

21 August 2007

Mr T J Oyler
Inquiry Secretary (2)
Groceries Market Investigation
Competition Commission
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Dear Tim

Response by ACS to CC working paper on Retail Competition (9 August 2007)

1. We have read with interest the working paper on retail competition published on the Commission's website and wish to make comments on a number of the issues raised in the paper.
2. Firstly we are concerned that the focus of much of the paper is on supermarkets, rather than the whole grocery market. For example paragraph 5 states that: "Some consumers have a limited choice of supermarket fascias and this could be reducing the extent of competition in the grocery retailing in these areas." This Inquiry should be focused on all retailers, and not just the supermarkets as in 2000. Competition cannot be viewed through the narrow lens of supermarkets; it should take into account the choice available to all consumers, particularly those who do not have a car, those who choose not to use a car for shopping, the elderly and those in rural areas who make up a significant section of the population. You have remarked in previous papers that such segments of the population may well be growing in number.

New Store Development

3. Paragraph 17 offers a useful insight into the expansion of supermarkets in recent years. Since June 2001 there have been 2 new supermarkets over 280sq^m built every week, a significant increase. Clearly the planning system is sufficiently liberal to allow such a large increase in store numbers in recent years. We are surprised that table 2 has been excised as it has been previously published in the barriers to entry paper and also as it could be reconstructed from the information provided in the annex. As we have already stated we believe there are widespread and unnecessary excisions in many papers, making it harder for us to comment properly on them.
4. However the most important factor is that of the 613 new builds not one was opened by an independent retailer. Paragraph 82, which highlights the lack of new independent large stores, is a crucial point which must be given further analysis. If major retailers are the only ones able to expand then we contend

this indicates significant market failure which must be addressed. Independents that operate large stores may and should have been contacted by the Commission, and we would like to see their analysis of why they have not been able to expand included in subsequent reports.

Prices

5. Paragraph 24 explains the possible reasons for food prices to be increasing at a faster rate in the UK than in other EU countries. The paper states that the Commission has been given a number of reasons by supermarkets as to why food prices have been rising faster than in other EU Countries. However, it is not clear how this information has been verified. A recent report from Deloitte showed that retailers' net margins in the UK are well above those in other countries, with a UK average of 5.5% compared to an average of 4% in the EU and 3.5% in the US¹. We are concerned that the Commission has appeared to take information from retailers on why prices may be increasing faster at face value and not interrogated the information further. If the Commission has carried out more work on food prices we would be interested to know what has been taken into account.

Product Range

6. The information provided in the paper on product range suggests an increase in choice to consumers over recent years. We would be interested to see more information on the figure of 2,000 new product lines for each of the largest retailers, and particularly how this takes into account the same products being introduced in each store and also the wider effect of own label products. Own Label is clearly more important in 2007 than in 2000 and we would be interested to see further analysis of the effect of own label on this choice particularly in categories like fresh and chilled products. We would also be interested to know what analysis has taken place of the merger between Morrisons and Sainsbury and how many lines can be accounted for by this merger.
7. The figures quoted do not appear to take into account product range in convenience stores. We have provided the Commission with information on the increased range that is offered within an independent convenience store compared to a Tesco Express store. We would be interested to know if the Commission disagrees that this is the case. The smaller range in multiple convenience stores has a negative effect on consumers and should be taken into account, rather than just focusing on range in supermarkets. In our view there are significant differences between fascias in this respect.
8. It is also important that the range of services available is taken into consideration, for example Post Office, PayPoint and PayZone. While we

¹ '2007 Global Powers of Retailing', [Deloitte](#) (2007)

understand that these services are not within the definition of grocery they are vital to many consumers and only available in independent stores who are willing to take small margins in order to offer them.

Store Choice

9. Paragraph 33 and footnote 30 comments on the submission ACS made with regard to the AIM paper on what consumers want. While it may only be by a small margin, according to the report independent stores do provide the greatest consumer satisfaction. Our submission focused on the fact that this report could be used as a basis to further examine these issues, and we would be interested to know if and how the CC has attempted to follow this up and what analysis has been done of what consumers want.

Market Definition and Retail Competition

10. This section on market definition, and specifically paragraph 36, looks at the competitive constraints within the market, based on store size. We believe that the Commission are treating consumers as one homogenous group, which is very different from the experience of ACS members, and indeed from reality
11. This also contradicts evidence within the paper about the changing nature of shopping missions towards more convenience and top up shopping (paragraph 9) and the fact that 21%, a significant group, use convenience stores for food and grocery shopping. We would be interested to know more information on this IGD figure, particularly what type of shopping mission this refers to. Given the fact that a significant minority use convenience stores and that consumer behaviour is changing more and more, further analysis needs to be carried out to ensure the needs of all consumers are met, and not just those who use supermarkets.

Competitive Initiatives at the National and Local Level

12. The Commission appears to have accepted that the major grocery retailers price on a national basis. However, we have provided significant evidence to the Commission about the ways that retailers use vouchers and other means to target local competition. There are examples, including Withernsea, which are clear evidence of local pricing. It is important that the Commission accepts that there are numerous examples which show national pricing is not a rigid policy which is stuck to by the major retailers. This section of the working paper also provides plenty of information from the supermarkets themselves that contradicts their own claims to national pricing and that the Commission must take seriously.
13. Paragraph 44 states that differences in prices between store formats are down to higher operating costs. It is not clear why the Commission has taken these

claims by retailers at face value. We have said in a number of submissions that the differences between, for example, One Stop and Express (both Tesco) are not to do with higher operating costs but reflect Tesco's choice to charge more. One Stop stores are of a similar size to Express stores yet charge higher prices. It should also be made clear that One Stop is not a legacy brand in decline; it continues to recruit new stores. We would be interested to know what the Commission has done to verify the information given to it, for example, have the differences that cause higher operating costs between a One Stop and Express store been analysed?

14. Paragraph 51 examines the use of local vouchering activity. This states that Sainsbury's and M&S do use reactive vouchering against local competition while other retailers, including Tesco, use vouchering mainly when their own store is refurbished or they open a new store.
15. However, this contradicts evidence that we have presented to the Commission and also evidence within this paper. Examples including Ludlow and Withernsea show that vouchers are used by Tesco proactively and not just in relation to their own refurbishments or new stores. While Tesco claim that their use of vouchering is *de minimis*, in reality they spent more on vouchers annually than Sainsbury's spent on television advertising annually between 2003-6 (footnote 46). This could amount to around £35m a year², which cannot be considered *de minimis*, and is clearly a significant spend only available to those with market power.
16. The use of vouchers against local competition is also a barrier to entry for many retailers. If an incumbent is known to use vouchers to target local competition then many independent retailers may avoid opening a new store in that area because they know that vouchering will take place which they will not have the financial strength to resist. This is a point made in the Commission's working paper on barriers to entry.
17. The Commission said in its working paper on quantitative analysis that without full evidence from all parties on the extent of vouchering it is difficult to assess their impact. Considering the large scale of vouchering that appears to take place according to this paper we would be interested to know what information the Commission has asked for and received and what further analysis has taken place.
18. Tesco's claims that they price nationally are also further contradicted by comments in paragraph 57 that they use short-term local marketing in response to investments by local competitors. This is done in every case where there will be a certain effect on % of sales or £ sales per week (although at what level this begins is excised.) Clearly the fact that there is a

² <http://www.intelligencia.com/news.asp?siteid=4&id=74677>

threshold for new entrants in place for Tesco over which they act with local marketing dispels the concept of national pricing.

19. Furthermore the CC does not appear to have investigated loyalty cards as yet, and the impact that they have on the local offer. Evidence we have submitted, included Micromarketing by Professor Paul Dobson, shows that loyalty cards are used to differentiate the local offer and we would be interested to know what further analysis the Commission has carried out on this issue.
20. The above examples clearly show that, while retailers claim to work off national price lists, in reality local pricing is a widespread practice to target local competition. This must be recognised by the Commission and further analysis is required of the extent and impact that this has on competition and choice for consumers.

Local Market Outcomes

21. The Commission's development of areas of high concentration (paragraph 76) does not take into account stores under 280sq^m and therefore does not examine the needs of many consumers. By only using a drive time isochrone of 10 minutes and 15 minutes those consumers who do not have cars (a significant minority) would be ignored and their needs not examined. This appears to us to be a further example of the CC's focus on supermarkets and more credence should be given to the local effects of competition on all retailers, not just supermarkets.

Barriers to Entry

22. Paragraph 84, which considers the effect of distribution on barriers to entry, seems to be counter-intuitive. The paper states that: "it is not clear that barriers to entry based on cost advantages harm consumers because they may allow provision where there would otherwise be none." If cost advantages from distribution are a barrier to entry then they stop new retailers entering the market, and therefore provision can only be reduced, harming choice.
23. The evidence provided in paragraph 87 shows that the 'need' test is not a barrier to entry. The fact that neither Tesco nor Asda can provide evidence of where a proposal has been rejected because of 'need' shows that it is not a barrier to entry. This is a vital point as it clearly shows that the planning system has been of little deterrence to Tesco and Asda building new stores.
24. Considering the large rate of development of new stores outlined at the beginning of the paper we find it hard to believe that the planning system may: "Act to impede the development of new stores that could compete effectively with existing large stores" (paragraph 88). If the planning system were a barrier to entry then 2 supermarkets a week would not have been built.

However, the fact that no new independent supermarkets have been built, and only 1 acquired, shows that there are other barriers to entry. The market power of the large retailers has made it impossible for independents, for example Jempsons, to expand their business. It is this barrier to entry that should be the main concern, not the planning system.

25. Paragraph 89 also highlights the fact that there is a link between buyer power and store development. If the land holdings of the major retailers were to be freed up this could augment buyer power, which is not an option for independents. Therefore the only retailers who can take advantage of holding onto land are those with buyer power, and by building on the land this is further enhanced.
26. Paragraph 92 states that the Commission: "Would encourage other grocery retailers to consider similar action" to that of Asda. However, this is not a point ACS can respond to as whatever review has been carried out has been excised.

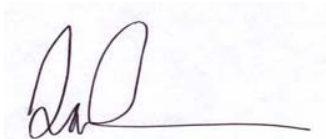
Interaction between larger grocery outlets and convenience stores

27. We remain of the view that the model of the waterbed effect which we have set out is a credible one and that the impact of this effect would not be eliminated by changes in the model's assumptions as suggested by the Commission (paragraph 98). This has been set out in detail in our earlier submissions and we will not repeat the points here.
28. However we are concerned that there is no further consideration in this paper of the pricing differentials at the wholesale stage which are created by buyer power and which were considered in the working paper on supplier pricing. The buying price advantages of the large supermarket groups, which in our view go well beyond anything justified by the volumes of their purchases, result in the profit margins of smaller retailers being squeezed as they seek to remain competitive with supermarket prices. At the margin this leads to closure of independent stores. It also acts as a deterrent to potential entrants into the market and to expansion by small or medium sized incumbents. The large supermarkets can also leverage this buying advantage into their own convenience store operations putting a further squeeze on the independent operators.
29. In our view no analysis of retail competition can be complete without a full analysis of these pricing differentials and the operation of buyer power.
30. The effects of below cost selling (paragraph 101) should be seen as taking place over a long period. The effect of a supermarket being introduced and using below cost selling will not be seen immediately. A store will not immediately be forced to close by below cost selling by a supermarket, but

after a longer period the overall effect may be that it is forced to either close or sell up.

31. We would also like to once again stress our concerns at the CC's reliance on the Experian Goad data as a reflection of convenience store entry and exit. As we have made clear before, Experian Goad only takes into account high street retailers, not neighbourhood retailers. Therefore any analysis using Experian Goad is likely to be inadequate for the Commission's purposes because it will not take into account the effect of supermarket entry on the majority of convenience stores. The data goes against that of the IGD and the Knowledge Store and as we have shown in our survey of Farnborough cannot be considered representative. We would once again urge the CC to recognise the limitations of this database for assessing the effect of supermarket entry on convenience stores as a whole.
32. The section in this working paper on alcohol refers to the below cost selling of alcohol, an issue which we have raised on a number of occasions. However, the working paper only refers to the impact of below cost selling on off licenses, and not all retailers who sell alcohol. Below cost selling affects all retailers in the alcohol category and there should be further analysis of the impact that this has.
33. While we welcome the information included on fuel pricing within the working paper we feel that it misses many of the main problems associated with fuel pricing and its link to grocery sales. This section does not analyse whether vouchers are predatory, whether fuel is price flexed based on local competition, whether it is sold below cost and the use of cross-subsidisation to fund low price fuel from grocery sales. While this is not an Inquiry into the fuel market these actions have come at a time when forecourts have reduced in number, by over 1, 000 since 2000 according to the IGD (a 10% decline). This clearly has a significant effect on consumers, and reduced outlets to buy petrol means that they must travel further to get fuel.
34. We would welcome further discussions with you on the work that has been carried out on the issues above and what more can be done to ensure all the relevant evidence is taken into account.

Yours sincerely

A handwritten signature in black ink, appearing to read 'James Lowman', written over a light blue rectangular background.

James Lowman
Chief Executive