

Summary of the hearing with Sainsbury's, October 2006

Competitive market

1. Sainsbury's told us that the market had been, and remained, competitive, illustrated by a number of dynamics, such as: the 8 per cent reduction in food prices; the continuing improvement in range, quality and choice, within both its own business and across the market more widely; and, all retailers constantly looking for other dimensions on which to differentiate themselves, whether it be service, or more recently corporate responsibility and environment issues.
2. Sainsbury's told us that it saw no evidence, either now or in the past since the last investigation, of price flexing. Pricing remained essentially a national dynamic for all the major retailers operating in this market; however, there was some evidence of voucher and promotions flexing at the local level. Sainsbury's noted that the Supermarket Code of Practice (SCOP) had operated well as a framework to guide relationships with suppliers, although it only actually applied compulsorily to the three largest retailers and voluntarily to Morrisons. Sainsbury's told us that it considered that the SCOP was weakened by it not being applied more widely across the market.
3. Sainsbury's observed that the Convenience market was hugely competitive. There were still in excess of 50,000 Convenience stores and it was, at the moment, as vibrant a sector as it had been at any time over the past 20 years. Sainsbury's told us that its presence in this sector remained relatively small at around 300 Convenience stores.

Changes to the market

4. Sainsbury's believed that the market had changed since the last investigation into supermarkets in 2000. Sainsbury's explained that the most notable development was the shape of the leading players in that market. Tesco's market share continued to grow to its present figure of around 34 per cent.
5. Sainsbury's noted that Morrisons/Safeway had not become the competitor that was envisaged in 2003. Sainsbury's told us that Morrisons's market share was now around 15 per cent, which was significantly less than envisaged when the two businesses combined. Sainsbury's explained that this was due to both a decline in Morrisons's/Safeway's core business and the disposal of a significantly larger number of stores than was envisaged at the time.
6. Sainsbury's told us that it was a better competitor today than for many years. It had been working on changing its retail offer, since the new management team arrived in 2004. Sainsbury's noted that it had significantly improved availability and reduced over 10,000 prices in the last two years. Sainsbury's explained that the competitiveness of its price position has materially improved from two years ago.
7. Sainsbury's observed that consumer preferences were changing, through a greater focus on fresh foods and quality.
8. Sainsbury's told us that the shape of the one-stop market had changed significantly since 2000. Sainsbury's explained that the market no longer consisted of four broadly equal retailers, but rather one large retailer (Tesco) followed by a large number of smaller competitors. Sainsbury's told us that the concept of the 'big 4' was no longer appropriate as a much broader range of competitors made up the competitive dynamic in the market.

Why these changes have occurred

9. Sainsbury's explained that most of Tesco's growth in market share to 34 per cent had been driven by space expansion. Sainsbury's told us that 50 per cent of Tesco's stores had greater than 50 per cent market share within the relevant isochrones around those stores. This has increased significantly from 2000.
10. Sainsbury's observed that the available land bank was skewed to Tesco, which held around 55 per cent of the publicly known land bank, which if rolled out could result in Tesco having 38 per cent market share, reaching around 43 per cent taking into account growth and maturing space. Sainsbury's stated that Tesco's land bank holding was disproportionately high in those areas where Tesco had a large market share and in those areas where there is a higher level of provision of grocery space in terms of square footage per head of population. Sainsbury's believed that this acted as a barrier to entry and would do so increasingly as Tesco grew.
11. Sainsbury's explained that this restricted and distorted competition, and harmed consumers by restricting choice. This was likely to worsen as Tesco expanded.
12. Sainsbury's also told us that, as Tesco's local dominance increased, so too would its national power and motivation to flex prices and marketing on a local basis and/or make national pricing decisions which would be harmful to consumers.
13. Sainsbury's observed that the size and competitive impact of Tesco's land bank was exacerbated by two factors. Firstly, the planning regime took no account of competition and secondly, the fascia test applied to acquisitions and mergers took no account of the size of store, quality, location, or sales per sq foot.
14. Sainsbury's told us that the needs test within the planning regime favoured stores with higher levels of non-grocery, since it is easier to prove need for non-grocery than grocery. Sainsbury's highlighted that this could and often did lead to direct conflict with the Town Centre First policy. Sainsbury's highlighted, in relation to the fascia test as applied to the disposal of stores after Morrisons's acquisition of Safeway, that Tesco was potentially eligible to buy more stores than Sainsbury's despite Tesco's much larger national market share.
15. Sainsbury's told us that, without the introduction of a competition analysis through a market share test, Tesco would continue to use its landbank to build positions of local dominance.

What could be done

16. Sainsbury's considered that there are three things to focus upon: the first was the regime for planning and, by association, acquisitions and divestment; the second was addressing the land bank; and, third, was ensuring a healthy competitive dynamic in the market which benefited consumers.
17. Sainsbury's told us that it considered, within the planning context, a fascia test would not work and that any test ought to take account of market share given that it was a measurable figure and was an effective way of determining whether customers had choice. Sainsbury's told us that planning and competition policy should be complementary considerations.
18. Sainsbury's observed strong market shares in areas where land banks were retained. It was foreseeable that this would lead to very significant levels of

concentration at a local level. Sainsbury's told us that the option of land divestment was one that should be considered.

19. Sainsbury's told us that, provided appropriate constraints were applied only to those that were in a dominant position, such divestment would create a more level playing field for all retailers. Sainsbury's believed that the growth of retailers in addition to itself, such as Morrisons, Asda, M&S, Waitrose, and Somerfield, would provide by far the best competitive dynamic in the groceries market for the benefit of consumers, given the current structure of one dominant player and following pack.

Impact of non-food

20. Sainsbury's observed that larger stores tended to have the benefits of non-food turnover. Sainsbury's further noted that non-food sales, broadly speaking, had lower sales densities and, although these sales typically had a higher gross margin, tended to have higher operating costs in terms of labour and shrinkage.
21. Sainsbury's told us about the increasing importance of non-food in the market and its development plans to grow this category by £700 million, as part of its £2.5 billion recovery plan. Sainsbury's noted that, even in its larger stores, customers' primary purpose when visiting, was to carry out their main weekly grocery shop. Sainsbury's explained that it positions non-food as complementary to food.

Market definition

22. Sainsbury's considered that the current concept of two product markets was a good and robust shorthand for the product market definition, and that these operated at both a national and local level. Sainsbury's considered that the one-stop shopping product market was distinct from convenience. Sainsbury's described the observed changes in the shopping mission: changes in shopping patterns; the increasing importance of fresh produce; and, more frequent visits, but emphasized that there remained a one-stop shopping product market. Sainsbury's agreed that it was pragmatic and fair to consider that stores of 1,394 sq metres (15,000 sq feet) or above were one-stop grocery shops and that a store of 279 sq metres (3,000 sq feet) or below was considered to be a convenience store. Stores between these two thresholds were either convenience or one stop, depending on size, range, location and facilities. Sainsbury's pointed to how the limited product range of a convenience store and its pricing would act as a disincentive to one-stop shoppers.
23. Sainsbury's viewed itself as having a broad competitor set. Sainsbury's told us that its aim was to deliver great food at fair prices and through this, deliver universal appeal.
24. Sainsbury's stated that it ensured it remained competitive by benchmarking against all players within the one-stop market, with particular reference to Tesco on price and Marks & Spencer's and Waitrose on quality.
25. Sainsbury's told us that it considered the current definition of the geographic market, being a 10-minute drive time in an urban area and a 15 minute drive time in a rural area, is a reasonable proxy. Sainsbury's noted that its larger and its more rurally located stores, which tended to be located out of town or adjacent to major road junctions, might, by exception, attract custom from a larger geographic area.

Internet shopping

26. Sainsbury's believed that Internet shopping remained, even with its spectacular growth, at a relatively small level representing around 1 to 2 per cent of total food retail sales. However, Sainsbury's expect it to continue to grow rapidly and see the online offer as an increasingly important tool to target competitors.

Below-cost selling

27. Sainsbury's told us that it did, as a result of competitive response, engage in minimal below-cost selling and that it accounted for between [X] per cent of sales. Sainsbury's explained that below-cost selling emerged as an ongoing competitive dynamic probably born from the late 1980s when the discounters came in from the Continent. Sainsbury's told us that any below-cost selling was, for the most part, driven by responding to competition in the market and the increased competition that arose at seasonal times.

Pricing

28. Sainsbury's told us that it had a national pricing policy by format. Sainsbury's explained that its customers expected price parity on branded products and own label, where there was no clear quality difference; however, Sainsbury's noted that its customers were prepared to pay a fair premium where there was a clear quality difference.
29. Sainsbury's told us that it applied rules to ensure pricing was consistent across all flavour variants and that outside of promotions larger packs were cheaper on a price/litre or price/gram basis than smaller packs.
30. Sainsbury's told us that it allowed almost no flexibility in pricing at a local level. Sainsbury's explained that it marked down product within individual stores, either to clear end of range stock or clear short life fresh food products.
31. Sainsbury's told us that there was a small price differential in its convenience stores relative to the main chain and that petrol prices were set centrally and could be differentially priced on a regional or local basis

Vouchers

32. Sainsbury's explained that vouchering would typically be used for a store opening, or for some form of store anniversary. Sainsbury's also explained that they conducted national vouchering activity that would impact at a local level, for example a voucher with a birthday card for customers, or vouchers which encourage customers to spend more in store or to buy certain products. Sainsbury's told us that it also used vouchering for promotional events, such as a relaunch of the 'Taste the Difference' range.

Local competition

33. Sainsbury's told us that when it became aware of a competitor opening a store in the catchment area of a present store, it would focus on the quality of its operations in its store in advance of that competitor opening, to ensure that the highest standards were consistently delivered. Sainsbury's explained that it would evaluate the standards of its store, such as: the quality of the store; its efficiency; its product

availability; the service standards of colleagues and queue times; the accessibility of the car park; and the type of trolleys that are used.

34. Sainsbury's told us that the product range of a store or group of stores was to some extent determined by the catchment area and local demographics.
35. Sainsbury's noted that over 50 per cent of Tesco's stores had greater than 50 per cent market share within the relevant isochrones around those stores. Sainsbury's explained that, as Tesco's dominance at a local level increased, so too would its national market power. Sainsbury's suggested that this position could potentially manifest itself in local price flexing and/or national pricing decisions that harmed consumers.

Own-label products

36. Sainsbury's told us that part of the rationale for the introduction of its own-label proposition was that it could deliver better value for money to consumers than the branded product. Sainsbury's explained that the higher the proportion of own-label product that consumers purchased, the better their perception of value for money, because own brand was cheaper than the branded goods of comparable quality. However, it also highlighted the importance of having a balanced overall mix between branded and own label.

Supplier relationships

37. Sainsbury's told us that its view of its relationships with its suppliers was that it was open, honest, transparent, acted with integrity, followed the SCOP and attempted to reach consensus with its suppliers about what they were trying to achieve together. Sainsbury's noted that it did have tough negotiations with its suppliers, because it was attempting to obtain the best possible products at the lowest possible prices for its customers.

Promotions

38. Sainsbury's told us that it did engage in a number of promotions and set out a promotional programme, which, at a headline level, operated on a rolling 12- to 18-month basis. Sainsbury's explained that it engaged its suppliers with this programme through establishing joint business plans wherever possible.
39. Sainsbury's told us that the funding of the promotions did depend on the particular product category, and the nature of the relationship that it had with the particular supplier. Sainsbury's explained that this could vary from no contribution with funding entirely from Sainsbury's to some instances where it would negotiate a 'buy one get one free' to be fully funded by the supplier because of the benefits of a substantial volume uplift.

Supermarket code of practice

40. Sainsbury's considered that the SCOP worked very effectively. Sainsbury's had already introduced an internal code of practice that was at least as stringent as the SCOP. Sainsbury's believed that the lack of complaints being escalated through the SCOP and the fact that issues were resolved on a bilateral basis between retailers and suppliers proved that the code was working effectively.

41. Sainsbury's told us that the SCOP should apply equally to all competitors in the one-stop market.

Developing a new site

42. Sainsbury's told us that, in planning for future growth in terms of new store sites, it had a network plan for the country, which identified potential locations that would be an attractive investment, taking into account current population, expected population growth, demographics, and competitor set. Sainsbury's explained that it would seek opportunities in those locations and would investigate the particular planning considerations once it had identified a specific location.

Overbidding on sites

43. Sainsbury's observed that Tesco had paid significantly higher prices for sites in areas where it already had very strong representation. Sainsbury's told us that the sites for which Tesco had outbid others were invariably in areas where Tesco had a very high market share. Sainsbury's believed that over-bidding might be aimed at preventing competitors from establishing a presence in a local market. Sainsbury's considered that the planning system did not prevent Tesco from employing this strategy to acquire sites in areas of high local market share, and thereby cement its dominance in such areas.