

Summary of second hearing with Marks and Spencer plc held on Thursday 7 June 2007

1. Marks and Spencer plc (M&S) said that during the last financial year its business had grown by 10 per cent, its store sales increased by 4 per cent and had added 8 per cent store space. Its market share increased from 4.1 to 4.3 per cent. It planned to grow the main chain estate by [redacted] to [redacted] per cent of additional footage over the next five years.
2. Competition for premium own-label had seen very large growth. Customers were trading-up, which would cause further growth of [redacted] per cent for those ranges. These premium ranges accounted for approximately [redacted] of M&S's turnover.
3. It had developed a new concept of franchise stores in BP forecourts, motorway service stations and railway stations, was moving into the hospitality arena (for example through its in-store Café Revives), and was continuing to expand its direct business through the Internet [redacted]. It planned to open [redacted] Simply Food stores next year, [redacted] of which would be franchise stores.
4. M&S had appointed independent economists to conduct an econometric study of the impact of openings of rival stores on M&S's sales. This study confirmed that M&S was an effective competitor to the other main grocery retailers and produced findings on local market definition. The study used data from M&S, data provided to the Competition Commission, data from IGD, and demographic data from national statistics. It found that there had been new entry by competitors but the overall rate of entry was low. The biggest new entry had been by Tesco and Sainsburys, followed by Waitrose and Asda. It found that distance had a significant impact on the number of entries; that using a ten-minute drive time caught three times the amount of new entry than that of five minutes. On average the entry of a competitor reduced the grocery revenues of its stores within a ten-minute drive time by [redacted] per cent within the month of entry. It also found a cumulative impact of entry over time, up to six months later, which was [redacted] per cent on average or [redacted] per cent for a medium or large entrant. A narrower catchment area increased the impact of entry, moving from [redacted] per cent for all stores to [redacted] per cent which caused a reduction in grocery revenues per store.
5. The study evidenced that the impact of entry did vary by the fascia of the particular entrant and that M&S's biggest competitor was [redacted], whose impact varied from [redacted] per cent in a ten-minute drive time to [redacted] per cent within five minutes. The next most significant entrant was [redacted], with an impact on M&S sales that ranged from between [redacted] to [redacted] per cent depending on the size of store and the catchment area. [redacted] also had a statistically significant impact. The lack of data measuring the impact by medium and large competitors within five minutes of M&S stores was due to the fact that no large Tesco or medium to large Sainsbury's had opened within the relevant period within a 5- to 10-minute drive time of existing M&S stores. For entry within a ten-minute drive time, however, there was an impact for medium and large competitors. The impact of [redacted] was very mixed, possibly also due to the lack of new entry, whereas with [redacted], there had been a very strong impact. This analysis reinforced the conclusion that M&S should be included within the effective set of competitors to the 'Big Four'.
6. M&S considered its closest competitor to be [redacted], but its largest single competitor to be [redacted]. Next, would be [redacted], [redacted] and [redacted]. After which, M&S looked to all the other grocery retailers, such as [redacted], [redacted] and [redacted]. M&S was also watching with interest the growth of the discounters.

7. M&S measured stores' financial performance using the return per sq foot. For example, if it found a store to be undertrading against set criteria, it would make adjustments during store modernization, by investing in improving the look, feel, finish and customer experience. It tended to put small Simply Food stores, which are really a convenience offer, in areas of either buyer high population density or very high flow of customer traffic (for example a railway station). It was increasing the size of its offer within its Simply Food stores and introducing some complementary items, such as household and toiletries. However, the strategy of the Simply Food stores remained to provide a food offering. The medium and larger M&S stores had a broadened range and M&S planned to expand this range further to include an Essential range of food offerings to provide more of a one-stop shop around its own label proposition.
8. [X] However, M&S had introduced partner brands into its electrical offering. Within clothing, it remained own brand or sub-brands. Its venture with BP represented the first time in its history that M&S food lines were being sold alongside branded goods, albeit within a clearly demarcated M&S area using M&S fridges and BP tills. In the ambient area, its products sat alongside branded products. [X]
9. It reacted to the entry of Whole Foods by modernizing its Kensington store and increasing its messaging. It had looked at areas it was known to be strong in [X] and had introduced a number of new lines within those areas. It had already introduced hospitality, by way of a Deli bar, hot food to go and looked at the training of its personnel and customer service. This local response would be applied to a number of other stores in Central London. By the end of this calendar year, 70 per cent of its estate would have been modernized. Its response to any new entry was to assess its local store in terms of whether it had had recent investment; if it was further down the modernization programme it might be pulled slightly forward. It might refresh its range. It would draw on its experience of how each product category or sub-category tended to be affected and then concentrate its efforts on any area of its range, which had suffered deflection previously. An example of this might be ensuring that it had stewing steak and minced steak upon entry of a grocery retailer which had a strong cooking-from-scratch type product, to mitigate any deflection. It told us that it would ideally aim to take defensive measures six weeks before and six weeks after a new entrant arrived in the local market. It prioritized the customer proposition, ie how it could deliver something better for consumers, and would tend to start with its larger stores first, because there were more customers shopping there and the effect was greater in terms of taking the brand forward.
10. When M&S opened a new store, it assessed the whole catchment and the type of location and would choose from a mix of marketing tools. It would distribute store leaflets advertising the opening date and what the new store would offer. In some cases, outside London, it also undertook radio advertising. One of the main grocery retailers had responded to M&S store openings with customer incentive schemes including mailshots to local customers with vouchers. These had three different levels of spend and save including a save £5 voucher on a £25 spend. In M&S's experience, that retailer would run such a targeted response for a month and then a second phase scheme some time later.
11. M&S had a target location list for Simply Food new openings based primarily on an assessment of the potential to trade and increase its market share. It would consider the catchment area the store would be likely to generate, the size of the food market, its current food market within that catchment and then the propensity for its market share growth. It looked at the competitive set; fewer competitors' fascia meant a higher likelihood of taking a bigger market share. In a locality dominated by one particular retailer, M&S would compete by providing customers with increased

choice, customer services and parking; its food business was strong because it offered a wider range of value-added food and distinctive quality levels.

12. It saw the premium own-label growth of other grocery retailers as a response to customer trends, and that consumers are increasingly prepared to pay more for better quality food, and considered that these ranges replicated the M&S brand, which is well known for its quality and value.
13. M&S considered independent corner shops to be less competition than a Tesco Express or Sainsbury's local, because the independents were still relatively small in terms of range in fresh and chilled foods and were more focused on the ambient and CTN offer. Whereas a much higher proportion of an independent's range would be ambient shelf-stable goods, as opposed to fresh food, M&S's offering would be the opposite. However, its stores might also bring extra business to the independent butchers and greengrocers on the high street. In the convenience sector, M&S had had recent growth and held a 4 per cent share of the overall grocery retailing market.
14. M&S's business had moved from a state of recovery to a stable period of growth and expansion. It had a national pricing policy in all main chain stores. However, in common with other grocery retailers, M&S operates 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. Each of the M&S franchisees operating stores in railway and motorway service stations set its own pricing at its discretion. 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. [✂] M&S did not price flex. It thought that it might be possible that competitors with a high concentration in one area might be able to share some of the cost burden across a number of sites, in terms of logistics and distribution, and management structure.
15. It operated its pricing regime under a set of rules and its focus was on value for money; encompassing both quality and price. M&S monitored prices on key products and if it were to observe large reductions in price elsewhere, it would reassess its competitive position. A small premium on some products might be justified because of M&S's procurement policies, for example its stance on using only non-genetically modified feed for animals, on using only selected farms, its milk pledge scheme, and its pesticide standards and quality specifications. However, for some products where customers were able to make a comparison with other retailers' goods because their quality was close enough to that of M&S, then M&S would conduct a review to maintain a price on a par with or close to that of its competitors. Any price adjustment would be national. M&S considered it was about half as promotional as its competitors. Any promotions it ran were done in conjunction with the supplier, which would support the mechanism that delivered better volume, and would share the cost of the promotion which was typically 50/50 or sometimes 75/25.
16. M&S told us that Tesco's prices were the most important because it had more customers that cross-shopped with Tesco than any other multiple. The customers that shopped between the two would, for some products, decide to buy the M&S brand. Historically, M&S would set the price architecture for products such as ready meals and its competitors would then replicate those products at lower prices. However, M&S was generally less promotional because it was more focused on quality and innovation; bringing new things to the market rather than leading on price.

17. Although M&S has increased the number of stores in its portfolio, this expansion was limited by the lack of suitable sites. Therefore, M&S has also focused on achieving continued growth in market share and presence by ongoing improvements to its existing stores over time. As a result, further investment in new stores would be balanced with the significant investment that M&S was making in modernizing the whole of the M&S estate. M&S had three main sources for property acquisition; existing properties, new developments where a developer had taken a group of redundant properties and demolished them to create new units, and the sites it had acquired from Iceland and Somerfeld. It said that the purchase price was dependent on the location and the scarcity of a site. Where there were a number of retailers competing for the same site, the price would be pushed up. For sites, it was often in competition with the other main grocery retailers.
18. The planning system operated as a constraint in two ways: the national policy with its combination of the sequential approach and needs test; and noticeable differences between councils in their role as planning authorities in terms of the ease and speed of the planning process, due to resources. M&S also explained that exclusivity covenants, as opposed to restrictive covenants, had prevented it from acquiring a site on 18 occasions and it considered that these arrangements had impeded its expansion.
19. Relations with suppliers were seen as a vital component of its business. Many relationships had existed for many years; some in excess of 40 years. M&S worked with a mix of public companies, private companies and family-owned businesses. The longevity of relations was viewed as a key enabler to its business; such long-term partnerships facilitated greater innovation. M&S gave [X] months' notice before introducing a change to suppliers' terms. For variation to or adjusting an order, it would adhere to the lead times agreed in the product specification. M&S tended to meet the bulk of costs associated with visiting buyers, creating artwork for packaging, consumer research, opening new stores or refurbishing. If a range failed, it would generally share the burden of the cost, whether that was a write-off of packaging or raw material, which meant paying half the costs of an agreed forward commitment on packaging and raw materials. When visiting suppliers for development or auditing, M&S paid the travel and hotel bills as policy. With an overseas trip, it would pay for the costs of M&S's representatives making that trip. It covered television advertising and had increased the amount of point of sale and literature; suppliers would contribute [X] per cent of costs of the business for marketing.
20. In its dealings with its suppliers, M&S had terms of trade in place, which captured the spirit of the principles of the SCOP, although the Code currently did not apply to M&S. Rather than providing narrow and inflexible rules regarding certain conduct that might or might not have an adverse effect on competition, what was key was that there was a dialogue with suppliers that ensured all changes were notified sufficiently in advance and discussed with suppliers before being implemented.