

# Regoverning Markets

Small-scale producers in modern agrifood markets

## Innovative Policy

### Argentina

**Best Commercial Practice Code (2000-2006)**  
as an efficient policy innovation to prevent  
conflict and solve controversies between  
suppliers, processors and supermarkets

Fernando Jorge Brom

COPAL / UCA / Quickfood SA

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2000-2006) as an efficient policy innovation to  
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**2007**

## **Regoverning Markets**

Regoverning Markets is a multi-partner collaborative research programme analyzing the growing concentration in the processing and retail sectors of national and regional agrifood systems and its impacts on rural livelihoods and communities in middle- and low-income countries. The aim of the programme is to provide strategic advice and guidance to the public sector, agrifood chain actors, civil society organizations and development agencies on approaches that can anticipate and manage the impacts of the dynamic changes in local and regional markets.

## **Innovative Policy series**

Innovative Policy is a series of short studies from the Regoverning Markets programme addressing a specific policy innovation in the public or private sector that improves the conditions for small-scale producers to access dynamic markets at national, regional and global level.

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# **1 Introduction**

This short article describes the Best Commercial Practices Code (BCPC) adopted in 2000 in Argentina by the leading actors of the private sector, with the support of the government, to improve the commercial relations between suppliers, processors and supermarkets. The article reviews the process leading to the approval of the Code, how the Code works in practice and the results and effects of this private sector policy.

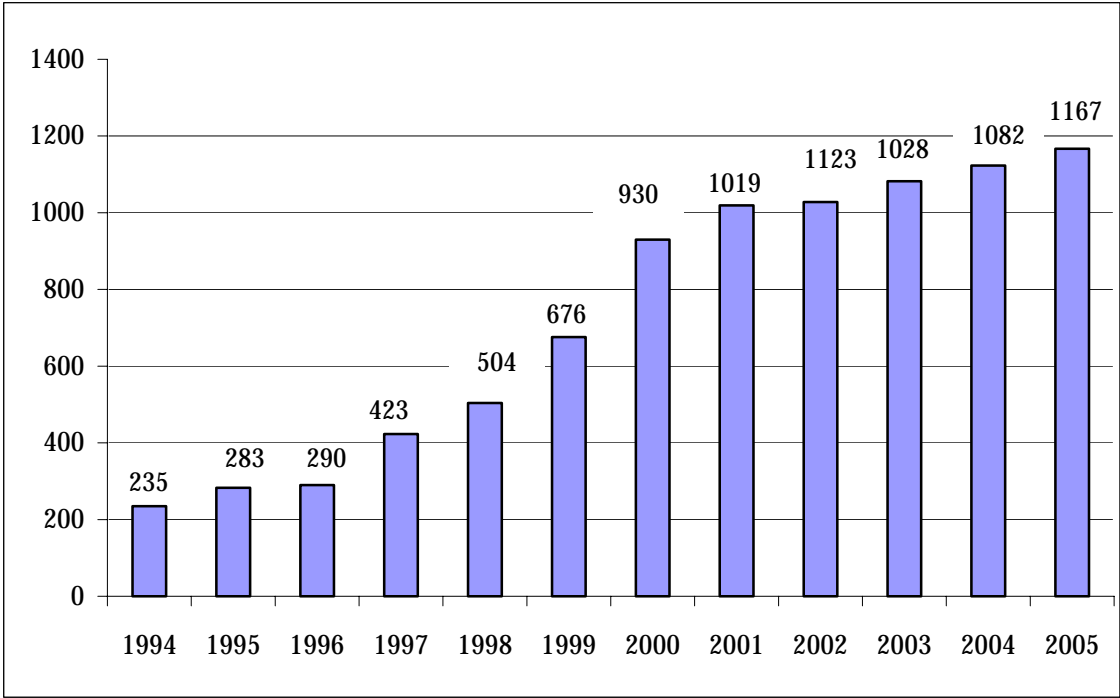
## 2 What was the situation before the policy innovation?

From 1990 through to 2000, the biggest global and regional retail players, such as Carrefour, Wal Mart, Makro, Royal Ahold, Auchan, Casino, and Jumbo heavily increased their investments in Argentina, opening near to 1 thousand stores in ten years (chart 2.1).

They were attracted by political stability, liberalization of foreign direct investment regulations and a favourable fixed currency exchange rate artificially sustained over a ten-year period (1 peso= 1 USD).

These retailers engaged in fierce competition for market share among themselves and with the already-established local big players such as Disco, COTO, La Anónima, Cooperativa Obrera and others. One key element of their competition strategies were their negotiations with their suppliers, soon transformed into mere imposition of trading conditions creating a very difficult situation for suppliers, in particular for small and medium firms with low capacity to internalize the costs of the supermarkets' unilateral demands.

**Chart 2.1: Number of stores of top seven retailers by end of year**



Source: CCR-IRI International Research Inc.

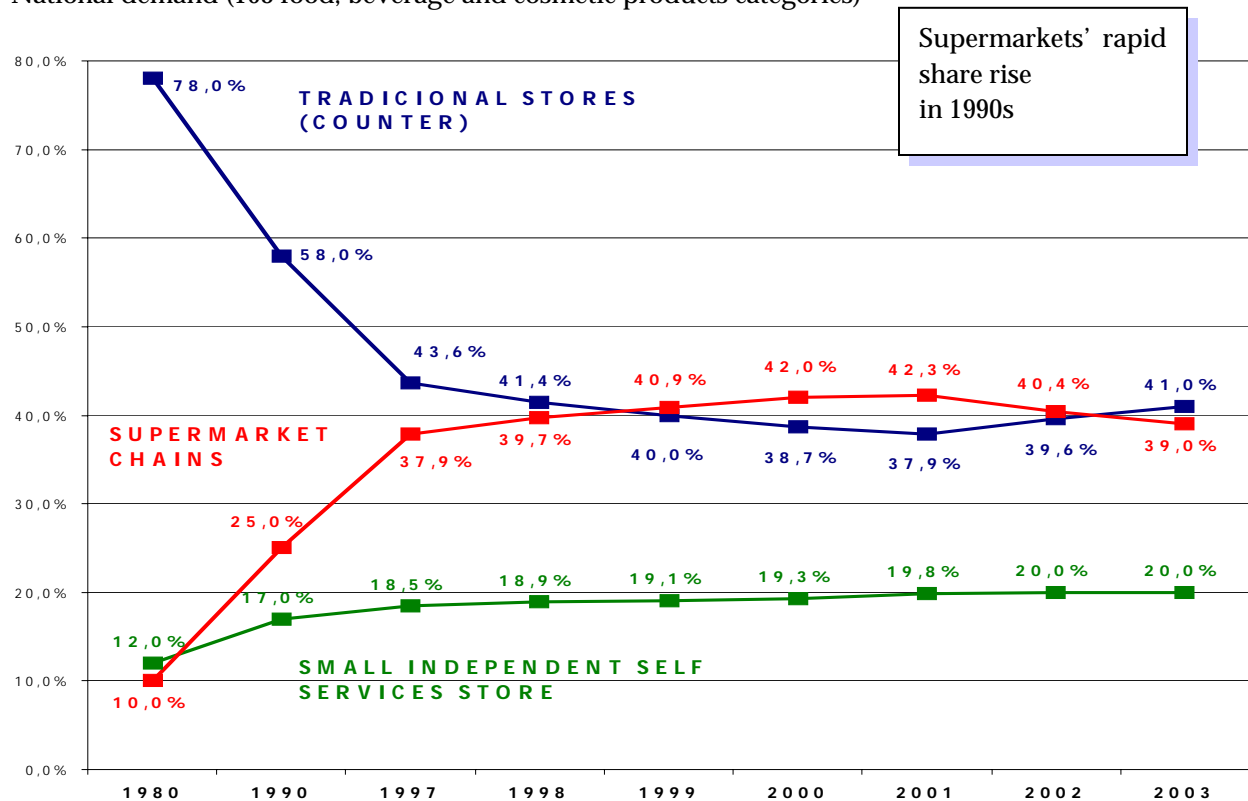
Typical and frequent unilateral ‘unfair practices’ included:

- extended and unpredictable payment terms (15 to 60-day delays, up to 180 days);
- high promotional fees of up to 10-25 per cent for each promotion;
- abrupt de-listing of suppliers (less than 5-10 days notice);
- charges of up to 5-15 per cent for undocumented or even non-existent product returns and
- 5-10 per cent yearly increase in annual agreement of commercial conditions.

Over 50 small and medium sized retail companies and more than 200 food and beverages suppliers went bankrupt under this ‘take it or leave it’ trade terms scenario. Little or no bargaining power was left even for big national players and global multinational suppliers.

**Chart 2.2: Trade scenario**

National demand (103 food, beverage and cosmetic products categories)



Everyday business was an ‘asymmetric negotiation’ in which one had more bargaining power than the other, in a win-lose situation. A high turnover of retail managers



migrating from one chain to the other further aggravated the situation due to the lack of confidentiality of the deals with each operator.

### **3 Key champions leading the policy innovation**

Towards the end of 1999, a high level of conflict was affecting both parties - suppliers and retailers. To give an example, each new hypermarket store opening generated pressure for a further 5 to 10 per cent discount on products or additional payment terms from 30 to 90 days. Suppliers started to mobilize political support. Something had to be done urgently.

The Argentine Supermarkets Chamber (CAS), representing 50 per cent of total food and beverages sales, and the Food & Beverages Manufacturers Association (COPAL), started receiving complaints from small and medium sized players at first, until gradually claims became generalized to operators of all sizes.

The most harmful and critical complaints referred to payment terms unilaterally delayed from 30 to 90 days on top of the agreed terms, 5 to 15 per cent extra discounts requested in each new annual agreement, and 5 to 10 per cent for merchandise returns by supermarkets.

At the same time, the government's Office of Fair Trading (OFT) (Secretaría de Defensa de la Competencia y el Consumidor) received increasing pressure from many lobbyists and key players to promulgate a law punishing competition restrictions with severe fines or non-monetary sanctions (discounts or volume scales abrupt elimination, temporary closings, etc.). More than five law projects were presented in both chambers (deputies and senators), some of them involving very extreme sanctions. For example a project in 1999 proposed a 0.5 per cent daily fine for each day of delay in payment terms.

This meant a severe risk for competitive conditions preservation, while opening the door to an abuse of power from the government if some anti-foreign or anti-large company ideology were to influence competition authorities or justice judgements.

At first, consumers did not complain because price wars were initially perceived as convenient by consumers since they were useful to control inflation and bring prices down. However, predatory pricing soon started to affect the profitability and even survival of small and medium sized retailers, causing bankruptcy or mergers of medium sized retailers as well more than a hundred of mergers, acquisitions or bankruptcies amongst suppliers.

At last supplies shortages were evident on the shelves, since when a retailer abused this price manipulation the manufacturers had to cut their deliveries to force predatory pricing to cease and so defend their brand image.

The other key players, small or traditional retailers representing a 50 per cent share of total sales, were informed of the negotiation of a Code, through the Wholesalers Association and the Groceries and Self Service Association. It was agreed that they would sign a similar Code after the aforementioned Code was signed. Two years later, in 2002, they finally signed their own specific BCPC for Wholesalers, similar in content, but contemplating a few additional chapters, such as penalties for selling counterfeited or smuggled brands, or offering stolen merchandise at elevated prices. It was agreed that predatory pricing or irregular supplies originating in criminal situations must be denounced judicially.

## **4 The policy innovation**

The government and some national congressmen presented five law projects with severe sanctions to stop abuses. This was seen as a very high risk for retail business. Though these projects seemed at first glance to be good news from the suppliers viewpoint, by stopping bad practices so suddenly government intervention could have unpredictable results and perhaps even lead to a worse scenario than the existing one. Global experience shows that fines are frequently proportioned, not according to the damage caused, but in line with the size (or nationality) of the company, with absurd and even abusive amounts (millions of dollars) and/or ideologically oriented sanctions.

On this account, both sides of the dispute, COPAL and CAS, suppliers and retailers, actively favoured a private instance for conflict prevention and arbitration. Each association, CAS and COPAL, named a task force composed of experts from both commercial and legal backgrounds, and they started collating cases of international experience (Spain, Portugal, France, European Union Predatory Pricing experience, etc.).

During 1999 the meetings took place on a monthly basis. In 2000, meetings started to take place at weekly intervals. Two months before the signing of the BCPC, meetings were taking place almost daily. This acceleration reflected the urgent need for a code, as well as consensus about its effectiveness.

Hundreds of meetings were held to discuss the best options. The author participated in many of these. Some of them were strictly commercial, some were legal, and others mixed both arenas. It is important to state that they were held without any direct government intervention. The OFT, as the main sponsor, was kept informed on the progress of the Code's drafting but was not an active participant in the process. If necessary, the OFT had the power to pass a law, and this threat worked as a very effective propulsion towards a Code agreement and signature.

### **4.1 Law versus Code**

A law would have the very clear advantage of its obligatory compliance, but on the other hand, there are political risks if there is a lack of equanimity in the justice judgements.

It was agreed that the retail business had technicalities or specific aspects that could be better understood and managed by its own operators than by competition regulators or justice officials.

A BCPC, written and agreed by consensus from both sides (CAS and COPAL) would be an ideal framework, a goal to be achieved. As voluntary agreements are not obligatory, a Code requires simultaneous general endorsement (via chamber) from the key or major operators as well as the individual signatures as written commitment.

**Chart 4.1: Summary of advantages and disadvantages of a law versus code**

	Code	Law
Accomplishment	Voluntary; just states rules of the game	Obligatory; compulsory accomplishment
Sanctions	Cease conduct Invitation to mediation <u>Arbitration:</u> Max. punishment : \$50,000	Legal Sanctions & fines (up to \$150 million)
Time frame	Quick process (2 weeks)	Slow and costly process (1-4 years)
Process	Executive-professional; managed by experts	Managed by justice officials (not experts)

## 4.2 The Code

### 4.2.1 The spirit of the Code

The spirit of the Code was to ensure free and fair trade, with similar opportunities for current players and newcomers. A balance between ample scope and precise limits was critical for a generalized acceptance and endorsement of the BCPC; ample scope to preserve business freedom with precise limits to stop bad practice.

The fact that the government does not play a primary role is a very important institutional aspect of the Code. However, the OFT has a critical role as depositary of the Code and is the last instance guarantor of its accomplishment (i.e. subsidiary role, not key player). The government remains the last instance ‘judge’ (i.e. not an everyday key player, but only brought in for exceptional situations). Mediation and arbitration are at first instance private, with competition regulators or legal officials only called in as a last resort.

The Code was signed on July 30<sup>th</sup>, 2000 at the Argentinean president's office, by both chambers, and more than 3 hundred business persons from both parties. At that time, the French retail chain Carrefour had merged with Promodes worldwide, and since this meant the chain would then hold 25 per cent of supermarket share, the OFT had a very powerful bargaining tool. It would not sign the merger of both companies in Argentina unless agreement was reached concerning a BCPC.

The Code and its procedures have three basic components:

- The Code (ten chapters)
- The procedures Code
- 11 complementary rules

#### **4.2.2 The Code**

The Code has ten chapters:

1. The strict fulfillment of written commercial agreements that will contain the general commercial conditions. This includes the frequency of delivery and of payment and the delay of the price-lists implementation. Supermarkets and suppliers promised to fulfill the delivery of merchandise, submitting any controversy before the arbitral instance (authority) foreseen in the Code.
2. It is stipulated that payments must be made with instruments discountable in financial markets, when the period of payment agreed upon is superior to thirty days. This clause becomes effective only for the biggest supermarkets.
3. A procedure for debits, credits and rejection of goods is established. Notes of debit will not be emitted unilaterally or for other reasons than the sale of merchandise, and a prior note of credit must be emitted by the supplier. In case of rejection of merchandise, the supermarket will have to notify the motives to the supplier, enabling the supplier to retire the produce (within six days) or to object to the reasons raised.
4. The current trading conditions must be maintained with respect to the uses and customs regarding other conditions than stated in the official invoice (annual deals).
5. The fifth point refers to brands image protection. Supermarkets will have to agree together with the suppliers about the politics and minimum price for offers calling

it legal selling price, which is the net price including taxes indicated in the legal invoice (with natural exceptions such as: end of season sales, product discontinuity or second quality items.). The aim of this clause is to protect the commercial image of the products from predatory pricing.

6. Joint programmes of logistics and administrative efficiency will be implemented to reduce costs, increase order fill and improve continuous and automatic replenishment.
7. The conditions for an uncaused interruption of relations are established. Ceasing commercial relations among big supermarkets and small suppliers will have to be notified with more than 60 days of anticipation. This prevents the abrupt interruption of commercial relations which can damage the organization or manufacturing plans of the supplier, destroying its competitive potential.
8. A mediation and arbitral instance and authority is established. The parties submit the commercial controversies related to the Code to an arbitral authority integrated by three members: one designated by supermarkets chamber, one from the supplier sector and the third from one of the two sectors (rotating per month sequentially), acting as an independent judge. These special umpires are named by mutual agreement of the two parties. In case of mediation (voluntary), the Arbitral Court can only order to cease the bad conduct under dispute, and the process is free of any cost. In case of arbitration (obligatory), fines can be imposed reaching a maximum of US \$50,000 and the fee of the umpire is US \$500 per hour with a maximum of US \$2,500 (five hours' fee).
9. The role of both chambers (CAS & COPAL) must be to promote the accomplishment of the Code designating the members of the Arbitral Court, and implementing a commission for the Code follow-up and update (Follow-up Commission).
10. The enforcement of the Code must be effective 60 days after its signature (July 14<sup>th</sup>, 2000), conditional upon its endorsement by all supermarket chains with annual revenues exceeding US\$100 million.

#### **4.2.3 The procedure Code**

This indicates steps and procedure in case of arbitration (obligatory) and mediation (voluntary), with the basic aim of avoiding the rupture of commercial relations while the conflict persists.

Mediation is the first natural step for solving a conflict, and it corresponds when there is no significant economic damage. It simply consists of one hearing in which both parties explain their viewpoints to a mediator, who recommends a course of action to correct the abuse or bad conduct invoked.

The umpire is a member of one of the two parties (CAS or COPAL, rotary on a monthly basis) as stated in chapter 8 of the Code, calling for a unique hearing where both parts expose their reasons, after which an immediate recommendation follows. This recommendation is not obligatory, and if it is not satisfactory for one or both parties they can ask for arbitration.

Arbitration corresponds when one or both parties consider they have suffered economic or financial loss, and it pursues its repair with a maximum fine limit of US\$50,000. The arbitrator is a renowned lawyer selected from a shortlist of five experts selected by each chamber, working under a symbolic fee of US\$500 per hour with a maximum of five hours' work. An economic limit for these arbitrations was deliberately established, leaving cases of superior damage repair claims to civil justice.

#### **4.2.4 Complementary rules**

These indicate procedures in very specific issues not covered precisely by the Code that may arise during the permanent meetings (bi-weekly) of the follow-up commission, whose key mission is monitoring and assuring the Code's success.

There have been eleven complementary rules since the beginning of the Code.

1. Discounts for future purchases (February 28, 2001)  
Whenever a discount is offered for future purchases of a certain product, the future net price must be equal or superior to the 'legal selling price' of art. 5 of the Code.
2. Minimum selling price for combos (April 19, 2001)  
Combos composed of two or more products must have a legal selling price equivalent to the sum of the individual legal price of each component.
3. Obligatory payment with financial instruments when terms exceed 30 days (April 19, 2001)  
The financial institution must be freely elected by the supplier, and not imposed by the retailer.

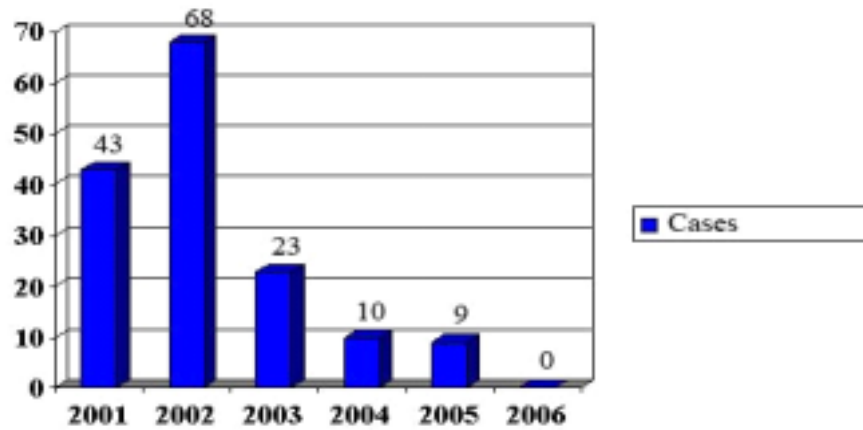


4. Annual agreement modifications (October 11, 2001)  
It is against the Code to modify unilaterally the annual agreement without both parties common consent.
5. Sanctions for pricing below the 'legal selling price' (LSP) (October 2001)  
No other sanction than mediation or arbitration can be implemented to punish violations of the predatory price.
6. Economic, financial or commercial damage (October 2001)  
A conduct must have an economic, financial or commercial damage to be considered a violation of the Code.
7. Transparent information about legal selling price (January 17, 2002)  
When a supermarket makes an offer below the legal selling price, the supplier is responsible for informing the mediation authority of the real 'legal selling price' in a maximum of five days.
- 7b. As point 7, but applied to supermarkets obligation to inform the legal selling price.
8. Umpire designation (February 14, 2002)  
In case there is no agreement between parties regarding the court of arbitration constitution, both chambers can recur to the Arbitral Court of the Buenos Aires Stock Exchange for the designation of an umpire.
9. Rejection of denunciation (June 13, 2002)  
When the secretary of the Court of Arbitration understands that a dispute exceeds the competence of the Code, the presentation can be rejected due to founded reasons. This is also possible due to three or more months of commercial relations interruption.
10. Regulation of arts. 19 and 20 of the Code of Procedures (August 2002)  
Several aspects are illustrated and cleared. For example: new price lists must have a ten to 30-day delay when inflation is high, marketing services must be invoiced by supermarkets previous agreement of price and terms of payment with suppliers, etc.
11. Time-terms for convoking to mediations and arbitrations (October 3, 2002)  
The secretary of the Court must convoke to mediation or arbitration in a ten day term since the reception of the request.

## 5 The situation after the policy innovation

Seven years of BCPCs (2000 to 2007) show a record of improvement in both free and fair practices, and thus also competitiveness. The culture or way of doing business has substantially changed, showing a dramatic fall in cases submitted for mediation or arbitration. The field and the name of the game are now clear, demonstrating that conflict prevention is least costly than late solutions.

**Chart 5.1: Mediations trend**



**Chart 5.2: Current situation (December 2000-March-2007)**

Closed	Mediation	153	100%
	Arbitration	19	12%
Absenteeism		10	7%
Rejected		3	2%
Pending		5	3%
Total cases		153	100%
Cases prevented		Thousands!!!	

From the supplier side, the main goals include: predatory price prevention (sale prices below cost determines no obligation to supply); payment terms are fully predictable and the cheque is received in advance by supplier; written yearly agreements without surprises in promotions or rebates; and return of goods must be announced previously with right to reject if it is unfounded.

From the retail side, there are no more irrational price wars. Unfair or disloyal rebates or promotions are exceptional (pre-Code they were generalized and funded coercively by suppliers) and competition is based on more ethical and fair terms.

## **6 Costs and benefits of the policy innovation**

Seven years of experience shows 153 interventions of the BPC authorities (153 mediations and 19 arbitrations) of which just two were presented by a supermarket. The most frequent subject of claim is concerning unilateral debt notes. Second is predatory pricing. Though this is the visible result of six years of Code life, the true benefit of the Code is the thousands of conflicts avoided.

The real advantage of this Code is the stimulation and rewarding of good practice, as well as the prevention and dissuasion of bad practice. To mention the best example, no matter what payment terms are agreed upon (average 60 days), all retailers now give their suppliers the post-dated cheque just seven to ten days after the delivery of goods. Previously, nobody knew the exact date of payment. This lends certainty to the collection terms and provides working capital for the supplier if he negotiates the cheque in financial markets.

Big players have the key role of making everybody (no matter what size or nationality) comply with the Code's rules, teaching through example from their own virtuous conduct.

It is important to note that there have been seven years of follow-up meetings (two per month). The follow-up commission (three representatives from each side) meets to monitor the Code's accomplishments, deliberate on problems and up-date rules whenever necessary.

It is very important that any bad practice that appears is maintained in secrecy until the bad conduct is changed or repaired. No action is published and no arbitration has reached the newspapers. This is basic for building credibility and trust in the system. Confidentiality is vital to the success of the Code.

### **Important:**

The excellent results obtained with the BPC encouraged the OFT (Argentina) to implement a similar Code in the banking sector (Good Banking Practices) and even in the horizontal properties housing consortium of owners rules. In both sectors, high conflict and abuses were detected and stopped.

## **7 Enabling conditions for the policy replication**

Asymmetric trading conditions occur worldwide, in developed and underdeveloped countries, in all sectors - food, beverages, financial services, utilities or whatever service we can think about. Any trade arena or market place where someone has (or acts as if he had) more power than the other generates a potentially inefficient assignment of resources (inequitable, not free or unfair scenario). Win-lose situations are not sustainable in the long term.

In the retail business, powerful local, regional and multinational retail players place growing pressure on their suppliers and fair competition is eventually damaged by generalized anti-market actions. In these cases, imposition (take-it or leave-it terms) replaces negotiation (win-win terms voluntarily accepted by all parties) and the society as a whole loses out since predatory practises (pricing, listing fees, de-listing procedures, etc.) normally result in poor competition and unfair practices.

This is why it is recommended to implement 'pro-market' procedures, whose benefits are higher than their costs for all players (government, consumers, suppliers, producers, and small and big retailers). Simply put, it is a matter of agreeing upon clear and transparent rules of the game and putting all agreements into writing.

Argentina's Code drew from European experience: European Community predatory practice jurisprudence, French legislation, Spanish and Portuguese amendments of their legislation regarding collecting terms and predatory prices, and UK BCPC (2000).

### **7.1 International experience**

#### **7.1.1 American experience**

It is important to note that Argentina 'exported' its BPC experience to Colombia (signed 2004) and Mexico (signed 2006), presenting it in supermarket conferences. Chile has a similar BCPC agreed with the government but not yet signed. Costa Rica has an agreed upon text (June 2006), but not yet signed. They are evaluating passing it by law, in order to make it obligatory.

#### **7.1.2 European Experience**

Brief and precise legislation on critical issues such as payment terms and predatory pricing has been passed in Spain, Portugal and France. UK BCPC involves a pragmatic and case-by-case approach that certainly works as dissuasive of bad practices.

**7.1.3 Asian experience**

China is not unaware of these realities. Its extraordinary and accelerated experience of market modernization includes the presence of global players and the Argentine case was presented in the first supermarket conference held in Shanghai, 2004. They have dealt with the issue with a law passed in November 2006, which states key practices that must be accomplished by all retail operators (e.g. payment terms must not exceed six months, promotional fee limits and annual agreements must be signed).

**7.2 Conditions for generating and applying a BCPC**

Best practices codes are applicable in any country, business or activity in which somebody exerts excessive pressure on the other, generating a win-lose situation.

**Chart 7.1**

<b>Conditions for generating a Code</b>	<b>Conditions for applying a Code</b>
<ul style="list-style-type: none"> <li>• Unfair competition (tax evasion, illegal activities, etc)</li> <li>• Predatory pricing (persistent below cost offers)</li> <li>• Win – lose negotiations</li> <li>• Compulsive contributions</li> <li>• Unpredictable or prolonged payment terms</li> <li>• High level of conflict</li> </ul>	<ul style="list-style-type: none"> <li>• Big and small players (retail and suppliers) aiming at fair and transparent (sustainable) competition</li> <li>• Government (fair trading authority) willing to guarantee free and fair trading simultaneously</li> <li>• Fair trading office and justice courts left as last instance (subsidiary role)</li> <li>• Empowering of top and bottom levels of suppliers and supermarkets (with values and ethical conducts)</li> </ul>

## **8 Summary:**

The Argentine BCPC (2000), and its international replications (i.e. Colombia in 2004, Mexico in 2006 and Costa Rica in 2006) seems to be a leading case for improving competitive conditions with policy innovations.

Businessmen should first try on their own to reach fair and free competitive conditions, with simultaneous benefits for consumers and workers, leaving the government, (fair trading authority or justice courts) as a second resort and legal justice as a last resort.

A rational win –win sequence seems to be:

- negotiation;
- mediation;
- arbitration;
- fair trading office intervention, and finally
- Justice courts.

BCPCs can pave the way for more rational, equitable and thus, sustainable trade scenarios.

## Regoverning Markets

Regoverning Markets is a multi-partner collaborative research programme analysing the growing concentration in the processing and retail sectors of national and regional agrifood systems and its impacts on rural livelihoods and communities in middle- and low-income countries. The aim of the programme is to provide strategic advice and guidance to the public sector, agrifood chain actors, civil society organizations and development agencies on approaches that can anticipate and manage the impacts of the dynamic changes in local and regional markets. The programme is funded by the UK Department for International Development (DFID), the International Development Research Centre (IDRC), ICCO, Cordaid, the Canadian International Development Agency (CIDA), and the US Agency for International Development (USAID).

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