

GROCERIES MARKET INVESTIGATION

Summary of the hearing with Morrisons, 20 September 2006

About Morrisons

1. Morrisons told us that it owned 371 stores ranging from Inverness to Penzance. Its store portfolio comprised stores which had always been Morrisons stores and those which were originally branded as Safeway and had now been converted to Morrisons (the latter accounted for around 220 stores). As regards the converted Safeway stores, Morrisons told us that some of these stores had been extended, in order to take the full Morrisons offer. Morrisons believed that its acquisition and conversion of Safeway stores had added to the competitive nature of the UK grocery market, given that there were now four strong national retailers competing head on, whereas previously there had only been three.
2. We were told that Morrisons' store portfolio amounted to approximately 10.5 million sq feet of selling space. The average sales area of a Morrisons store was 2,648 sq metres (28,500 sq feet), but stores could vary between 1,394 and 3,716 sq metres (15,000 and 40,000 sq feet), in round figures. Morrisons considered itself to be primarily a food retailer, focusing in particular on offering a one-stop shop where customers could carry out a weekly or fortnightly shop. Morrisons noted that certain aspects of its business were vertically integrated; in particular, fresh produce and meat.

Changes to the market

3. Morrisons told us that the market remained fiercely competitive and competition and innovation in the grocery market had never been greater. It said that choice had increased, that there were a greater number of suppliers and that product ranges had increased in all the major multiples. It considered all of these developments to be of benefit to the consumer. Morrisons believed that its acquisition of Safeway and its redevelopment and rebranding of the Safeway stores had contributed to this increased choice and competition.
4. Morrisons considered that there had been two main developments since the 2000 report into supermarkets from the consumer's perspective. These were (a) the opening of more large stores, and (b) the entry of traditional large store operators into the convenience market. As regards the latter point, Morrisons noted the expansion of Tesco and Sainsbury into the convenience market, offering a wider range and better value in that sector, which it viewed as providing more competition in the market for secondary shopping trips. Morrisons believed that this evolution was likely to continue over the coming years.
5. We asked Morrisons whether it thought Tesco would continue to forge ahead or whether the market would eventually come into balance. It told us that it understood that Tesco was growing fast and that an increase in its size gave it greater buying power. Morrisons said that this was because Tesco's increased market share meant that it was selling greater volumes and this was likely to allow it to obtain lower prices from its supply base. Morrisons told us that this would present a challenge to Morrisons and to others, which was likely to continue to keep the market competitive.

Market definition

6. Morrisons said that the CC had previously identified that there were clearly two markets: one in relation to stores of 1,400 sq metres and above and one for stores below this size. Morrisons suggested that developments in the market over the last three or four years had resulted in the market becoming more homogenous, as some of the same fascias were now present across a wider range of stores and store formats than previously.

Market conditions

7. Morrisons told us that, given its origins in the North of England, it had historically viewed Asda as its closest competitor. However, as time has progressed, Tesco and Sainsbury had extended their presence northwards and Morrisons had opened stores in the South, and acquired the Safeway portfolio, with the consequence that it now also viewed Tesco and Sainsbury as close competitors.
8. However, Morrisons told us that it considered it was in competition with anybody who sold a competing product. Accordingly, it sought to compete not only with the other three national chains, but with Waitrose and Somerfield, as well as the discount chains such as Aldi, Lidl and Netto, and it also challenged itself to be as good as the local greengrocer, butcher or baker as regards the quality and price of its produce. Morrisons told us that this meant that there was a great deal of competition in the food business coming from a variety of different sources.
9. Morrisons said that the impact of the opening of a new store by a competitor would depend on the number of other major stores there were present in that particular catchment area. Accordingly, if a store was the only grocery store in that town and another supermarket opened, it would expect to see a greater impact than in a situation where three stores were already trading and a fourth store opened. Morrisons told us that the closer the new store was to an existing Morrisons store, the more dramatic the effect was likely to be on trade during that initial period.

Pricing

10. Morrisons told us that it operated a single national pricing policy, since this was an important part of its brand. Morrisons operated all its stores under a single Morrisons brand (as opposed to operating several different formats, which some operators did) and a consistent one pricing policy was considered to be a key element of its brand offering. Morrisons also noted that this policy offered additional operational efficiencies.

Below-cost selling

11. We asked Morrisons about below-cost selling. It told us that the intensity of competition sometimes obliged it to sell some items below cost, although the majority of items were not sold below cost. Below-cost selling was not something which it wanted to do, but market conditions meant that it was sometimes required to sell below cost in order to meet competition and maintain footfall. A price which amounted to below-cost selling for Morrisons would not necessarily amount to below-cost selling for some or all of its competitors.
12. Morrisons told us that, where it occurred, below-cost selling was usually on high-volume items. These high-volume items would be 'known value items' (KVIs) to many consumers, and customers would judge Morrisons' price competitiveness based on

the price of such KVIs. The products which were sold below cost would vary from season to season, particularly around Christmas, but where it occurred it was more likely to arise generally in its Bettabuy economy range of products.

13. Morrisons told us that the evolution of selling items below cost began in the early 1990s when discounters entered the UK from Continental Europe. With the introduction of the discounters' secondary lines at very low prices, the supermarkets generally chose to compete by launching an economy range of products. Some of these products had remained loss leaders since their inception and others had become loss-making as the market had become more competitive.

Use of vouchering

14. We asked Morrisons whether it used discount vouchers. It told us that it had occasionally used discount vouchers, primarily in relation to the opening of a new Morrisons store. It had observed, during the process of conversion of Safeway stores to the Morrisons brand, that some competitors within the catchments of these stores used vouchers during the initial period following the reopening of the Morrisons stores.

Morrisons' relationships with its suppliers

15. Morrisons told us that it always required good suppliers across its entire range of products, and that it needed to maintain good relationships with those suppliers. As regards branded products, there were some suppliers that it 'couldn't afford to fall out with'. It told us that, when making an agreement with its branded suppliers, it sought to work in partnership to maintain value, maintain a margin and, most importantly, to maintain availability on the shelf.
16. Morrisons sold some products under its own label. It sought suppliers for own-label products which could work with it, could provide the product specifications that it wanted, and which wanted to develop their business with Morrisons over time. Since the brand of the product was Morrisons' own, the quality and availability of the product was of particular importance to it. Morrisons was always looking for new, innovative suppliers for its own-brand products.
17. As regards fresh produce, Morrisons was most concerned with developing relationships with suppliers and using its knowledge of the market to ensure that it was able to offer the best value (in terms of both quality and price). It did not believe that buying only the cheapest produce was the best approach, and that it had to be prepared to pay more for the pick of the crop. It considered that its vertical integration helped its ability to source direct from the primary producer and to provide customers with the freshest produce and best availability. Morrisons had some relationships with growers which had lasted for over 25 years.

Land and planning issues

18. Morrisons told us that the principal determinant in deciding which sites to develop was the availability of planning permission. Accordingly, expansion of the Morrisons estate was determined principally by appropriate sites becoming available which were suitable for development, in an area where Morrisons believed a store would be able to trade well, and where planning permission was likely to be obtained. Morrisons did not generally identify particular locations where it wished to open new stores and then seek appropriate sites, since this was unlikely to coincide with where the opportunities actually arose.

19. Morrisons told us that its strategy in developing new stores was that, once investment was made in a site, as soon as planning permission had been gained it aimed to build the store, complete the development and start serving customers as quickly as possible.
20. Morrisons said that the presence or otherwise of competitors in the catchment population would have a bearing on the likelihood of securing planning consent, but would not affect its decision to open a store in a particular locality. It was confident in its ability to attract enough trade from competitors and trade profitably, providing the catchment population was of sufficient size.
21. We asked Morrisons whether it thought that the planning regime could be changed such that it took account of the fascias already present in a locality. It told us that it was unsure whether the planning policy framework could be adjusted to reflect competitive issues. It considered that local authorities were likely to be ill equipped and unwilling to assess the economic issues of competition during a planning application. It seemed unlikely that the existing planning policy, which had been stable for ten years, could be easily changed.
22. Morrisons believed that planning policy should place more emphasis on qualitative components than on quantitative components, and should consider whether a proposed development would extend customer choice. It considered that one of the problems of the current planning system, with its focus on quantitative matters, was that it protected incumbents, irrespective of the quality of their offering, and did not make an assessment as to whether the incumbent was trading to the best of its ability.
23. In respect of 'land banks', Morrisons did not consider that sites held with a view to them being developed in the ordinary course of business amounted to a 'land bank'. It said that having some undeveloped land holdings was the ordinary course of business for a supermarket operator and was consistent with proper management of new development sites. Morrisons would consider a land bank to comprise land that was being held, which could be developed, but which was not being developed and was not likely to be developed in the future.