, however, may change between advertisements.

1.3 The Informant alleges that the prices on offer are below cost. Table 1 provides examples of the prices of some goods on offer compared with the cost price as provided by the Informant, i.e., the price at which the *Informant* obtains the goods from the supplier.

Table 1: A comparison of the discounted price and cost for selected goods

Item	*Super Plus' offer price*	*Future Food's cost price*
Nestle Milk	$30.95	$[✂]
Pepsi 2 litre	$33.95	$[✂]
Grace Mackerel 5 oz.	$13.95	$[✂]
Grace Baked Beens 10 oz.	$28.95	$[✂]
Grace Vienna Sausages 4 oz.	$19.95	$[✂]

2. The Fair Competition Act

2.1 Competition lies at the heart of any successful market economy and is crucial to the protection of consumers' interests and the efficient allocation of resources. It is a process whereby firms constantly try to gain an advantage over their rivals and win more business by offering more attractive terms to customers or by developing better products or more effective ways of meeting their requirements. Competition has several dimensions of which price is only one, albeit in many markets the most important. It encourages the development of new or improved products or processes and, in the long run, enhances economic growth and living standards. The objective of the Fair Competition Act (FCA) is therefore to ensure that the benefits of the competition process in Jamaica are unhindered by anti-competitive activity.

2.2 The allegation falls under Section 20 of the Fair Competition Act (FCA) which prohibits the abuse of dominance. Under Section 20(1), an enterprise would be considered to have abused a dominant position if it impedes the maintenance or development of effective competition in a market. For the purposes of the Act an enterprise holds a dominant position in a market if by itself or together with an interconnected company, it occupies such a position of economic strength as will enable it to operate in the market without effective constraints from its competitors or potential competitors.

2.3 Subsection 20(1)(d) states that an enterprise abuses a dominant position if it "directly or indirectly imposes unfair purchase or selling prices or other uncompetitive practices". The Commission interprets section 20(1)(d) to include "predatory pricing". Behavior that may constitute predatory pricing and the general methodology of investigation is discussed in section 3. Section 4 analyses the allegation of predatory pricing against Super Plus using the principles detailed in section 3.

3. Predatory Pricing under the Fair Competition Act

3.1 Predatory behavior constitutes a class of anti-competitive behavior where prices are set so low so as to eliminate some undertakings and threaten the competitive process itself. In these circumstances, consumers may benefit in the short run from lower prices, but in the longer term, weakened competition will lead to higher prices, reduced quality and less choice.

3.2 Distinguishing predatory behavior from legitimate competition is difficult. Since the main objective of competition policy is to create conditions where consumers benefit from effective competition, the distinction must be drawn between low prices that result from predatory behavior, and low prices that result from legitimate competitive behavior. Indeed, it must be noted that *structural* conditions in most markets do not allow for predation. As summed up by the OECD:

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> "Perhaps all that can be said is that cases of predation may arise but at most only very infrequently. Complaints of predation, however, are presented to competition authorities with some regularity, although the great majority of these cases involve nothing more than healthy price competition. Thus, competition authorities need some method to separate systematically the occasional violation from numerous complaints."[1]

3.4 In Canada, for example, some 550 complaints alleging an offense under the predatory pricing provisions were lodged between 1980 – 1990. Of those complaints, only 23 resulted in formal inquiries under the Competition Act, four were referred to the Attorney General and only three resulted in the laying of charges.[2] This observation is supported by the U.S. Supreme Court who notes that "predatory pricing schemes are rarely tried, and even more rarely successful".[3]

3.5 There are three key elements to predatory behavior:

- *Intent*—Predation does not happen 'by coincidence'. There must be first an intention to predate. Nevertheless, intent is a subjective concept and difficult to determine. Sometimes intent is inferred if an incumbent reduces price upon entry of new competitor, therefore forcing the new competitor to exit, and subsequently raises price back to its original level. Such behavior, however, may also obtain under competitive circumstances. After all, new entry raises overall market output

[1] OECD, *Predatory Pricing* (1989).
[2] Director of Investigation and Research, *Predatory Pricing Enforcement Guidelines.* Competition Act. Canada (1992).
[3] In Matsushita Electric Industry Co., Ltd. V. Zenith Radio Corp., 475 U.S. 574, 589 (1986).

and forces the incumbent to decrease its price or else concede market share. Such a price reduction often is not predatory but is instead a natural response to the increased competition. If the new entrant is, for example less efficient than the incumbent, such that its costs are higher than the new market price, it will exit the market. The exit of a new entrant in this manner, commonly observed in reality, is part and parcel of the natural workings of the free market. That is to say, not all entry is efficient and not all exit is inefficient, even in an industry with a dominant incumbent.

Besides, boardroom talk and statements in internal memos revealing the intentions to "squish rivals like a bug" or "pound them into the sand" – phrases that at times show up as evidence in predation cases – are also entirely consistent with fierce but healthy competition.

- *Feasibility*—certain structural conditions of the market must exist for predation to be feasible. Specifically, successful predation requires market power during the predation period. This is because the predator must expand output in order to depress the overall market price and put pressure on his rivals. To have a strong impact on market price, the predating firm would need a sufficiently high market share from the start. Otherwise the predating firm itself will not be able to survive through the predation period. Moreover, if market demand is elastic, the predator must take on extra sales at a loss to satisfy the new demand that is created at the lower price, apart from the extra sales it has to take over from its victims. All this makes predatory pricing in fact more costly – at least in the short term – for the predator than its victims. For this reason, predatory pricing almost always comes under the category of abuse of dominance, where dominance must first be established.

  Furthermore, predation involves the predator incurring short run losses so that it can increase profits in the long run. In the short run, it incurs losses in order to eliminate competitors. In the long run, it will expect to recoup the losses by charging higher prices (or offering less favorable terms). Predation works only if the firm will be able to recoup its short run losses by charging higher prices in the future – which will be possible only if the undertaking will not face significant competition *in the future*, from new entrants, for example.

  While *future* market power is distinct from *current* market power, a currently dominant undertaking can be expected to retain future dominance and to recoup losses following predatory action. In other words, the market structure is likely to be retained. A scenario in which current market power may differ from future market power could arise where a dominant undertaking is alleged to be engaging in predation in a *related* market, but one in which it is not currently dominant. Even so, if future dominance in the related market arises following successful predation, the undertaking would have an ability to recoup its short-run losses.

- *Execution*—Finally a pricing policy that is in some way below cost in a manner that is consistent with the intention to predate must be implemented.

3.6 All these three elements must be present for a genuine case of predatory pricing to exist. The following discusses a methodology for investigating allegations of predatory pricing.

Predatory pricing: investigation guidelines

3.7 Many competition authorities apply a two-step method in investigating predatory pricing.[4] The first step is to determine the feasibility of market structure for predation. If the structural conditions are considered not to be feasible for successful predation, the conclusion drawn is that there is no predation and the investigation terminates.

3.8 If the structural conditions suggest that successful predation is feasible, however, then the second step is implemented whereby a price-cost comparison is carried out to determine if below cost pricing has been implemented in a manner that could be considered predatory. Both these steps – market structure and price-cost analyses – are further explained below. Intent is normally not taken into consideration in the analysis as it is highly improbable that strong evidence would exist.

Step 1: Analysis of market structure

3.9 For reasons discussed above, a pre-condition for successful predation is a market structure in which the undertaking has sufficiently large market share. It is common practice amongst competition authorities to apply the test of dominance as a pre-requisite for predation. Dominance is commonly defined as a position of economic strength that enables an undertaking to operate in the market without effective constraints from its competitors or potential competitors.[5] Put differently, a dominant firm is one that is able to behave to an appreciable extent independently of its competitors, customers and ultimately of consumers.[6] Therefore, the first step in the investigation is to determine if the undertaking is dominant in the *relevant* market. Dominance is usually determined by consideration of market shares and barriers to entry.

3.10 *Market shares*—a market share of between 40 – 50% is commonly used by competition authorities as a guideline threshold for dominance. The European Court, for example, has stated that dominance can be presumed in the absence of evidence to the contrary if an undertaking has a market share persistently above 50%.[7] The Office of Fair Trading in the UK considers it unlikely that an undertaking will be individually dominant if its market share is below 40%.[8]

These are, however, guideline thresholds that are not set in stone. Dominance could be established even below the 40% threshold if other relevant factors, such

[4] For example, in the United Kingdom and Canada.
[5] See section 19 of the Fair Competition Act.
[6] See, for example, the definition taken by the European Court in Case 27/76 United Brands v EC Commission [1978] ECR 207, [1978] 1 CMLR 429.
[7] see Case C62/86, *AKZO Chemie BV v Commission* [1993] 5 CMLR 215
[8] OFT (1999), *The Competition Act 1998: The Chapter II Prohibition*, March.

as weak position of competitors in that market provided strong evidence of dominance. If, for example, the largest player in the market has 30% market share and many other small firms, none possessing more than 3% or the market, sharing the remainder of the market. In this scenario, 30% market share could be sufficient to meet the dominance test.

Consider another scenario in which a market is equally shared between two players, each accounting for 50% of the market. In this case, collusive behavior aside, neither of them can be said to be truly dominant as neither is therefore likely to be able to act independently of the other. Actions of one player are likely to be met by equally forceful reactions from the competitor who himself commands a similar degree of market power. In this case, a competition authority may see it appropriate to raise the dominance threshold level to between 70 – 80% market share.

3.11 *Barriers to entry*—the ability of an undertaking to dominate a market is constrained to the extent that ne market shares and barriers to entry. entrants may easily enter the market. Put differently, a firm is said to dominate a market if it is able to act independently of competitive pressures, allowing it to charge higher prices profitably. If, however, barriers to entry are low, any action by the firm to increase prices – and therefore profitability –would attract new entrants who would put competitive pressures onto the undertaking, forcing it to reduce prices again. In this case, the firm cannot be considered to be dominant. On the other hand, if barriers to entry are high, entry is unlikely even if the market is highly profitable. In this case, the firm will be able to sustain high prices and profitability and can therefore be said to be dominant. High barriers to entry could exist for various reasons including licensing and regulatory requirements for entry (including patent rights) and high sunk costs.[9] Factors that would constitute barriers to entry would differ according to the case and circumstance.

3.12 In sum, a firm can be considered to be dominant if it has a market share of approximately 50% - the guideline threshold being dependent on circumstance – and there are high barriers to entry. An undertaking must be dominant for it to be able to predate successfully. Therefore, the investigation should continue on to the second step only if the undertaking is found to be dominant. If not, the investigation should stop and the conclusion would be that there is no predation.

Step 2: Analysis of prices and costs

3.13 If a firm is found to be dominant, the next step is to analyse the price-cost relationship so as to ascertain if predation did indeed take place. Following the guidelines set out by the competition authorities in the UK and Canada, it would be reasonable to use the following rules:

[9] Sunk costs refer to the investments that have to be made to enable production of a good or service. These costs are incurred even before a single unit of good or service is produced. An example of sunk costs can be found in telecommunications where the cable network has to be put in place – at a high cost – before any voice or data transmission can be made.

- A price at or above average *total* cost will not be regarded as unreasonably low;
- A price below average *variable* cost is likely to be considered predatory unless there is a clear justification such as the need to sell perishable inventory;
- Prices in the "gray range" between average total and variable cost require further investigation into the surrounding circumstances. Findings would be based on a case-by-case analysis. For example, a price in this range may be reasonable in situations of declining demand or excess capacity. It may be predatory if there was direct evidence of the undertaking's intent to predate. Other evidence on costs may also be considered, for example, whether the undertaking is covering its long-run avoidable costs.

3.14 Long run avoidable costs are costs that could be avoided if the undertaking were to cease the activity in question (the activity being the part of the business accused of predating). It would include both fixed and variable costs, but would not generally include:

- common costs (costs which may be attributed to a number of different activities). The undertaking may, however, be expected to cover common costs through the activities to which these costs contribute; or
- sunk costs, although sunk costs may be included in avoidable costs if they are incurred as part of the alleged predatory strategy, since the undertaking could then have avoided them by not incurring them.

3.15 In addition, an analysis of pricing behavior should also take into account the period and extent of predation. Specifically, below-cost pricing must be in effect for 'long enough' so as to be sufficient to inflict material harm upon competitors; otherwise it cannot be considered to be predation. Indeed, what is considered to be 'long enough' a time period differs from market to market. Similarly, below cost pricing on only a fraction of a product line cannot drive competitors out of a competitively meaningful market consisting of the entire product line. Such 'limited' action, therefore, would not constitute predation.

4. Future Foods *vs* Super Plus: An analysis

4.1 This section analyses the allegation of predatory pricing by Super Plus using the principles outlined in section 3. First, the relevant market is defined; followed by an analysis of the promotion scheme in question; and a conclusion.

Defining the Relevant Market

4.2 Before assessing whether a firm is dominant, the relevant market must be determined. This relevant market will have two dimensions - the relevant goods (i.e., the product market); and the geographic extent of the market (the geographic market).

4.3 *The product market*—the boundaries of the market are determined by taking the products relevant tot he investigation and looking at the closest substitute products, those products which consumers would switch to if prices of the relevant products rose. These substitute products are included in the market is substitution by consumers would prevent prices of the products relevant to the investigation from rising above competitive levels. The alternative products do not need to be perfect substitutes, but alternatives that would fill a similar role to the goods in question, and to which consumers would switch to in the event of a price increase. Essentially any similar goods that would prevent price-setting above competitive levels should be included in the definition of the relevant product market.

In addition to this substitution by customers (so-called "demand substitution"), prices can also be constrained by the potential behavior of suppliers production other products ("supply substitution). Businesses that are not currently supplying a particular product might switch some of their existing facilities to supplying that product (or close substitutes) if prices rose significantly.

An example of supply substitution may be found in the paper industry. Although low quality paper is often not considered to be a substitute for high quality paper from a consumer's point of view, the different grades of paper are almost perfect substitutes from the producer's point of view. This is because the production methods are identical across all grades of paper where only the input (pulp) has to be changed in order to change the output from low to high quality paper. In this example, even though there is no demand substitutability, a rise in the price of high quality paper is likely to see paper manufacturers switching from low quality paper towards producing more high quality material. In other words, a similar product should be included in the same relevant market as the product in question as long as either demand or supply substitution apply.

4.4 *The geographic market*—Similar methods are used to define the geographic boundaries of a market. The geographic market will sometimes be the area supplied by the informant, or the parties to the conduct concerned. However, consideration should also be given as to whether customers could easily obtain similar products from suppliers in other areas on reasonable terms. If so, those other areas may form part of the geographic market. The geographic market may be a part of Jamaica, the whole of it, or may even extend beyond Jamaica.

The relevant market for supermarkets

4.5 *Product market*—in defining the market, the characteristics of demand for groceries such as consumers' pattern of grocery shopping and the nature and range of substitutes for particular types of shopping available to them should be examined. Grocery shopping involves purchasing a bundle of individual products. The size and contents of the bundle will vary according to the size of the consumer's income and the reason for the shopping expedition.

4.6 Most, if not all, goods that are sold in a supermarket are also sold in other outlets including smaller "dry goods" grocery stores, green grocers or non-grocery outlets like pharmacies and even petrol stations. It is therefore necessary to examine whether these other outlets collectively form a competitive constraint on the supermarket's offer.

4.7 The key distinction between a supermarket and these alternative outlets is the wide range of goods sold in the supermarket. Specifically, with the wide range of goods offered, supermarkets offer consumers the facility of "one-stop shopping" that is not available elsewhere. In other words, consumers may use supermarkets either for:

- *"one-stop shopping"* which allows for regular major replenishment of supplies. For consumers falling in this category, the other outlets that sell only a partial range of the goods would not be considered to be close substitutes to supermarkets. In this case, the relevant market definition would be confined to supermarkets;
- *secondary shopping* which includes "top-up" of customary purchases, emergency or impulse items. Consumers in this category would, at any one time, purchase only a limited range of products from the supermarket. To these consumers, the other outlets that offer a partial range of products would be considered to be close substitutes for the supermarket. The relevant market definition for supermarkets should therefore include the alternative outlets mentioned.

4.8 An analysis of supermarkets in the UK found that consumers there used supermarkets primarily for their "one-stop shopping". Therefore, the relevant product market definition in the UK was constrained to supermarkets.[10]

4.9 In the analysis of supermarkets in Jamaica, however, it is our view that the relevant product market for the urban areas differs from that of the rural areas. In the urban areas supermarkets tend to stock a full product line (all that the consumer needs for its domestic use) and the majority of supermarket customers are those who place great importance on convenience shopping. If a supermarket should effect a small but significant non-transitory increase in price (SSNIP) it is unlikely to lose its customers to one of the stores that provide a partial substitute to its product line. The relevant product market definition for urban areas should therefore be constrained to supermarkets.

4.10 In rural Jamaica, where Super Plus has most of its outlets, shoppers place more emphasis on "quality and freshness" rather than convenience and rarely purchase meat11 or "fresh produce" at the supermarkets. In response to this demand pattern most rural supermarkets do not include these food groups in their product line and instead offer "non-fresh produce", toiletries, cleaning supplies etc. The rural supermarket therefore offers a product mix that is similar to a smaller "dry goods" grocery store albeit the supermarket would be able to offer more differentiated products. If a rural supermarket effected an SSNIP it is likely that it would lose

[10] See "Supermarkets: A report on the supply of groceries from multiple stores in the United Kingdom" at http://www.competition-commission.gov.uk/fulltext/446c2.pdf.

[11] Flesh of mammals.

some of its customers to the smaller “dry goods” grocery store. Therefore for rural areas the relevant product market can be broadly defined as the market for grocery stores. This definition encompasses a range of stores from supermarkets to small “non-self-serve” grocery shops.

4.11 In sum, there are two relevant product market definitions in this case which is reflective of the difference between urban and the rural grocery consumer. The main users of the urban supermarket are “one-stop shoppers” and it is to these shoppers that its offer is primarily directed. This constrains the definition of the product market to supermarkets. On the other hand, in the rural areas the supermarkets product line competes directly with other types of grocery stores and the product market can be defined as the market for grocery stores.

4.12 *Geographic market*—the boundaries for the relevant geographic market for groceries are dependent on the cost of transportation and other constraints on consumers’ mobility. It is our view that the search for groceries in Jamaica is essentially local and that a grocery store gets its customers from the store’s “catchment area”. The “catchment area” is defined as the area surrounding the store from which the grocer expects to draw the majority of his customers.[12] Consumers are more likely to travel further in rural than in urban areas thus making size of the “catchment area” greater in rural areas. Taking this latter point into consideration the geographic market for groceries will be defined as each of the eight parishes (St. Elizabeth, Clarendon, Manchester, St. Catherine, St. Andrew, St Ann, Westmoreland and St. James) in which the Respondent, Super Plus, has outlets.

Nature of the promotion

4.13 The question is, is the promotion scheme offered by Super Plus sufficiently aggressive to effect a predatory outcome? As emphasized in section 3, predatory pricing is one of a class of behaviors aimed at eliminating some undertakings from the market. If a practice is to be considered predatory it must have the potential to inflict real damage. If this is found not to be true, then the behavior cannot be found to be predatory; it is instead likely to be healthy competition.

4.14 As detailed in section 1, the promotion offered by Super Plus in the form of the coupon scheme advertised in the local newspapers, offered a variety of goods at discounted prices. Specific brands were on offer; on the particular advertisement, there were 35 items in the offer. In order to get these discounted prices, the consumer had to cut out the coupons and take them to the Super Plus store. The coupons were redeemable only up to a certain date, between one to two weeks of the publication of each advertisement. There were limits on the number of items, ranging between one and twelve, that could be bought at the discounted price on each coupon.

4.15 What is evident is that Super Plus is selling varying items at a discounted price (potentially below cost) for limited periods as “loss leaders” to entice people into

[12] See “Supermarkets: A report on the supply of groceries from multiple stores in the United Kingdom” at http://www.competition-commission.gov.uk/fulltext/446c2.pdf.

its supermarkets and increase its customer base. The loss-leader items would change on a regular basis. The reduced (potentially negative) margins on the promotion goods are made up by increased sales on non-promotion goods.

4.16 As discussed in section 3, predatory pricing is behavior aimed at, and that has real potential to, materially reduce market share of other players or to discourage entry, such that, in the longer term, weakened competition will lead to higher prices (see section 3). In this regard, the duration and extent of the behavior is important. Specifically, below-cost pricing must be:

- in effect for 'long enough' so as to be sufficient to inflict material harm upon competitors; and
- on a sufficiently large range of the product line – below cost pricing on only a fraction of a product line cannot drive competitors out of the relevant market consisting of the entire product line.

4.17 If the alleged behavior fails to meet the above criteria, it is not considered to be predatory *even if* it is below cost.

4.18 An analysis of the promotion offer in question shows that:

- the range and quantity of goods on offer are limited compared to the range of goods sold in supermarkets/grocery stores, which is the relevant market in question;
- the duration of the offer on the coupons is limited; and
- the proportion of customers that will actually benefit *may* not be significant as some customers will not bother to cut out the coupons in order to take advantage of the offer.

4.19 The Commission is of the view that the promotional offer by Super Plus does not meet the criteria of predatory pricing. This conclusion takes into consideration the observation that the promotion scheme is on-going with advertisements appearing regularly in the daily tabloids.

Conclusion

4.20 An analysis of predatory pricing commonly involves, first, the determination of whether the Respondent is dominant, followed by an analysis of the price-cost relationship. An initial study of the promotion scheme in question, however, indicates that it does not meet the criteria of predatory pricing as it is neither in place for a prolonged period nor for a sufficiently wide range of the product line relevant to the market. Given that the promotion scheme does not meet these two tests of predatory behavior, the Commission did not see it necessary to determine dominance or further investigate the price-cost relationship of the actual goods in question. Even if the goods were offered below cost, the scheme is not 'aggressive enough' to be considered predatory. In other words, this particular strategy of discounting to attract customers is markedly different from a sustained effort to destroy competition by selling a wide range of items below cost over a prolonged period of time. No breach of the FCA was therefore found.