

Summary of hearing with the Federation of Wholesale Distributors held on 8 September 2006

Background

1. The Federation of Wholesale Distributors (FWD) represents the interests of UK wholesalers operating in the food, drink, tobacco, household and related non-food markets. It has approximately 420 member firms, operating out of 880 depots and supplying retail outlets and caterers of all types. In 2005, the Institution of Grocery Distribution valued the sector at £16.9 billion, split between cash and carry (£9.3 billion) and delivered wholesale (£7.6 billion). The core customer base of these wholesalers (representing some 70 per cent of turnover) is smaller, independently-owned retail outlets.

Developments since 2000

2. The FWD said that the main development of concern to it since the CC's inquiry in 1999/2000 was the major multiples' move into the convenience market. A continuing concern was the widening differential between what the big four multiples on the one hand and the FWD's members on the other paid manufacturers. It hoped that the CC would look at pricing for like-for-like volumes.
3. The FWD said that it appeared from TLS market research that the rate of decline of the independent retailer had accelerated demonstrably in the last 12 months and that there had been a particularly big step down in the most recent quarter, because of pricing pressure from the multiples on beers and spirits and the effect of the World Cup. The market appeared to be becoming more aggressive against the independent retailer.
4. Asked whether the buyer power of the multiple retailers was confined to or concentrated on certain lines, such as alcohol, the FWD said that over Christmas 2005 there was less competition between the multiples on groceries and more on other products, in particular spirits and DVDs and other products not usually associated with the multiple channel. The multiples had also priced very aggressively on Easter eggs, where the independents were usually strong, and on beer at the time of the World Cup. Pressure on the independents was intensifying whereas there was probably less competition between some of the multiples. The FWD suggested that this aggressive pricing of alcohol and confectionery also raised questions about responsible retailing.

Competition issues

5. Asked about the characteristics that distinguished competition between multiples from competition between multiples and independents, the FWD said that price wars between multiples usually occurred on items where they had very strong market shares, for example breakfast cereals. However, they were now so dominant in these areas that they no longer needed to compete, and pricing of core grocery items was similar in all the different multiples. Where they were not so strong in the market they were competing with other channels and other types of retailer rather than among themselves. For example, the multiples had roughly 50 per cent of the market in beers, wines and spirits compared with 75 or 80 per cent of the pure grocery market, which equated to about 15 per cent of a typical multiple store's sales, but these categories amounted to up to a third of the wholesale channel's business and approaching that proportion of independent retailers' business. The multiples had

decided to chase that business by selling beer and spirits at ridiculously low prices. The purchase of spirits was a relatively straightforward market, with little override or retrospective money involved, so it was quite easy to reach a true cost price. A wholesaler buying in the most economically viable way, full loads of one product, and comparing like with like would pay at least 20 per cent more for spirits than for example the retail selling price of litre bottles of major brands in the multiples at Christmas 2005.

6. The FWD said that if the multiples succeeded in removing a large part of the competition for sales of alcohol, they would raise prices and use the increased margins to compete in other product areas. They had already used this strategy in fresh fruit and vegetables, meat and bakery, where independent retailers had largely been wiped out of the high street. The multiples had hugely increased the prices of core products and had started selling new products at premium prices. Regardless of their intent, if the effect of what they were doing was to reduce or eliminate independent or non-multiple competition in that sector, then prices would subsequently rise again.
7. The FWD said that competition between the multiples had declined since the CC's last investigation because the ability to build more superstores had been restricted and the convenience sector had become an appropriate avenue for growth. The multiples had been able to take supermarket prices down to convenience stores and were undoubtedly making more profit in those outlets than a regular convenience business would make because of their huge cost price advantage. Nevertheless, a major supermarket would be more profitable than a convenience store, because of the economies of scale it offered. In the past five years the multiples had opened up next door to the customers of the wholesalers, and had distorted the market because of their ability to use their huge buying advantage to get lower prices from suppliers. Independent retailers could buy many basic grocery products from major supermarkets at a lower price than from wholesalers, so the supermarkets were competing in the wholesale sector as well as the retail sector.

Buyer power and differential pricing

8. The FWD recognized that the multiples' move into the convenience sector could result in customers paying less for convenience in the short term. However, it was concerned that there was not a level playing field in the basic cost price paid for products. Stores owned by a major multiple would make about four times the profit of other convenience stores simply because of the greater purchasing power of the multiples. This was simply a function of market share and had nothing to do with efficiency of operation or economies of scale.
9. The FWD pointed out that a typical large Wholesale distribution centre supplies around 700 stores (annual turnover £350 million) this was comparable in size and volume to a major multiples regional distribution centre, but because of smaller market share between wholesaler and multiple the wholesaler would be unable to get as favourable terms from the manufacturer as the multiple enjoyed. The nature of the wholesalers' business also meant that there was not a like-for-like negotiating process. Wholesalers were buying as distributors, providing a mechanism for retailers to obtain the goods rather than determining which range they would sell. They were likely to stock any product that was economically viable and, except in extreme circumstances, did not have the sanction of refusing to list a product. In contrast, the consequences for a manufacturer of not having its product stocked by a major multiple were so dire that the multiples were able to leverage much greater price advantages. Even where the wholesalers were able to get stock at similar

prices to the multiples, the timing, quality and availability might not be the same: for instance, wholesalers often got short-dated stock of a product that had failed in the multiples. It was fair to say that the major multiples received preferential treatment across all terms of business.

10. The FWD said that all the multiples generally tended to behave in similar ways, although Tesco's particularly strong position allowed it to engage in local pricing against other multiples as well as independents. For example, it had used vouchers against a newly opened store in Scarborough.
11. The FWD said that it was necessary to look at the economics of wholesaling when trying to quantify what would be a justifiable differential between wholesalers and the major multiples for like-for-like purchasing. It believed that the differential was currently between 15 and 20 per cent, which was out of all proportion to any economic scale benefits. It believed it should be no more than 1 per cent.
12. With regard to consumer harm, the FWD said that the UK multiples made very high margins and were the most profitable in Europe, if not the world. If the wholesalers could buy at the same prices as the multiples then they could bring down consumer prices, which were currently artificially high because of the multiples' margins. Their buying power masked the fact that they made high profits and consumers were not actually getting a good deal. This was also true in terms of choice and service to the community because the major multiples were cherry-picking the best sites for convenience stores, which was having knock-on effects on peripheral sites and putting people out of business. The interests of the four major multiples was in stocking a smaller range and driving it harder, whereas the independent sector was maintaining a wider range of choice and meeting the needs of local markets.
13. The FWD recognized that while the creation of a level playing field in buying power might increase price competition in the convenience sector, the out-of town superstores, that competed only with each other, could become more expensive to consumers, but said that this would depend on how the CC decided that the differential should be narrowed. It pointed out that a longer-term outcome would be the lowering of a real barrier to entry, which could encourage innovative, entrepreneurial people to come into the market and provide true competition to the multiples in branded groceries. The experience in the Republic of Ireland when the Grocers Order was in existence supported this view.
14. Asked whether it was not in the interests of the manufacturers to maintain the diversity of retail channels and therefore to avoid large price differentials, the FWD said that diversity might be a strategic intent, but faced with delisting by a major retailer the commercial reality was that a manufacturer would come to terms with the retailer on price. The short-term interest would prevail, especially as most of the manufacturers were listed companies.

Below-cost selling

15. The FWD suggested that the major multiples engaged in below-cost selling, not just heavy discounting. It believed that examples of products where this had occurred were spirits, beer and Easter eggs.

Decline of the wholesale market

16. Asked whether there was evidence of decline in the wholesale market, in terms of the distribution networks, the FWD said that it currently had around 280 members com-

pared with 350 some five years ago. Consolidation and reduction in the number of depots had been going on for many years. It thought that this had led to a diminution of competition in certain areas, for example Oswestry and Monmouth where in each of those areas a small independent wholesaler had left the market and there was only one remaining wholesaler. The speed of decline was linked to the speed with which the multiples were moving into the high street and the impact this had on independent retailers. As the number of independents dwindled, their suppliers, the wholesalers, would go out of business at the same speed. The FWD thought that the tipping point might vary between regions because of the differing impact of cost pressures such as rising fuel prices, the minimum wage and the Working Time Directive. The effects were likely to be worse in more remote or rural areas.

Product range

17. The FWD said that independent retailers tended to carry a more differentiated range of stock than the major multiples and to respond to customers' needs rather than dictating what customers could have. Unlike the multiples, they could not afford to discount customers who, for example, wanted to buy a more unusual product, or to continue paying by cheque. The independent stores also helped to increase consumer choice by acting as a route to market for small local producers.

Market definition

18. The FWD said that it had some concern about the 'two markets' definition that was established in 2000. It saw a single market from the buying side, with the multiples able to exercise a huge advantage and translate it into a small high street location. It believed that Tesco's purchase of the T&S stores might have been referred to the CC if the two markets definition had not been applied.

Planning issues

19. The FWD believed that the multiples abused the planning system in the UK. It gave the example of Tesco's behaviour in Stockport: it had obtained outline planning consent for a store of approximately 9,290 sq metres (100,000 sq feet). It did not obtain full planning permission but went ahead and built the store. About six weeks before the store was due for completion it became apparent that it was approximately 20 per cent larger than allowed for by the outline planning permission. The store opened in November 2004 and had been taking more than £1 million a week since. The Council was originally minded to permit a variation, but, because of the public reaction, had insisted on a retrospective application. The FWD said that this case illustrated how the multiples dominated and browbeat the planning system. Tesco had traded for nearly two years with no planning permission, with doubtful legality, and had gradually worn down the Council with a weight of resource, money and consultancy that was out of all proportion to anything that local authorities could and should bring to bear because of their responsibilities to local residents. It was likely that planning permission would be granted, although in the FWD's view this would be inconsistent with the constraints that the Council had previously imposed, which took account of the effects on competition and traffic.
20. The FWD also told us of a 1,115 sq metres (12,000 sq foot) Asda supermarket in Pwllheli, for which there had been two variations in permission, the first to extend the area to 18,000 square feet and the second to raise the height and put in a mezzanine floor. Asda was now seeking a further variation, in the comparison goods condition that was put on the planning application. The FWD said that the resources brought to

bear by the multiples and the threat to a local authority of the huge cost of judicial review or planning inquiries was such that the multiples would get their way in the majority of cases. They could also bring pressure to bear by drawing on their profits to fund projects in the local community.

21. The FWD commented that there was not a level playing field for the multiples and smaller retailers. An infringement of the planning requirements by a small retailer installing a security shutter would lead to an enforcement notice and threat of closure. That was out of all proportion compared, for example, with the 20 per cent increase in the size of the Tesco store in Stockport.
22. The FWD said that it took exception to the OFT's view that there would be benefits from many more out-of-town sites, with new players coming in to give the current incumbents some competition. It did not believe that proliferating out-of-town sites would do any good for the high street and particularly for its business model.
23. The FWD commented that, as a result of their buyer power, the multiples had phenomenal ability to outbid anybody else for stores. The better independent retailers were being offered substantial sums, in excess of what had previously been the market price, to sell out to the major multiples.

Tobacco sales

24. The FWD told us that tobacco was very important to the wholesale market and the convenience sector, where it was a footfall driver. Analysis it had undertaken suggested that in 2003 an independent retailer probably made about £2,900 profit a year from tobacco sales, but by 2005 this had fallen to about £2,000. Although it had no hard evidence, it suspected that the multiples had not seen a comparable drop in profitability over the same period. It thought that any gap would be due to price-marked packs, the range of value cigarettes available to the different channels and, perhaps, to the multiples' better buying terms.