30 November 2006

Mr T OYLER
Inquiry Secretary (2)
Groceries Market Investigation
Competition Commission
Floor 6, Zone 4, Point 58
Victoria House
Southampton Row
LONDON WC1B 4AD

Dear Tim

Grocery Market Inquiry: ACS Evidence

Further to a number of discussions with the Competition Commission panel and secretariat, I am enclosing further economic argument and evidence for consideration as part of the inquiry.

With our colleagues FWD, SGF and NIIRTA, ACS has asked some academic and professional economists to assist with its development of arguments in a number of important areas. The purpose and key points raised by each paper, and some other key issues arising at this point in the inquiry, are summarized below:

1. **Micro-Marketing & Discriminatory Practices in UK Grocery Retailing, by Professor Paul Dobson, Loughborough University Business School**

It has been suggested by a number of major multiple retailers that practices such as price flexing are the result, sometimes almost accidental, of local decision-making. Professor Dobson's report refutes this suggestion, explaining how supermarket retailers segment markets and carefully and systematically adapt their offer. Furthermore, Professor Dobson states how this activity may restrict and distort competition, giving rise to consumer detriment. The report makes use of significant evidence of micro-marketing activity.

Two further points are worth noting in relation to Professor Dobson's paper. Firstly, that this pricing activity arises as a result of the buyer power of the major multiple retailers. ACS maintains that this is the root cause of many of the competitive issues in the market, and this paper provides support for this view.

Secondly, the Commission has questioned ACS' view of below-cost selling and its detriment to consumers when higher prices are applied to some products to compensate for the below-cost prices of others. The Commission has suggested that prices would already be raised to their highest level at which sales could be maintained, and therefore that net revenues from compensatory price increases would not arise. We draw the Commission's attention to the published evidence of Morrisons, who state that some prices <u>are</u> increased to compensate for below cost selling on other products. .

2. **Effects of Planning Rules on Competition in the Retail Grocery Sector, by Europe Economics**

We are aware of the Commission's remit to examine planning issues and the implications of the land banks held by the major multiple retailers. We are also aware of the evidence submitted by some retailers suggesting that current restrictions in the planning system are an impediment to competition. This paper examines the juxtaposition of the planning system and competition in the grocery market. It questions the view expressed by other parties that reducing the powers of planning authorities and allowing more large scale retail development in local markets is the best way to ensure greater competition. This particular "remedy" looks only at the economics of decision making for retail developers and alleged cost benefits to the consumer of proposed developments.

Our paper enclosed explains how the planning system cannot be viewed as the cause of the dominant position of the Big 4 grocers and further explains that it is a major untested assumption that removing existing planning restrictions would lead to better competition and consumer benefit.

3. **Analysis of Choice in Local Markets, by Professor Martin Clarke, University of Leeds**

We are keen to put forward evidence as to whether and how consumer choice at a local level is being affected by the national decline of independently owned stores. By using data on independent stores and combining it with data on multiple outlet development, we were able to assess consumer choice in a number of different post code areas, and to track changes in these markets from 2000 to 2006.

The report comes to two important conclusions. Firstly, in a number of areas consumer choice has clearly declined. Secondly, the decline in consumer choice appears to be greater in rural than in urban areas. ACS contends that consumer choice is a critical component of competition, and that this research demonstrates detriment to consumers by virtue of a reduction in the choices available to them. And again, ACS contends that the cause of this decline in choice is the buyer power and seller power exercised by the major multiples, which is leading to unfair competition with smaller operators and eventually to independent store closures.

This paper is being finalised and will be sent to you in the next few days.

4. **Modelling of Independent Stores, by Europe Economics (CONFIDENTIAL)**

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5. **The 'Waterbed Effect'. How Non-Cost Related Discounts to Large Retailers can Harm Consumers, by Professor Roman Inderst, London School of Economics, and Europe Economics**

ACS has raised with the Commission the waterbed effect, specifically our view that the buyer power of the major multiples is being used to the detriment of other buyers and, ultimately, consumers, because excessive discounts achieved by supermarket buyers are compensated for by higher prices charged to wholesalers supplying the independent trade. Waterbed effects also show through as a reduction in investment and innovation among suppliers, together with loss of brands and an increase in brand ownership concentration.

This paper demonstrates that there is a strong theoretical basis for the operation of a waterbed effect as a result of the negotiation of non-cost related discounts by larger retailers, and that this can harm not only the consumers using smaller retail outlets but consumers as a whole.

It is our contention that these effects cannot be simply dismissed in the way suggested by the large retailers. They must be fully investigated by the Commission, drawing on the detailed information it has available from submissions and questionnaires provided by retailers, wholesalers and suppliers.

6. **Further Evidence – Supplier Discrimination (CONFIDENTIAL)**

In addition to these papers we wish to add two further pieces of evidence to the inquiry.

Thus far, ACS has focussed on the differentials in buyer power in terms of price discrimination. However, we also believe there are other forms of discrimination, including the non-availability of products for the independent trade which are made available to the multiple sector. We have uncovered two examples of this practice…….

7. **Fuel Pricing**

ACS has submitted detailed evidence to the Commission on the issue of fuel pricing. We would like to reiterate the importance of this product to the Inquiry. We believe that the sale and pricing of fuel is a vital area of investigation in terms of assessing the use of below cost selling and price flexing and the impact this has on the consumer.

We believe this is of relevance to the grocery Inquiry for three reasons. Firstly the evidence suggests that in order to conduct the pricing strategies they do retailers have to cross-subsidise the sale of fuel from their grocery business; secondly that this is a loss leading strategy heavily affected by price flexing designed to drive customers into their grocery stores; and finally because supermarkets selling fuel have a direct adverse competitive impact on forecourt convenience stores that are important parties to the Inquiry.

We would in particular draw your attention to the recent deep discounting activity undertaken by Tesco in the month of November whereby they offering a discount of 5p per litre on fuel where the customer pays £50 or more in store.

We are aware that under the terms of reference of the Inquiry the grocery definition does not include fuel, but we believe that grocery retailers' pricing of fuel affects competition in the market for groceries and therefore it is of relevance to the Inquiry as is consistent with paragraph 22 of the Statement of Issues.

8. Evidence Required

During our hearing with the Commission on September 26th, we discussed the need for evidence to support the arguments we wish to put to the Commission (see page 53-54 of the transcript). We had already advised the OFT, and we took the opportunity of our hearing with the Commission to emphasise, that there are quite severe limits on the ability of ACS to obtain comprehensive evidence , especially in relation to buyer power and its consequences. We have done our best, both in our September 22nd submission and in the present package of further submissions, to present such evidence as we and our members have been able to gather. We acknowledge nevertheless that some of it is no more than anecdotal, and that other elements fall short of presenting a nation-wide picture of the issues at stake.

On the other hand, both the OFT and the Commission have statutory powers to obtain information which we cannot, and to apply such information to the arguments we make. For the avoidance of doubt, we urge the Commission (since the OFT declined to do so) to use its powers to compel the production of information which neither ACS nor its members can hope to get. In our view, the following are the main subject headings under which the Commission needs to gather evidence:

- The prices at which suppliers sell to each of the Big Four supermarket groups and the prices at which the same goods are sold to wholesalers supplying non-supermarket retailers.

- The reasons for discount differentials, where they arise, and the extent to which they are explained by scale differences and other differences that bear directly upon suppliers' costs.

- Whether and to what extent manufacturers or processors of grocery products restrict or deny supplies to non-supermarket buyers, either to give supermarkets a structural competitive advantage (through availability) or to give supermarkets preference when products might be in short supply or are newly launched.

- Whether suppliers say they have reacted to price pressure from the Big Four in ways that directly increase prices (or reduce discounts) to non-supermarket buyers, reduce product innovation, or result in brand discontinuation.

- Whether suppliers say they have found their investment, or prospective investment, in brands undermined by Big Four practices in relation to sourcing own-label products.

- Whether, to what extent and why the Big Four supermarkets sell products below cost or at margins which do not make a fair contribution to their fixed costs.

You will appreciate that these issues go to the heart of our contention that the Big Four supermarket groups enjoy and abuse both buyer power and seller power, and use each to buttress the other. We are certain that the practices we describe in the bullet points above go on, and that their effects are real and continuing.

The authors of the five papers appended to this letter would be pleased to meet Commission members or staff to explain their findings in more detail and to be questioned on their reports and conclusions.

Yours sincerely

James Lowman
Chief Executive