Summary of hearing with Marks & Spencer, October 2007

Background

1. Marks & Spencer (M&S) said that as a 100 per cent own-label business it had a targeted range, which covered the key grocery product segments but avoided the duplication of offering a number of different versions of the same product. As a result of focusing on offering a single, quality product under the M&S brand, M&S sold significant volumes in some key parts of its business, which enabled M&S to offer good value to customers, deliver market-leading quality and provide a level of innovation through its control of its supply chain, across its entire product range. The focus of M&S's business model over the years had been to make excellent quality products accessible to the consumer.

2. M&S's strategy was to take its food business from [✄] over the next six-year period. Following a period when [✄], M&S had recently been increasing its market share. M&S considered that all grocery retailers, convenience stores, delicatessens, specialist food shops, and department store food-halls competed with it. However, certain retailers competed more strongly on certain elements of competition than others. M&S saw Waitrose as its closest competitor in terms of cross-over of customer type and produce range. That said, Tesco, Sainsbury's, and ASDA had introduced new ranges and premium labels that also increasingly competed directly with M&S.

3. M&S told us that it was spending [✄] in 2006 on the modernization of its existing estate and expected to complete its programme of modernization over the next [✄] years. Its aim was to make its food more accessible to consumers and to win new, loyal customers, in particular younger and family customers. Its portfolio was currently nearly [✄] stores and its aspiration was to [✄].[✄] It expected to have [✄].

4. M&S had always seen itself as being in direct competition with the major multiples. It used them as the benchmark when it carried out comparative shops within its ranges. During the recent period [✄], the multiples had become more competitive in fresh and chilled foods and premium ranges. As a consequence, M&S had started to broaden its range and fill the gaps. Whereas it might have been difficult, six years ago, to do a full one-stop shop in M&S, it was now possible to get very close to it and M&S saw that as the way forward for its business. [✄]

Product market definition

5. In M&S's view, there was still a 'one-stop shopping' market and the definition used by the CC in 2000, ie that this took place in stores over 14,000 feet, was still an appropriate starting point. M&S would generally experience higher levels of customer deflection from the opening of a very large one-stop grocery store nearby than from a competitor that was of the same size or smaller, for example a Tesco Express. However, there has been a blurring of the distinction between one-stop and top-up shopping that took place in mid-tier stores. M&S thought that all stores of all sizes could provide a competitive constraint on each other, although the level of competition would always depend on a number of factors: for example, the size of the store, the access to and egress from that store, and product offering, and it was therefore necessary to consider the types of shopping undertaken in that store. The situation now was that the mid-tier category of stores, in which M&S would include its Simply Food stores, could compete and did compete very effectively with one-stop

stores. While space was important as a consideration, it should be recognized that customers' shopping missions were changing. They were shopping for a lot more fresh food, shopping much more frequently for fewer items, shopping across a repertoire of fascia and that the nature of shopping carried out even in one-stop shops was increasingly ‘secondary’. Broadly speaking, the basket size in the main grocery retailers’ stores was going down, whereas M&S’s basket size had increased dramatically as it continued to introduce more stores of around 10,000 sq feet. In conclusion, M&S believed that mid-size stores could now compete very effectively with one-stop shop stores in catering for one-stop and secondary shopping. There were indeed many towns without a one-stop store, yet the food market traded successfully through what would be termed mid-tier stores.

6. However, there was a point where the limited space in smaller, convenience stores would preclude that store from being able to cater for one-stop shopping. Smaller stores within the convenience sector found it more difficult to compete with one-stop shops because, for example, they did not necessarily have the car parking to provide for big bulk shopping.

7. M&S did not consider that it was constrained as strongly by independent corner shops. They were competitors in that they sold food, but their range tended to be limited in that it was dominated by long-life food, branded goods, tobacco and newspapers. In launching Simply Food, M&S had recognized that the convenience sector was changing, with consumers increasingly demanding fresh food. M&S offered [✂] per cent fresh food and [✂] per cent ambient goods, which was the converse of the typical corner shop offering. Simply Food was probably taking some sales from the corner shops but, to a degree, a Simply Food store and local convenience stores would be complementary in that it might be possible for the customer to carry out a complete one-stop shop using the two types of store. It seemed clear that the consumer trend was towards the Simply Food mid-range model, as evidenced by the move of Tesco and Sainsbury’s into smaller format stores and by the marked growth in their chilled, fresh offering. M&S also considered that many of the traditional independent corner shops needed to modernize their offering in order to close the gap between them and the quality and standards of mid-range and one-stop outlets.

8. M&S also regarded the franchise retail groups as competitors. With regard to the discounters (Aldi, Lidl, etc) M&S said that there was not at present a dramatic crossover. However, having seen the market shares the discounters had captured in other European countries in recent years and in light of the way in which discounters had moved into fresh foods once they had gained a foothold in those markets, M&S believed that discounters would become stronger competitors in the UK. M&S did not believe that it currently acted as a strong competitive constraint to the discounters.

Local competition

9. M&S described how it might react to the opening by a competitor of new store nearby. It would assess the quality of the management in the M&S store and provide them with expertise from its retail team to ensure that they were working to the latest standards. If necessary, M&S would also invest in the stores to bring it up to the latest standard if, for example, the till bank was not located properly or the equipment was not to latest specification. It would then look at its local marketing, to understand whether the M&S store had the right range in place to meet local consumer demand, and review its communication to customers, to see whether it needed to remind people about the core values of M&S. Lastly, in some circumstances, M&S might consider offering incentives for a limited time, the most effective being [✂]. On rare occasions, M&S might offer a voucher [✂]. However, at no stage would M&S change

the price file in the store, which always remained consistent with the national price file.

10. Before M&S entered a market, it would have assessed the location and customer type and propensity to shop with M&S and have decided the size of store it wanted to open. Increasingly, this was a mid-size store, wherever possible with parking. M&S would then advertise the opening locally. Recently, M&S store openings had generated a lot of local interest and in some locations there seemed to be a pent-up demand for M&S to open a store. [✂] M&S saw itself as primarily offering greater choice in a local market rather than lower prices. Whereas a lot of the main supermarkets had the same tiering to their ranges and sold the same brands, M&S, through its points of difference, provided a quality of choice to the market which was different from just another version of a supermarket opening. As a consequence, if the targeting was right, M&S would achieve a good level of return on its investment in opening a new store in that area.

11. There was evidence that competitors responded to local M&S store openings by increasing the proportion of their premium ranges in local stores. M&S had the impression that competitors also responded by putting extra staff into their stores and paying attention to store standards. Some competitors, including Sainsbury's and Tesco, undertook specific marketing targeted at M&S openings, often handing out leaflets and discount vouchers in front of the new store. There had also been examples of Tesco buying advertising sites in advance very close to a new M&S store.

Pricing

12. M&S told us that it operated a national pricing policy. However, in common with other grocery retailers, M&S operated differential pricing within one of its formats, Simply Food, in certain high-cost locations to reflect the higher cost of operating there, whether this was due to the cost of renting space, delivery costs or the intensity of trading. Differential pricing was limited to Simply Food stores in prime city centres as well as some London suburbs. It was entirely cost driven. M&S believed that its competitors behaved similarly. It said that differential pricing was applied in the convenience format generally, for example in Tesco Express and Sainsbury's Local stores. Customers seemed to understand that they were paying for convenient location and extended opening hours. Each of the M&S franchisees operating stores in railway and motorway service stations sets its own pricing at its sole discretion and, hence, the pricing in these stores was not determined by M&S price files but those of the franchisees. Franchisees could therefore price according to conditions in the particular environment (eg railway station, motorway services) in which they operated. The overwhelming majority of M&S's sales were made at the national price and this proportion was unlikely to change.

13. M&S did not feel that it was obliged to sell some products very cheaply, but it was clear that it had to price known value items competitively. For example, the retail price of its milk [✂] but the milk was the same price at all M&S stores; there was no premium charged for milk in stores on railway stations etc.

Geographic market definition

14. M&S believed that the relevant geographical market was primarily local. There was a generally accepted length of time that customers would spend driving to a food store and the length of that time would vary depending on the offering of the store. M&S commented that there were instances of restricted competition in some local

markets, noting that in areas where one grocery retailer had more than a 40 per cent market share consumer choice would be restricted. One of the reasons why M&S got a positive consumer response when it opened new stores was that it brought a level of choice and a point of difference to the market that perhaps did not exist with just the main grocery retailers. M&S agreed that there could be opportunities for national grocery retailers such as itself to respond to the lack of consumer choice in a particular local market by entering that market, provided that competing grocery retailers could find a site and get planning consent.

15. We asked M&S how it saw the role of national advertising, given its belief in local markets and the evidence that customers were shopping more frequently and making greater use of convenience stores. M&S said that it had only recently undertaken national television advertising, in order to get its fair weight of voice in the marketplace. Judged against spend per customer, it believed that it had [✂]. More people were consistently shopping in its stores more frequently. [✂] Customers' willingness to travel further did not, however, replace the need for good geographic coverage.

Relations with suppliers

16. M&S said that it had market leading trading practices with its suppliers. It believed that it led the way in terms of fairness. Because its business was focused on differentiation, quality and innovation, the costs to M&S and its suppliers of delivering those aspects, for example through product development capability, would tend to be higher than the cost to its competitors.

17. M&S suggested that complaints from suppliers in general about the behaviour of supermarkets might arise because of overcapacity in certain areas, which meant that buyers could shop around. M&S's supplier relationships were characterized by longevity. It had been working with 90 per cent of its suppliers for more than ten years. The primary focus of its discussions with suppliers was the quality of the product rather than the price.

18. M&S told us that it dealt with its farmers direct as well as through the processor/distributor. [✂] It also aimed to have long-term relationships with processors, and open dialogue with them and the farmers to ensure that everyone was happy with the arrangements. This helped to avoid fragmentation of the supply base. [✂] In fruit and vegetables it had relationships with growers, but not everything they produced would necessarily be to the specification M&S wanted and in relation to which the price would be set.

19. As regards chilled and prepared foods, M&S was growing at twice the rate of the rest of the market through product innovation and development. It looked for suppliers who were dynamic and not necessarily those with the lowest production costs. Because of the size of the ranges it was developing, it normally had agreements with a collection of suppliers who could provide the level of capacity or product type that it was seeking. [✂]

20. M&S told us that it [✂], but had long-term relationships, in some cases going back more than 30 years. [✂] M&S could remember [✂].

21. [✂]

22. [✂]

23. M&S recognized that regional food was an important trend. It sold regional milk and other products in Scottish and Welsh stores and was in discussions with potential local suppliers. [✂]

Planning issues

24. M&S said that getting sites suitable for food retailing was a serious problem. Even for a high street convenience store it would be looking for a footprint of [✂] and a lot of units were too small. Increasingly, the customer would expect car parking somewhere nearby. There was considerable competition for sites and this pushed prices up, particularly when the major multiples were trying to outbid each other for a site. This limited availability of sites is, to a large extent, due to the operation of the sequential approach and the needs test in PPS6.

25. In M&S's view, the PPS6 needs test did not give sufficient weight to the benefits of competition. It said that there was an imbalance between the quantitative side and the qualitative side of the test. The combined effect of this and the sequential approach meant that frequently the applicant had to prove quantitative need generally for additional grocery floor space, but such quantitative need was not always there. M&S offered a qualitative change, in the sense of a distinguishable retail offer that improved consumer choice, and it would like to see a modest change in PPS6 to give equal weight to quality and quantity. That would bring in more competition at all levels of the groceries market.

26. The length of the planning process could also cause problems and had led to M&S losing sites in some instances. Under current guidelines, a lot more information was now required before local planning authorities accepted a planning application. In addition, if the applicant wanted to make changes during the application process, it was quite common for the planning officers to require a new planning application to be submitted, instead of allowing the existing application to be amended, principally in order to avoid the risk of not determining an application within the target time scales set by Government. There were also noticeable differences between councils in their role as planning authorities in terms of the ease and speed of the process.

27. M&S said that it was not aware of its competitors having particular land banks. It had no land banks itself. In the past it had bought properties adjacent to its stores into which it had subsequently expanded. But where a planned expansion did not happen it had sold the property rather than retained it as part of a land bank. [✂]

28. M&S said that there were two types of restrictive covenant. The first was where someone wanted to sell a piece of property and placed restrictions on the sale. The second type was where, for example, a grocery retailer might agree to rent a unit on a retail park on condition that no competitor would be allowed on the site or would only be allocated a restricted space. M&S said that it had experienced this type of restriction in a number of retail parks where it had been interested in opening a Simply Food store and where either Tesco, Sainsbury's or Asda had imposed restrictions, thus limiting competition and customer choice. M&S would not itself seek to impose restrictions where it was the anchor tenant in a retail development.

M&S's market position

29. [✂]