31 July 2007

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

Dear Tim

Response by ACS to CC working papers on (i) market definition (May 7 2007), (ii) barriers to entry (June 5 2007) and (iii) entry and exit of small and specialist stores (June 8 2007)

1 We have chosen to make a single response to these three CC papers because we see the subject matter they cover as closely connected.

Summary of CC findings

2 The CC's principal thesis in relation to market definition is that geographic retail markets are local in nature (generally defined by a maximum 15-minute drive time). It says that that 60 per cent of shoppers still do a main weekly shop in a larger store. It acknowledges that 16 per cent walk to the shops, that 10 per cent go by public transport, and that these percentages may be increasing, but regards drive time as still the best metric.

3 Retail product markets are defined less straightforwardly.

4 The CC suggests that price, quality, range, cleanliness and parking are all important, and that the "offer" of retailers is best defined by fascia. The CC goes on to observe that, in its view, stores with a retailing area greater than 1400 sq. m. constrain each other's behaviour, and that they also constrain the behaviour of stores between 280 and 1400 sq. m. It finds that stores under 280 sq. m. (convenience stores) do not constrain the behaviour of larger stores. The margins of large stores have been analysed (but the results excised, so comment is impossible) and the effects on large stores of entry by other large stores are also reported. But no such analysis has been done of the effects of small store opening on larger stores or of large store opening on smaller stores. The CC says that it will in due course explore the former, though there is no commitment to the latter.

5 Provisionally, the CC concludes that stores of 280 sq. m. or less (which enjoy longer opening hours under Sunday trading law) may constitute a separate market. It reinforces this provisional conclusion by reporting that median expenditure per trip in the very largest stores is £20+, while median expenditure in c-stores is £4.80. The number of trips made to each type of store is not, however, analysed.

6 The CC's working paper on barriers to entry concentrates on larger stores and on barriers erected or implied by planning policy and land holdings. It finds, provisionally, that the planning régime (essentially the town centre first policy) may have restricted entry by "new grocery stores of a scale sufficient to compete with incumbent stores". But until the CC completes its analysis of the extent to which smaller stores constrain the behaviour of larger stores it says it remains uncertain about the significance of this barrier to entry. Also provisionally, the CC concludes that the "needs test" for out-of-town retail developments is a potential barrier to entry. And it notes "a number of instances" (the number not specified) where the Big Four own land "in areas where they already have a high share of net sales area". Finally, it notes that, in general, a strong position occupied by one retailer in a given area is not generally eroded by the entry or expansion of other retailers, though again the analysis is confined to large retailers.

7 The working paper does not consider barriers to entry, or barriers to expansion, by small stores, nor is there any commitment by the CC to consider the subject.

8 The working paper on the entry and exit of small stores finds that supermarket entry actually stimulates c-store entry, although it results in the exit of other types of small specialist stores, such as bakers, greengrocers and fishmongers. In reaching this conclusion the CC acknowledges that it has relied on the Experian-Goad ("EG") database rather than on statistics produced by the IGD. This is a departure from industry practice, which regards IGD as its standard source of retail statistics. The CC also acknowledges that the EG database concentrates on town-centre locations. It does not attempt to reconcile the differences between the IGD statistics, which for several years past show a steady decline in the number of c-stores, and those produced by its analysis of the EG database. It does, however, note that where net exit is taking place the rate of exit is slowing down and that some entry still takes place.

9 In summary, the CC's view as it relates to the c-store sector, provisional though this view may still be, is that:

- c-stores may very well lie in a separate market outside the competitive arena occupied by larger stores;

– if there are any barriers to entry or expansion by c-stores, these are not yet identified; and

– supermarket entry appears to stimulate c-store presence.

10 We now comment on these findings.

The response of ACS

11 Our position overall is that we agree that retail markets in grocery are local – but we disagree with a significant number of the CC's other findings. In some cases the analysis presented has been so obscured by excisions on grounds of confidentiality that reasoned comment is impossible (a concern we have of other CC papers too).

12 Much of the argument behind the points with which we disagree has already been lodged with, and indeed published by, the CC, so for that reason this response is deliberately kept brief.

Market definition

13 We consider that the CC's provisional finding that c-stores form a product market distinct from the market represented by stores above 280 sq. m. is incorrect. We do not agree that consumer retail markets in grocery are defined by store size.

14 Consumers have a variety of reasons for frequenting a variety of stores. The patterns of shopping have changed since the CC's report on *Supermarkets* in 2000, and we welcome the current panel's conclusion that the definitions of "one stop" and "top up" shopping are no longer sufficient to define what shoppers do. It may be true that 60 per cent of shoppers still do a weekly "main shop", yet the habits of the other 40 per cent are not considered.

15 Similarly, the CC's acknowledgement that 26 per cent of shoppers go to shops on foot or by public transport is not followed through: instead, the CC relies on a largely unsubstantiated assertion that drive time is still the best metric for geographic definition. We agree it may be the best metric for defining how long consumers are willing to take to get to a supermarket, and that 15 minutes may be the right number, but it does not measure how far consumers go for other types of shopping or what their mix of shopping expeditions is. The him! Convenience Tracking Programme (CTP)[1] 2006 indicates that about half of all

[1] "him!" is the trading name of what used to be known as Harris International Marketing.

shoppers travel less than a quarter of a mile to the shop (i.e. the c-store) and that about half of that half walk there.

16 The CC's finding that the median spend per shopping expedition in a c-store is £4.80 but £20+ in the largest type of supermarket is meaningless unless it synthesises this particular finding with numbers of shopping trips. If the figure of £20 is a figure per week (i.e. if the median number of trips per week to the largest type of supermarket is 1) it would take only an average of four trips per week to a c-store to bring expenditure in each type of store roughly into line.

17 The advantage that c-stores enjoy of longer Sunday trading hours (relative to larger stores) applies only for a few hours on one day of the week.

18 We do not accept that there is a significant break point in the way stores interact above and below 280 sq. m. The practical interaction between larger and smaller retailers is determined principally by proximity and by quality and range of products available, not by store size. For many, the question is this: does the lesser time needed to shop in a c-store counterbalance the lesser range that might be available (compared with the supermarket) and/or any price difference? If the CC were to take into account the trade-off that consumers apply, then it would follow that, given the opportunity to compete on level terms, small retailers would be in a better position to influence the behaviour of larger players. In saying that smaller stores do not constrain the behaviour of larger stores, the CC seems simply to be anointing the position that may be viewed by many as existing today, and is failing to consider the position that would apply if competition were effective. The question the CC needs to ask is why smaller stores do not more effectively constrain the behaviour of larger ones.

19 We acknowledge entirely that the smallest c-store cannot do much to constrain the behaviour of (say) a Tesco Extra store a mile away, but that is not the whole of the picture. If smaller stores do not constrain the behaviour of larger stores, why then do successful independent stores, whether above or below 280 sq. m., provoke a reaction from nearby superstores? We have given the examples of Tesco's reaction (deep discounting) to Tuffin's store in Ludlow, Shropshire, and to the Proudfoot store (now sold) in Withernsea, Lincolnshire, and we have seen nothing yet from the CC which persuades us that these and other examples are not worthy of consideration in an analysis of how competition works – and, more importantly, how it could work. It is not enough for such cases to be dismissed merely as aberrations.

20 In any event, it is important not to think of each small retailer as a competitor in isolation. Groups of small outlets in a high street or shopping parade can compete with a large supermarket offering the same range of products. If (as the

EG database suggests) supermarket entry affects the viability of small specialist stores, the weakening of the street or parade in which they trade is bound to affect the other shops in that street or parade by reducing the footfall. The submission to the CC from Opolka (Nigel Dowdney, a c-store owner/operator in north Norfolk) provides an example of this sort of systematic decline. This too is in our view a subject worthy of more analysis than appears in the CC's working papers.

21 The Retail Enterprise Network wrote to the CC that[2]:

> "Broad objectives which we believe are important for this investigation are:
>
> To develop an understanding of the dynamics of the SME retail sector;
>
> To develop an understanding of the importance of SME retailers to consumers;
>
> To develop an understanding of the importance of SME retailers to competition and the wider business network;
>
> To develop an understanding of the interaction between SME retailers and the external environment and building a picture of how business viability is affected; and
>
> To develop an understanding of any issues surrounding the viability of SME retailers that give rise to competition concerns and to investigate how these issues might be addressed."

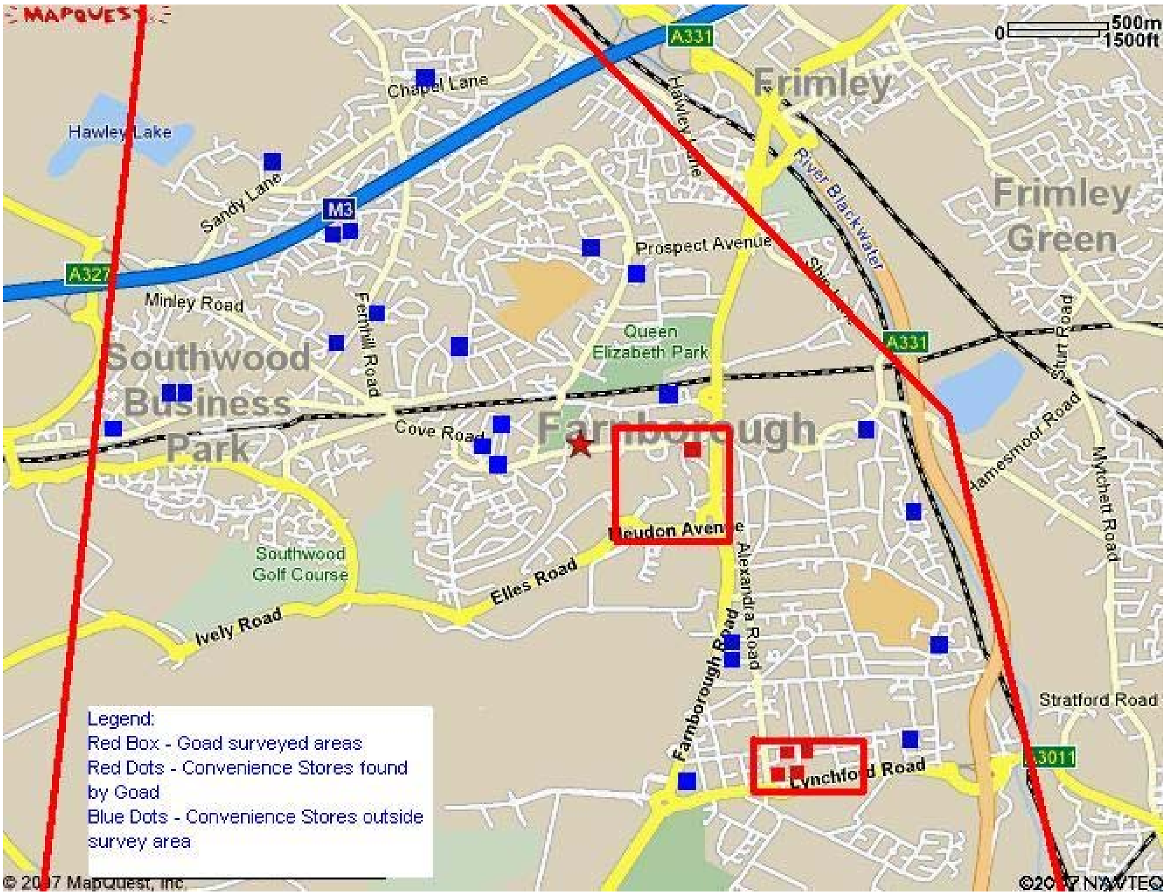
22 We agree strongly with all of this. Yet the CC's focus of attention, in the generality of documents that it has drafted, seems to us to be on the large retailers rather than on the whole grocery market.

Entry and exit of small stores

23 The CC's finding in its original working paper (based on an analysis of the EG database) that supermarket entry *encourages* the entry or survival of c-stores seems to us completely counter-intuitive, especially when set against its finding that supermarket entry undermines the viability of other small specialist stores. Such a conclusion deserves further analysis.

2 The submission is undated in the document that appears on the CC website, but the wording suggests that it dates from early in the investigation.

24 In order to get a better understanding of the scope of the EG database we analysed their current maps for Farnborough, Hampshire, where ACS is headquartered. The maps for Farnborough and Farnborough North Camp cover the town's two main shopping areas (apart from the edge-of-town retail parks which we have excluded). These two maps show three convenience stores – one in the town centre and two in North Camp – and three supermarkets. Yet our own on the ground review (we walked and drove round the streets), coupled with Yell



and other local listings, identified a further 23 convenience stores in parts of the town not covered by EG.

25 We have no reason to think that Farnborough is unrepresentative of other parts of the country. We note that 80 per cent of SPAR stores are classified as 'Neighbourhood' and by no means all of the other 20 per cent will be in town centre locations. Our findings suggest that the EG database only covers a small proportion of convenience stores in the country as a whole. As such we think it is unlikely to be representative of developments in the wider market.

26 It is surprising that, within the narrow coverage of the database, the CC should conclude that there is growth in the population of independent c-stores. In the published version of its working paper, new Figure 16 shows an average of less than one independent convenience store in each location. We find it difficult to see how the limited coverage provided by the EG database can be regarded by the CC as a firm basis for drawing such a strong conclusion. We also note that the revised econometric analysis in the published version of the paper no longer supports the CC's original conclusions (in paragraphs 30 and 31) that supermarket opening has a positive effect on convenience store entry.

27 For the avoidance of doubt, we do not criticise the make-up of the EG database: our objection is to its being taken by the CC as representative of the pattern of retailing across the country as a whole. In our view that represents a mis-use of data which cannot lead to reliable conclusions.

28 Our view concerning the number of convenience stores in operation is as follows:

Segment	**2000**	**%**	**2001**	**%**	**2002**	**%**	**2003**	**%**
Non-affiliated Independents	**35,500**	**63.6**	**34,250**	**62.4**	**33,787**	**61.7**	**32900**	**61.1**
Affiliated independents	6,058		6,155		6,283		6,587	
Affiliated multiples	903		1,020		1,088		1,207	
Total affiliated (note 1)	**6,961**	**12.5**	**7,175**	**13.1**	**7,371**	**13.5**	**7,794**	**14.5**
Total forecourts	**9,386**	**16.8**	**9,367**	**17.1**	**9,437**	**17.2**	**9,005**	**16.7**
Convenience multiples	**2,715**	**4.9**	**2,756**	**5.0**	**2,804**	**5.1**	**2,186**	**4.1**
Co-operatives	**1,236**	**2.2**	**1,297**	**2.4**	**1,381**	**2.5**	**1,977**	**3.7**
Total Convenience	**55,798**	**100.00**	**54,845**	**100.0**	**54,780**	**100.0**	**53,862**	**100.0**
Change year-on-year			953		65		918	
Independent Retailers (note 2)	**41,558**		**40,405**		**40,070**		**39,487**	
Decline in independents			1,153		335		583	

Segment	2004	%	2005	%	2006	%
Non-affiliated Independents	**28220**	**52.6**	**26873**	**51.6**	**25,893**	**49.7**
Affiliated independents	11,408		11,003		11,643	
Affiliated multiples	1,334		1,397		1,392	
Total affiliated (note 1)	**12,742**	**23.7**	**12,400**	**23.8**	**13,035**	**25.0**
Total forecourts	**8,375**	**15.6**	**8,112**	**15.6**	**7,837**	**15.0**
Convenience multiples	**2,213**	**4.1**	**2,379**	**4.6**	**2,427**	**4.7**
Co-operatives	**2,129**	**4.0**	**2,321**	**4.5**	**2,334**	**4.5**
Total Convenience	**53,679**	**100.0**	**52,085**	**100.0**	**51,526**	**100.0**
Change year-on-year	183		1,594		559	
Independent Retailers (note 2)	**39,628**		**37,876**		**37,536**	
Decline in independents	-141		1,752		340	

Note 1: Knowledgestore redefined symbol groups between 2003 and 2004, putting more independents into the affiliated category
Note 2: Independent retailers are calculated by adding non-affiliated and affiliated independent retailers

Source: ACS from IGD

29 IGD statistics suggest that there was a net loss of just over 4,000 c-stores between 2000 and 2006, and a further loss of just under 2,000 forecourt c-stores. There is a total net loss of nearly 4,300 c-stores after adjustment for reclassification. This is consistent with our own members' experiences.

30 We note that the CC paper does not estimate absolute numbers of c-stores. It is thus impossible to reconcile the numbers implied by the EG database with those published by the Knowledge Store – in our view a serious flaw in the CC's analysis.

31 The CC does not distinguish different types of c-store but treats them as a homogeneous collection, regardless of size or other characteristics. For example, during the inquiry so far, the CC has not identified any particular issues arising for forecourt c-stores. Because it is of importance to forecourt c-stores we had expected that by now some analysis would have been done in relation to fuel pricing as an element of competition between supermarkets and other retailers, but nothing has emerged. We do acknowledge that fuel is not a grocery item, but at an early meeting of the CC team with interested parties (on June 19th 2006) the then Inquiry Director, John Kirkpatrick, gave an assurance that products that might bear upon competition in grocery would form part of the investigation – and he mentioned fuel as one example.

Barriers to entry

32 As we remarked in paragraph 7, the CC's paper considers only larger stores, and then only issues arising for them in relation to the planning process and land holdings by the largest players.

33 The CC reports (in Table 3, page 16) that of the 220 new stores of over 1,400 sq. m. built since 2001, 203 (92 per cent) are owned by the Big Four – 42 per cent by Tesco alone. And that of the 345 acquisitions of stores of 1400 sq. m. or more in that time, 304 (88 per cent) are owned by the Big Four. The CC ventures the view that "this might indicate that barriers to entry are more substantial for small retailers…"

34 In our view, it does. The ability of any independent company to enter the larger end of the store spectrum either by new build or acquisition appears to be seriously constrained. According to the CC's own research only one store was developed by an independent operator (Booths) over the period. Operators such as Jempson's and Proudfoots have been unable to expand. The question we ask the CC to address is: what does this say about the ability of new firms to enter or expand in local retail markets, not just about the ability of established firms to enter local markets where they are not already present? We suggest that a company can only enter additional local markets (and thus expand nationally) if it already has the scale and to do so, and, we argue, an integrated supply chain. By extension, the CC must explore what is happening in procurement and distribution (for short the wholesale market) which is having such an impact on choice and competition in local retail markets.

35 One way of looking at this is that barriers to entry and expansion are high enough to deter smaller players, but are low enough for large operators to surmount them with sufficient agility to develop an average of one new store a week. It is, in effect, a situation which contrives to keep the big players big and the small players small. That ought to be of very serious concern to the CC. By the CC's own analysis, "softer" barriers such as planning appear to have less influence on outcomes than "harder" economic and financial barriers.

36 We acknowledge that c-store entry at the lowest level of scale (typically through a CTN which is then expanded in scope to form a c-store) is not an insuperable problem. But the constraint that bites next on entry at a higher level, or on expansion into it, is the availability of competitive wholesalers. We have previously said to the CC that we are disturbed that it appears not to recognise the existence of a separate wholesale procurement market, which we contend is at least a national market, rather than the series of multiple local markets which represent retail. This is, for ACS members, a matter of critical importance. It is at the wholesale procurement level that our core concern – the price differentials which we believe so seriously disadvantage wholesalers supplying the independent trade – arises in relation to competition between bigger and smaller retailers. We ask the CC to explain clearly whether it acknowledges the existence of a wholesale market which has relevance to retail in the market.

37 At our hearing with the panel on June 14 questions arose about the decline in population of cash-and-carry outlets. FWD promised to carry out further work on this subject, and that work will be available shortly.

38 The differential in buying prices between the Big 4 supermarket chains and smaller retailers (even those that are members of buying groups) is now creating a further barrier to entry through its effect on the price of suitable sites for convenience stores. Both Tesco and Sainsbury's have been active developers of new convenience stores and are in direct competition with independents for sites. Their convenience stores benefit from the buying power of the parent group as a whole and as a result are able to bid higher prices for sites than independents and still achieve the same overall return. Even quite small buying price differentials can make a significant difference to the overall economics of a new store and therefore to the price that an entrant will be prepared to pay for the site.

39 Buying price differentials are, therefore, an issue not just for their impact on the ability of existing small retailers to compete with the large supermarkets but also because the leveraging of this buying power into the convenience store segment is effectively excluding entrants and existing players wishing to expand from access to sites which are also attractive to the large players.

In summary

40 We conclude by summarising the issues on which we ask the CC to complete its further analysis or to clarify its current thinking.

- Could the CC complete its analysis of median expenditure per trip to different sizes of store by assessing the number of trips to each?
- Why does the CC think smaller stores do not constrain the behaviour of larger ones? When will the CC develop its thinking on this point?
- Why do supermarkets appear to stimulate the population of c-stores but reduce the population of other small specialist stores? Does the use that the CC has made of the EG database fairly support such a conclusion?
- What does the CC think the population of c-stores actually is?
- When may we expect to see something on the relevance to groceries of related products (such as fuel)?
- What does the CC think about the existence – and importance to competition – of a national market in wholesale grocery procurement?

- What explanation does the CC have for the fact that, to all intents and purposes, only the largest established players have opened new large stores in the past seven years?

Please do contact us if we can be of any further assistance.

Yours sincerely

James Lowman
Chief Executive