Supermarkets

A report on the supply of groceries from multiple stores in the United Kingdom

Volume 1: Summary and Conclusions

COMPETITION COMMISSION

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Members of the Competition Commission as at 31 July 2000

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[1]These members formed the Group which was responsible for this report under the Chairmanship of Dr D J Morris.

Note by the Department of Trade and Industry

In accordance with section 83(3) and (3A) of the Fair Trading Act 1973, the Secretary of State has excluded from the copies of the report, as laid before Parliament and as published, certain matters, publication of which appears to the Secretary of State to be against the public interest, or which he considers would not be in the public interest to disclose and which, in his opinion, would seriously and prejudicially affect certain interests.

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Summary and Conclusions

1 Summary

1.1. On 8 April 1999, the Director General of Fair Trading (DGFT) referred to this Commission for investigation and report under the monopoly provisions of the Fair Trading Act 1973 (FTA) the supply in Great Britain of groceries from multiple stores, that is, supermarkets with 600 sq metres or more of grocery sales area, where the space devoted to the retail sale of food and non-alcoholic drinks exceeds 300 sq metres and which are controlled by a person who controls ten or more such stores. We use the term 'reference stores' to mean stores which meet these conditions. In our terms of reference 'groceries' includes food and drink, cleaning products, toiletries and household goods. We were asked to report within a period of one year. Subsequently the scope of the inquiry was extended to the UK and the inquiry period was extended until 31 July 2000. Our terms of reference are set out in Appendix 1.1.

1.2. The origins of the reference lay, first, in a public perception that the price of groceries in the UK tended to be higher than in other comparable EC countries and the USA; secondly, in an apparent disparity between farm-gate and retail prices, which was seen as evidence by some that grocery multiples were profiting from the crisis in the farming industry; and thirdly, continuing concern that large out-of-town supermarkets were contributing to the decay of the high street in many towns. The Office of Fair Trading (OFT) conducted an initial investigation in 1998/99 which identified several further areas of concern including barriers to entry limiting competition, the level of supermarket operators' profitability, the price of land impacting adversely on the costs of stores, concerns about the intensity of price competition between the supermarket operators and about the relationship between the supermarket operators and their suppliers. The breadth of these concerns was reflected in over 200 submissions which we received in the early stages of our inquiry.

1.3. We identified 24 multiple grocery retailers who supplied groceries from reference stores; they are: Aldi Stores Ltd (Aldi); Anglia Regional Co-operative Society Ltd; ASDA Group Ltd (Asda); Budgens Stores Ltd (Budgens); Colchester and East Essex Co-operative Society Ltd; CRS Ltd; CWS Ltd (CWS); E H Booth & Co Ltd (Booth); Iceland Frozen Foods plc (Iceland); Lidl UK GmbH (Lidl); Marks & Spencer plc (M&S); Midlands Co-operative Society Ltd; Netto Foodstores Ltd (Netto); Oxford, Swindon and Gloucester Co-operative Society Ltd; Plymouth and South Devon Co-operative Society Ltd; Safeway plc (Safeway); Sainsbury's Supermarkets Ltd and Savacentre Ltd (Sainsbury); Scottish Midland Co-operative Society Ltd; Somerfield plc (Somerfield); Tesco plc (Tesco); United Norwest Co-operatives; Waitrose Ltd (Waitrose); Wm Morrison Supermarkets plc (Morrison); and Yorkshire Co-operatives Ltd. We refer to these companies as the 'main parties'.

1.4. During our inquiry we looked at certain pricing practices, and at a range of practices in relation to suppliers which were brought to our attention (see paragraphs 1.5 to 1.12). In addition, we examined a substantial number of other relevant features of the industry, summarized in subparagraphs *(a)* to *(h)* below. Our conclusions on all these matters are detailed in Chapter 2. Factual support is to be found in Chapters 3 to 15 and their accompanying appendices. In summary:

(a) We examined price trends in the industry, and found an overall decline (of 9.4 per cent) in the real price of food from 1989 to 1998.

(b) We carried out a detailed international comparison of grocery prices which, allowing for quality and tax differences, showed that in late 1999 UK prices were on average 12 to 16 per cent higher than those in France, Germany and the Netherlands. However, the comparison was heavily affected by the value of sterling at the time, an effect that could distort the comparison between grocery prices in the UK and elsewhere by between 7 and 17 per cent. We also noted that land and building costs were somewhat higher in the UK. We concluded that there was no evidence from such comparisons that UK grocery retailers were acting in an anti-competitive manner so as to generate higher prices than would otherwise be the case.

(c) We looked at whether the recent declines in wholesale prices, especially in the livestock sector, were being fully reflected in retail prices charged to consumers in reference stores. This stemmed from complaints that price cuts suffered by UK farmers during 1997/98 had not been fully reflected in corresponding falls in supermarket prices. We were satisfied that cost reductions at the farm gate had either been passed through to retail prices or, where they had not, that there had been cost increases elsewhere in the supply chain. In a competitive environment, we would expect most or all of the impact of various shocks to the farming industry to have fallen mainly on farmers rather than on retailers; but the existence of buyer power among some of the main parties has meant that the burden of cost increases in the supply chain has fallen disproportionately heavily on small suppliers such as farmers.

(d) We looked closely at the profitability of the main parties using a number of measures and a range of comparators. We found that the overall profitability of the industry could not be considered excessive over the period 1996 to 1999. However, we noted that profitability had been higher prior to 1996 and that recently announced figures showed a continued downward pressure on profits. We examined whether potentially higher profits were being absorbed through inefficiencies, but found that this was the case to only a very limited degree. However, land and building costs are higher in the UK than abroad, and profitability is measured after allowing for these higher costs.

(e) We conducted a consumer survey. The evidence we received showed a high degree of satisfaction with supermarkets by those who shopped in them. However, our survey exposed some unsatisfied demand for particular supermarket fascias in some localities.

(f) We examined the relevant aspects of the planning system and found that the more restricted availability of sites brought about by the changed planning guidelines in the 1990s had made entry into, and expansion within, multiple grocery retailing more difficult for parties wanting to acquire large sites in out-of-town locations.

(g) We have found no reason to suggest changes to the planning regime or the balance of interests which the latest guidelines are seeking to achieve. The latest planning guidance in our view balances broader social and environmental objectives relating to the vitality of town and city centres with the needs of consumers for stores (but see paragraphs 1.13 to 1.15).

(h) We considered a range of social and environmental issues relating to the growth of supermarkets, including their impact on employment, access by low-income groups, the impact on the viability and stability of town centres, some transport considerations and the emergence of food deserts. We identified problems in some of these areas, but none attributable to any anti-competitive behaviour on the part of the main parties.

1.5. We examined a number of practices in the industry. One group of practices concerned the pricing of grocery products. The second concerned actions by the main parties in their relations with their suppliers. For the purpose of investigating the pricing practices, we first identified the relevant economic market. We conclude that the market is for one-stop grocery shopping carried out in stores of 1,400 sq metres (about 15,000 sq feet) or more. We conclude that one-stop shopping patterns are primarily local, with consumers rarely travelling more than 10 minutes in urban areas, and rarely more than 15 minutes elsewhere to do their main weekly shopping. We consider that on the basis of various economic criteria, five of the main parties are able to exercise power in this market, namely Asda, Morrison, Safeway, Sainsbury and Tesco.

1.6. Regarding pricing practices, we examined five practices allegedly carried out by the main parties, about which we had received complaints. We concluded that three of them (see *(a)*, *(b)* and *(c)* below) distorted competition and gave rise to a complex monopoly situation for the purposes of the FTA, and that two of these (*(a)* and *(b)*) also operated against the public interest:

(a) We found that all the main parties (with the exception of M&S and Lidl) engaged in the practice of persistently selling some frequently purchased products below cost, and that this contributed to the situation in which the majority of their products were not fully exposed to competitive pressure and distorted competition in the supply of groceries. We took account of the fact that some consumers could benefit from being able to buy goods below cost, particularly low-income consumers, but at the same time that the practice damaged smaller reference stores and non-reference grocery outlets. This would in turn impact adversely on consumers, in particular the elderly and less mobile who tend to rely more on such stores. We conclude that the practice of persistent below-cost selling when conducted by Asda, Morrison, Safeway, Sainsbury and Tesco, ie those parties with market power, operates against the public interest.

(b) We found that the practice of varying prices in different geographical locations in the light of local competitive conditions, such variation not being related to costs (which we termed ‘price flexing’), was carried on by Budgens, the Co-ops, Netto, Safeway, Sainsbury, Somerfield and Tesco. We found that this practice contributed to a situation in which the majority of their products were not fully exposed to competitive pressures and which distorted competition in the supply of groceries. We conclude that the practice, when carried on by Safeway, Sainsbury and Tesco, who have market power, operates against the public interest because their customers tend to pay more at stores that do not face particular competitors than they would if those competitors were present in the area.

(c) We found that Asda, Booth, Budgens, the Co-ops, Safeway, Sainsbury, Somerfield, Tesco and Waitrose adopted pricing structures and regimes that, by focusing competition on a relatively small proportion of their product lines, restrict active competition on the majority of product lines. We conclude that this distorts competition in the retail supply of groceries because not all the parties’ products are fully exposed to competitive pressure. However, we found no evidence that this practice has contributed to excessive profits, or that consumers are paying higher prices overall. The majority of local areas provide adequate choice and competitive opportunity as between different pricing strategies pursued by the main parties. If there were consumer needs or preferences not being met in such areas, we believe that alternative price strategies would emerge and to some extent they have done so. We therefore conclude that the practice by 18 of the main parties of pricing so as to focus competition on a relatively small proportion of their product lines, while it does bring about a distortion of competition in the supply of groceries, does not on balance operate, and may not be expected to operate, against the public interest.

We considered two further alleged practices:

(d) Setting the prices of own-label products in relation to their branded equivalents rather than their costs: we found that while the prices of branded and own-label products

influenced each other, there was no evidence that own-label prices sheltered under a branded price 'umbrella' or, given the cost structures involved, that own-label products were excessively profitable.

(e) Not reflecting changes in wholesale prices rapidly enough in retail prices: we found overall that in most cases there was a fairly rapid and reasonably complete transmission of short-term cost changes from wholesale to retail level, and so we conclude that the main parties do not follow this practice.

1.7. We considered the following possible remedies in relation to the pricing practices that we found to be against the public interest:

(a) On persistent below-cost selling, we noted that prohibitions in other countries had not been very effective. For example, a report by the Irish Fair Trade Commission in 1991 considered that there was persuasive evidence that the prohibition of below-cost selling had resulted in higher prices overall, a decrease in price competition and an increase in margins. We also found difficulties with a possible remedy based on permitting other smaller retailers to purchase from the major parties any volume of goods at below cost for resale. We also considered that both remedies would require monitoring and intervention that would be disproportionate to the adverse effects they were designed to remedy. Therefore we make no recommendations for remedial action.

(b) On price flexing, we considered a number of possible remedies, in particular: the imposition of national pricing; a requirement that prices should be broadly related to costs; and a requirement that the parties should publish their prices on the Internet. We conclude that all these remedies are either undesirable, disproportionate or present practical difficulties. We therefore make no recommendation for remedial action in respect of price flexing.

1.8. We recognize that it is unusual, although not unprecedented, for the CC to recommend no remedy for identified adverse effects. However, we consider that this is appropriate in the light of our overall finding that the market is generally competitive, and consistent with our duty to ensure that intervention in such a market must be proportionate and impose the least regulatory cost in seeking to remedy any adverse effects found.

1.9. As regards the second group of practices, relating to suppliers, we received many allegations from suppliers about the behaviour of the main parties in the course of their trading relationships. Most suppliers were unwilling to be named, or to name the main party that was the subject of the allegation. There appeared to us to be a climate of apprehension among many suppliers in their relationship with the main parties. We therefore put a list of 52 alleged practices to the main parties and asked them to tell us which of them they had engaged in during the last five years. We found that a majority of these practices were carried out by many of the main parties. They included requiring or requesting from some of their suppliers various non-cost-related payments or discounts, sometimes retrospectively; imposing charges and making changes to contractual arrangements without adequate notice; and unreasonably transferring risks from the main party to the supplier. We believed that, where the request came from a main party with buyer power, it amounted to the same thing as a requirement.

1.10. We conclude that five multiples (the major buyers—Asda, Safeway, Sainsbury, Somerfield and Tesco), each having at least an 8 per cent share of grocery purchases for resale from their stores, have sufficient buyer power that 30 of the practices identified, when carried out by any of these companies, adversely affect the competitiveness of some of their suppliers and distort competition in the supplier market—and in some cases in the retail market—for the supply of groceries. We find that these practices give rise to a second complex monopoly situation.

1.11. These practices, when carried on by any of the major buyers, adversely affect the competitiveness of some of their suppliers with the result that the suppliers are likely to invest less and spend less on new product development and innovation, leading to lower quality and less consumer choice. This is likely to result in fewer new entrants to the supplier market than otherwise. Certain of the practices give the major buyers substantial advantages over other smaller retailers, whose competitiveness is likely to suffer as a result, again leading to a reduction in consumer choice. We took into account the advantages that can result from buyer power in relation to those suppliers with market power, and other offsetting benefits in relation to certain of the practices. We nonetheless conclude that the exercise of 27 of these practices by the five major buyers meeting the 8 per cent criterion operates against the public interest.

1.12. We believe that the most effective way of addressing these adverse effects would be a Code of Practice. We do not believe that a voluntary code would be adequate. Any multiple meeting the 8 per cent criterion should be required to give undertakings to comply with the Code of Practice, which should be designed to meet the concerns we have identified. It should include provisions for independent dispute resolution. The Code would best be drawn up by retailers and representatives of suppliers, but it should be approved by the DGFT as meeting our concerns. We consider it highly desirable that the other main parties should be involved in the process and comply with the Code.

1.13. Taking all the above matters into consideration, we are satisfied that the industry is currently broadly competitive and that, overall, excessive prices are not being charged, nor excessive profits earned. However, we have concerns about some aspects of the structure of local markets for one-stop grocery retailing in certain areas of the UK, and in particular about the limited choice of supermarket fascia for some consumers in some areas. This has been exacerbated by the shortage of land for new development and expansion. Moreover, whilst profitability among the main parties was not excessive from 1996 to 1999, it had been higher in previous years. Any further local concentration could weaken competition in some areas and might result in a return to higher levels of profitability.

1.14. We have found no reason to suggest any changes in the balance of interests now reflected in the planning system. However, the planning system is not designed to safeguard competition and consumer choice in multiple grocery retailing and we believe there is currently no way of addressing, through changes in the planning regime, the particular manifestations of lack of consumer choice that we have identified. We therefore recommend a new system of approval designed to address this problem. As this recommendation does not follow from adverse findings on either of the complex monopoly situations that we identified, or from facts found during the course of our inquiry, we recognize that it would not be enforceable without appropriate legislation.

1.15. We recommend that in certain clearly defined circumstances, the DGFT's approval should be required for particular parties to be allowed to acquire or develop large new stores. These are that if Asda, Morrison, Safeway, Sainsbury or Tesco wish to acquire an existing store, or build a new store, having over 1,000 sq metres (about 11,000 sq feet) of grocery retail sales area within a 15-minute drive time of one of its existing stores, or significantly to extend the grocery retailing area of an existing store, it should be required to apply to the DGFT for consent. We think that a small, dedicated unit should be established to deal with such cases within the OFT. We recognize that this proposal would represent an additional burden and some business risk for the parties and would entail a staffing and resource cost for the OFT. Despite these considerations, however, we believe the benefit to consumers would clearly outweigh these costs.