

GROCERIES MARKET INVESTIGATION

Summary of the hearing with Tesco October 2006

Competitive overview

1. Tesco said that it hoped it was uncontroversial that the intense competition between UK supermarkets had brought huge benefits for consumers. Tesco had played its part in this, delivering lower prices (a 15 per cent reduction in real terms in five years), greater convenience, a wider range and better quality, including healthier foods and more fresh fruit and vegetables—all the things that customers told Tesco they wanted. Customers had rewarded Tesco by choosing to shop in its stores.
2. Tesco told us that the issue of choice was very important. Consumers had a wide range of stores to choose from—94 per cent of people had a choice of at least three supermarkets within 15 minutes of where they live, and a number of other specialist grocery stores. Consumers passed judgement on stores and switched between them. Total switching had almost doubled in the last five years. If a grocery retailer got its offer right, it won customers. If it got its offer wrong, as Tesco had on occasion, it lost customers. Retailer fortunes could change very quickly and no one was unassailable in retailing.
3. Tesco said that this competitive pressure kept retailers on their toes, driving them to innovate and improve to give consumers what they wanted. Competition did not make life easy for anyone in business, but it had made Tesco a much better company. It had been competition that had driven the improvements in Tesco. In order to keep its customers happy, Tesco had to keep its shelves fully stocked with safe, good-quality produce at competitive prices.
4. Tesco told us that this process worked because the consumer was king. The UK grocery market was a world-leading industry—dynamic, vibrant, innovative and changing. This had been brought about by consumers exercising their choices. It was very important that consumers retained their ability to choose and that this was not taken away from them.

Market definition

5. Tesco said that when you looked at individual customers or customer groups you saw a complete spectrum of shopping activity. People purchased large amounts in small shops and small amounts in large shops. At different times of the week or the year, the same person would undertake different sizes of shops. There was no discernible pattern that allowed you consistently to predict that a certain type of customer would do this type of shop in this type of store. When a customer walked into a store, the retailer would not know what type of shop he or she was about to do. In terms of the economic theory, it was not possible for a retailer to identify a group of shoppers who were one-stop shoppers for whom prices could be raised.
6. Tesco told us that customers did not fit into a neat 'stereotype'. On a particular shop, a customer might have Finest olive oil and Value kitchen roll in the same shopping basket. Traditionally, it might have been thought that less affluent customers would shop in discounters, but they treated themselves and sometimes shopped in more upmarket retailers. Similarly, people might have felt that affluent shoppers would shop in Marks & Spencer or Waitrose, but now they could equally shop at a discounter. The view that people had of discounters was changing. People accepted

them more, and thought that they offered some quality and some innovation as well as a great price.

7. In response to questions about whether the discounters competed with Tesco, Tesco said that they did. New entrants and discounters were making their mark. Lidl and Aldi, for example, were growing strongly and were predicted to have 1,000 stores by 2010. Tesco paid a lot of attention to areas where discounters were strong, such as on price and quality mix.
8. Tesco said that it responded to competition from the discounters and other operators such as Marks & Spencer when centrally planning its overall offer. Tesco built into its overall offer products and prices which it thought would appeal to customers who might otherwise shop in competitor stores.
9. Tesco told us that as a consequence of competition, there has probably been a bigger expansion in more affluent products within the marketplace. Tesco told us that as a consequence of competition with Marks & Spencer, and also with improvements at Waitrose and the resurgence of Sainsbury, there had been a recent expansion in products targeted mainly at more affluent customers.
10. However, Tesco said that while it respected competitors and learned from them, it had also learned that it was far better to focus on customers in its own business than to focus overmuch on individual competitors. Tesco was very focused on customers. What it tried to do was build an offer across the full range of PQRS components that was strong enough to retain customers to Tesco whatever was offered by each of its different competitors.
11. Tesco told us that decisions were overwhelmingly national in its industry. What customers chose between was set nationally and did not vary locally to any material extent. All the key decisions were made on a national basis—decisions on price, range, advertising, service levels and how stores looked. The benefits that customers had experienced, such as lower prices and increased range, service and choice, had been experienced across the whole country. Tesco told us that the price that is paid in a Tesco store, the service that you receive and the product range that is available does not vary.
12. Tesco said that in the UK people's tolerance of price differences between local areas was low. This was because the UK was small and densely populated with chains of substitution, and there was also a single national media. In addition, setting prices nationally had organizational advantages and avoided considerable complexity in marketing. It was therefore not surprising that retailers set national prices.
13. Tesco said that the geographic market was national. Customer choice was exercised locally, but isochrones overlapped and there were chains of substitution. A good proportion of customers at the edge of an isochrone could choose other stores located outside the isochrone. The behaviour of retailers in one group of stores was constrained by the next group of stores.
14. Tesco told us that it might centrally set a slightly different range in a particular locality according to demographics of the catchment, with there being more scope for flexibility in bigger stores. But you could clearly see very strong common threads to Tesco's offer around the country—Tesco stores in Aberdeen and Southampton would be far more similar to one another than they would be to an Asda store in the same local area.

15. On a local basis, Tesco said that it maintained its offer, irrespective of what fascias were around it. When Tesco refurbished one of its stores, it might carry out some local marketing for a short period of time to give customers an incentive to come and try the refurbished store. Tesco did very little when a competitor store opened, save on occasion for a similar short period of local marketing, this time to give an incentive to its customers not to desert Tesco. These two types of local marketing activity were extremely limited, together accounting for less than 1,000th of Tesco's turnover. Of Tesco's overall promotional spend, only 1 per cent was local, with 99 per cent being national.
16. Tesco agreed that together we would debate further the extent to which the geographic market was national or local.

Below-cost selling

17. In response to questions about products sold below cost, Tesco told us that it sold a very limited number of items below the cost that it paid for them. Items persistently sold below cost accounted for only 0.2 per cent of sales. Tesco told us that sales below cost were a direct result of national competition. As to the identity of the products sold below cost, there was no logic to it. It was simply that if a competitor sold a product very cheaply, Tesco had to be very cheap on that product.
18. Tesco said that it monitored 23,000 prices each week. It had a national price basket and its buyers had very clear policies. There was no instruction in Tesco's commercial team to sell things and lose money. But when Tesco identified that there had been a price change in the marketplace, it responded to that price change and reflected on why a competitor was able to offer a better price. One of the things that Tesco had learned was that the limited range Continental discounters had a very efficient way of buying products.

Supply chain

19. Tesco told us that it manufactured virtually nothing of what it sold. In order to be able to operate on that basis, it needed to have strong suppliers on whom it was able to rely for all aspects of the service they provided.
20. Tesco said that its suppliers were delivering a huge amount of innovation—over 8,000 new products for Tesco in the last year alone. It told us that it considered food to be safe, plentiful, and of great variety—there had been an explosion in genuine choice and diversity for consumers.
21. Tesco told us that it now had more than 1,200 organic lines; 430 healthy living lines; 150 'free from' lines, for people who had dietary specific needs; 87 whole foods lines, a range of natural nuts and seeds; and just shy of 100 Fair Trade products.
22. Tesco stated that for its suppliers to be able to take the risks necessary to innovate, it needed to build strong, professional long-term relationships and to work in partnership. Tesco stated that it would make no business sense to be constantly chopping and changing suppliers or setting out to weaken suppliers or to destroy their profitability.
23. Tesco said that cooperating with its suppliers on matters like logistics and planning had brought about substantial efficiencies. Tesco's Step Change programme saved £330 million last year alone.

24. Tesco told us that the supply base contained different types of supplier. The majority was large branded suppliers who owned the brands. Another sizable proportion was suppliers of global commodities, such as orange juice and coffee. Then there were other suppliers, many from the UK, including own-brand suppliers and smaller suppliers.
25. Tesco said that, in relation to buyer power, for certain products from large branded suppliers Tesco had nowhere else to go. Tesco was also unable to influence the price of global commodities, such as bananas and orange juice. Even in respect of other suppliers, within long-term relationships buyer power was very much overplayed. If, for example, one of Tesco's produce suppliers stopped its supply tomorrow, Tesco could not readily switch to another supplier.
26. Tesco said that in the last inquiry we had looked at buying terms as an expression of buying power. It revealed that there was not a huge difference in buying terms as companies got larger and certainly not enough to explain differences in performance in the market. Scale benefits were often overplayed. Buying terms were often about the skill of the buyer—some smaller retailers punched above their weight.
27. Tesco noted that farmers did not generally supply it directly, but rather indirectly through intermediaries such as processors. Nonetheless, Tesco said that it spoke directly to farmers in its supply chain and cared about their situation. As the largest customer of UK farming, Tesco had a vested interest in strong farming.
28. Tesco said that any disquiet on the part of farmers needed to be seen in context. The challenges faced by farmers were mostly to do with the way in which farming and agriculture had changed in recent years. CAP reform was changing farming subsidies and exposing UK agriculture to a more competitive marketplace. Some UK suppliers would have done worse as a result of the globalization of markets.
29. Tesco told us that its promotional offers could take a combination of forms. Manufacturers come forward and suggest a particular promotion. The nature of this promotion could vary in terms of the level of contribution from Tesco and from the manufacturer. At the moment so many manufacturers were suggesting promotions that Tesco's challenge was to restrict their number, rather than to encourage them.

Supermarket Code of Practice

30. Tesco told us that the previous inquiry in 2000 concluded that it would be better if the relationships between supermarkets and their suppliers were made more transparent, and as a result a code was written. Tesco told us that it supported the code's development because the conduct that it wanted to see was the conduct that we wanted to see, and Tesco had followed it to the letter and in the spirit. Tesco said that we should consider whether the code of practice ought to be extended to other retailers or intermediaries.

Land and planning

31. Tesco told us that there was no shortage of land available to open new stores. Different perceptions of the availability of land may be dictated by different strategies. To a greater extent than a number of other major operators, Tesco acted as its own developer, looking for land itself, rather than relying on third party developers. Tesco had developed a range of formats and adapted its business model so that there were no 'no-go' areas. Other retailers had excluded themselves from parts of the market by not running an appropriate format or business model.

32. Tesco said that when it opened a store in a town or on a high street, that town or high street might benefit because people stayed and shopped in the local area, rather than travel to an out-of-town supermarket. Because they stayed in the local area, they did linked shopping trips.
33. Tesco told us that navigation through processes related to planning was the main hurdle that had to be overcome in order to open a new store, but it had not deterred or stopped retailers from getting on—many new stores had opened.
34. Tesco said that the planning process could be long, complex and costly. It was longer for retailers which acted as their own developers and therefore started earlier in the process, and for complex projects such as regeneration schemes. Smaller stores, on the other hand, went through the process much more quickly.
35. Tesco said that getting rid of the need test would make navigating through the planning process a little easier. The need test was a difficult and highly subjective thing to assess as it was based on a whole series of variables which provided ample opportunity to argue. It put in the hands of a few planners a judgement over what consumers wanted. The need test involved 'double counting' in many respects because need, in the sense of the quantitative analysis of available expenditure, had always been a factor in planning assessments as part of the test of retail impact. If you were looking at the impact on a town centre of a store out of the town centre, for example, you had to know what the available expenditure was to see whether others were able to compete for the same expenditure and whether expenditure increased. Need was always within the planning system as part of the 'vitality and viability' test, but had been introduced as an extra test in itself.
36. Tesco pointed out that planning was not so much of a problem for the smaller retailers. There was an ample property investment market. It could count against retailers if they were big. Smaller stores went through the planning system significantly more quickly than larger stores because it was easier for them to satisfy policy and there was less opposition: see DCLG planning statistics produced in late September 2006 and compare the time for processing major retail applications (19 per cent dealt with in eight weeks) and minor applications (79 per cent dealt with in eight weeks). These figures backed up the approach in the Barker Interim Report that smaller sites did get through the system much more easily than the larger sites.
37. When asked whether incumbents had an advantage in the planning system, for example because it was easier to get permission for an extension than for a new store, Tesco said that they did not. The same planning criteria applied to all (see PPS6, paragraph 3.29). In relation to extensions, it was possible to argue the point the other way. At the end of the 1980s, planning was easier and many stores were built in the suburbs. On the basis of today's planning criteria, those stores were now in the wrong location. It could be harder to extend a store in the suburbs than it was to open a new store on a site which accorded with present sequential planning policy.
38. Tesco noted that government planning policy did focus on choice. National policy in PPS6 sought to promote competition and choice for consumers and stated that 'provision should be made for a range of sites for shopping, leisure and local services which allow genuine choice to meet the needs of the whole community'. However, the way in which this was to be achieved was by the proactive plan-led system and by active management by local authorities. A key difficulty, and this was reflected in the Barker Interim Report, was the under-resourcing of local authorities.
39. Tesco said that at the end of the planning process retailers had achieved a high level of success. Hundreds of new stores had been opened by many different retailers.

Since 2000, 2,972,897.28 sq metres (32 million sq feet) of grocery retail space had opened. One would expect Tesco to try to grow, but many of its competitors had had their fair share of growth, with some growing faster than Tesco in terms of the percentage rates of growth of new space. In the locations in which we had said in 2000 that Tesco had a share of more than 25 per cent, more than three competitors had opened in 70 per cent of cases.

40. Tesco told us that it bought land to build developments with stores and not for any other purpose. Unlike some of its competitors, Tesco had been consistent over time in continuing to look for sites and had taken on riskier and more complex projects, such as regeneration schemes. Tesco's land pipeline had increased because the period for which it had to hold land had increased as changes had slowed down the planning system. Once the planning process had been completed, Tesco built very quickly.
41. When asked what its national market share would be if it developed all of its land pipeline, Tesco said that this was difficult to assess because a company's market share was determined largely by the competitiveness of its offer, rather than by the amount of new space that it opened. Most of Tesco's growth comes from attracting customers and spend to existing stores rather than from opening new stores. It was perfectly possible that a retailer could increase its market share by opening new space but lose more than that from its existing space because of a weakening of its competitive offer. Tesco explained that the figures that had appeared in the press were wildly inaccurate.
42. Tesco stated that it did not accept that local authorities were intimidated by the cost, for example, of multiple appeals or by the financial resources available to Tesco in planning applications. Local authorities had the ability to say 'no' to applications. It was a feature of the planning system that it allowed local authorities and members of the public, who might not be well-resourced, to have their say on applications. Local authority members did not find themselves in reality unable to refuse planning applications. The figures on success rates showed that other retailers were at least as good as Tesco in terms of gaining planning applications.
43. When asked to comment on suggestions that it had failed fully to comply with conditions on planning permissions, Tesco told us that the same three or four instances that had been cited repeatedly over several years, such as Stockport, were often misrepresented and had been resolved satisfactorily. In any event, they were isolated cases out of thousands of planning applications.
44. Tesco told us that enforcement action was a regular feature of the planning system, and planning authorities had a wide battery of powers. If the planning authorities genuinely considered that non-compliance with planning permission was a material matter, they were under a duty to consider it in the interest of their area generally and might take action. However, government advice to planning authorities was not to enforce unless it would serve a proper purpose. In many cases there was scope for amendment after the event.
45. Tesco told us that in the main it had used restrictive covenants only when selling mixed development flats and the like. After observing the property disposals that had taken place in Tesco, there were about 20 examples out of several hundred disposals where a restrictive covenant had been used in relation to a retail property—a very low percentage. Restrictive covenants were a convention in property and were used widely, not just in retailing.

Evidence

46. Generally, in relation to the volume of comment about the position of Tesco, Tesco said that this had to be kept in proportion. The grocery industry served millions of customers and much of the critical comment did not reflect the views of the vast majority of grocery customers. Tesco said that competition resulted in winners and losers. The complaints that were heard were a sign of real competition between suppliers and between retailers, and consumers were reaping huge benefits from this competition. Tesco had seen no evidence to support the complaints made against it. It noted that many of the criticisms and allegations that had been put to it were based on media reports. It said that in this process evidence had to be weighed against evidence, not evidence against complaints.