



News Release

61/07

31 October 2007

GROCERIES MARKET PROVISIONAL FINDINGS

The UK groceries market is delivering a good deal for consumers but action is needed to improve competition in a number of local markets and to address relationships between retailers and their suppliers, the Competition Commission (CC) has provisionally concluded.

In its provisional findings report, published today, the CC states that a lack of competition in certain local markets not only disadvantages consumers in those areas but also allows retailers to weaken their offer to consumers nationally. Further, some retailer land holdings and other practices, such as restrictive covenants, mean that competition is not as effective as it could be in a number of areas.

The CC is also concerned about the ability of grocery retailers to transfer excessive risk and costs to suppliers through various purchasing practices, such as retrospective changes to supply agreements. The CC considers that these practices could damage investment and innovation in the supply chain to the ultimate detriment of consumers.

The CC will now consider a range of measures to address these concerns before deciding on its final remedies. Options under consideration include the lifting of restrictive covenants and exclusivity arrangements, sales of land holdings, and recommending changes to the planning system to place greater weight on competition and choice. The CC will also consider changes to the Supermarkets Code of Practice (SCOP), which regulates retailer-supplier relationships.

Peter Freeman, Chairman of the CC and Inquiry Group Chairman said:

Our focus throughout this inquiry has been whether consumers are receiving the benefits of vigorous competition, such as value, choice, innovation and convenience—and on most counts the groceries market delivers just that. However, we feel that consumers could be even better served.

Having looked in detail at local grocery markets, in most areas shoppers have a good choice and benefit from the strong competition between retailers, but in a number of local areas more competition would benefit consumers both locally and more generally.

We are concerned that retailers could be using existing land holdings and restrictive covenants to frustrate potential competition. Further, whilst we

understand that the planning system has to balance conflicting demands, not all of which favour development, it can act as a barrier to new competing stores.

We have looked carefully at the concerns that have been raised with us regarding small shops. The evidence is that convenience stores and specialist grocers that provide consumers with a strong retail offer will prosper. This is not to say that life is easy for small retailers, but we do not see evidence of unfair distortions in competition between large grocery retailers and small stores.

We do have concerns about aspects of the way retailers deal with their suppliers, which, if left unchecked, could harm consumers. We are concerned that the transfer of unexpected costs and excessive risk on to suppliers is likely to affect their ability to invest and innovate, which could then adversely affect product quality and innovation for consumers. Whilst the Code of Practice does have some effect, it does not entirely prevent the potential harm.

As a result of these concerns, we have published a list of potential measures to enhance and preserve competition which we will now look to discuss with all interested parties before we publish our final report next year.

The CC has carried out an exhaustive inquiry into all aspects of the groceries market, having received over 550 submissions; held 65 hearings with main and third parties; undertaken three separate surveys as well as analysing existing data and research covering the whole industry; collected a dataset of 14,000 grocery stores and published 26 working papers.

A summary of the findings and possible remedies is as follows:

Findings

Market definition

- Precise market definition will differ across local geographic markets but there are three major product markets: larger grocery stores (ie stores larger than 1,000–2,000 sq metres) which compete with stores of the same size; mid-sized stores, (ie all stores larger than 280 sq metres) which compete with both mid-sized and larger stores; and convenience stores, which compete with grocery stores of all sizes. To analyse collectively a large number of local markets, we have used the lower size thresholds of 280 sq metres for mid-sized stores and 1,400 sq metres for larger stores.
- The geographic market for the supply of groceries by grocery retailers is local—larger stores compete with other larger stores within a 10- to 15-minute drive-time, with the distance between competing stores in the same local market progressively reducing for smaller stores.

Concentration

- A significant number of local markets have high levels of concentration, which have persisted over a number of years. Weak competition in local markets lets grocery retailers weaken their retail offer in all of the markets in which they operate, as well as in those individual markets where competition is weak.

Barriers to entry

- The four largest grocery retailers own a significant number of landbank sites, as well as controlling further sites through leases to third parties, restrictive covenants and exclusivity arrangements.
- In many cases, these landbank sites represent a pipeline of future development activity that does not raise competition concerns. However, approximately 10 per cent of all larger grocery stores in highly-concentrated local markets have a nearby landsite which is controlled by the retailer and is likely to be constraining entry by competitors. In addition, there are instances of local markets where controlled land holdings, particularly the use of restrictive covenants, may be constraining entry by convenience stores.
- The planning regime aims to promote a series of public interest objectives such as orderly growth and development of existing town centres and the provision of a wide range of services in a pleasant and widely accessible environment. Nevertheless, the planning system for retail development and the manner in which it is applied by local planning authorities also acts as a barrier to entry or expansion, by limiting construction of new stores on out-of-centre or edge-of-centre sites, and by imposing costs and risks on smaller retailers and potential entrants.
- The economies of scale resulting from the distribution systems of the national grocery retailers, as well as the significant purchasing cost advantages held by larger retailers, are likely to act as a barrier to entry or expansion by smaller retailers and new entrants. However, the presence of the grocery wholesaling sector mitigates the detrimental effects of this barrier on smaller retailers and new entrants.
- Tesco is not in such a strong position that other retailers cannot compete. Expansion by other grocery retailers continues, which suggests that Tesco's purchasing cost advantage, share of national grocery sales or expansion into convenience store retailing is not acting as a barrier to expansion by other grocery retailers.

Effects on convenience stores and smaller retailers

- Below-cost selling by national retailers is not part of a predatory strategy aimed at convenience stores or specialist stores and is not having significant unintended effects on smaller stores.
- There is insufficient evidence to conclude that local vouchering is being used by larger grocery retailers with any intention beyond that of normal competitive behaviour.
- The characteristics of UK grocery retailing that we observe do not support the argument that a 'waterbed' effect is distorting competition between large and small retailers. Large retailers do not always get the best price from suppliers. In addition, convenience and specialist store numbers are not in such a state of decline to suggest that a waterbed effect exists.
- There is no evidence to suggest that the financial viability of the wholesaler sector is seriously under threat. In addition, consolidation at the wholesale level is unlikely to damage the competitiveness of the convenience store sector.

Coordination between grocery retailers

- We have not seen direct evidence of tacit coordination between grocery retailers. However, given the structure of the grocery retailing market, such conduct might arise in the future. In particular, practices such as category management are capable of facilitating exchanges of information between retailers.
- Our review of emails between Asda and Tesco and their suppliers shows that suppliers facilitate the exchange of information on retail prices charged by rival retailers. Further consolidation among suppliers may be a cause for concern if it is likely to facilitate coordination, but there is no direct evidence of tacit coordination at present.

Supply chain

- There are no systemic problems with the financial viability of UK food and drink manufacturers, nor are there significant barriers to entry or expansion for small grocery suppliers.
- Trends in supplier investment or product innovation in the UK are positive, but we have concerns about the effect of practices carried out by grocery retailers that transfer risks and increase costs to suppliers on future levels of investment and innovation. Each of the national grocery retailers, and some symbol groups, are likely to have buyer power with respect to at least some of their suppliers. The SCOP appears, at least to some extent, to be constraining the exercise of buyer power by the retailers to which it applies.
- There is no evidence to suggest that the sale of own-label products by grocery retailers is giving rise to material competition concerns.

Possible remedies

- Require grocery retailers to divest land holdings in areas where concentration is weak.
- Prohibit grocery retailers from using restrictive covenants or exclusivity arrangements that reduce the likelihood of land being used for a competing supermarket.
- Recommend changes to the planning system that would provide greater opportunities for developments on the edge of town centres, while maintaining constraints on out-of-town developments.
- Introduce a competition test that would allow the existing local position of a grocery retailer to be taken into account in planning decisions.
- Include more retailers in the scope of the SCOP, tightening of various provisions within the SCOP and changing arrangements for its monitoring.

The CC would like to hear from all interested parties, in writing about both the provisional findings report (by 30 November 2007) and the notice of possible remedies (by 23 November 2007). To submit evidence, please email: Groceries@cc.gsi.gov.uk or write to:

The Inquiry Secretary
 (Groceries Market Investigation)
 Competition Commission
 Victoria House

Southampton Row
LONDON
WC1B 4AD

Notes for editors

1. Under the Enterprise Act 2002 the Office of Fair Trading (OFT) can make a market investigation reference to the CC if it has reasonable grounds for suspecting that competition is not working effectively in that market.
2. The inquiry was referred by the OFT on 9 May 2006. This market reference follows an initial OFT study into the sector and public consultation.
3. The CC is considering whether features of this market or markets prevent, restrict or distort competition. If so, it will find an adverse effect on competition and consider whether action should be taken to remedy or prevent the adverse effect or any resulting adverse effect on customers in the form of higher prices, lower quality or less choice of goods and services, or less innovation. The CC is required to publish its final report by 8 May 2008.
4. The members of the Inquiry Group are: Peter Freeman (Group Chairman), Jayne Almond, Barbara Donoghue, Alan Gregory, Alan Hamlin and Bruce Lyons. The Inquiry Director is Andrew Taylor.
5. Further information on the CC and its procedures, including its policy on the provision of information and the disclosure of evidence, can be obtained from its website at: www.competition-commission.org.uk.
6. Enquiries should be directed to Rory Taylor (email rory.taylor@cc.gsi.gov.uk) on 020 7271 0242.