ANTI-COMPETITIVE SUPERMARKET ACTIVITY IN THE UK CONVENIENCE STORE SECTOR - (Perspective of an independent retailer)

THE CASE

The past three years have seen an alarming degree of penetration of the UK Convenience sector by supermarkets with market power. By one definition focusing on the medium sized neighbourhood store, which arguably forms the economic core of the sector the supermarkets have achieved a massive 25% market share in this short period – We might therefore be forgiven for extrapolating this incursion to the point of near oblivion for the independent sector within 5 years; if anti-competitive activity remains unregulated?

The retailer will be dismayed by the conjecture of industry pundits that supermarket behaviour has been at least partially encouraged by the Treasury in the mistaken belief that it would contribute to the substantial reduction of food prices in the UK. The core neighbourhood convenience sector accounts for just 10% of grocery consumption. Allowing for Tobacco, alcohol and impulse lines Tesco's vaunted 10% price advantage would lead to a 0.5% reduction in grocery prices if they were allowed to take over the entire sector. But, true to the monopolistic aspirations of firms with market power, as a position of monopoly is approached - so prices will inevitably increase. No wonder Julian Hunt, the Editor of The Grocer magazine, recently accused the OFT of making a number of regulatory decisions regarding the convenience sector that are 'plain stupid.'

With their deep pockets the supermarkets excel in obfuscating the key issues, to the point where respected industry advisors state that the independent sector has a rosy future, even if Tesco are allowed to open 2,000 Express stores. So, it is perhaps not surprising that the independent sector has been slow to react to events; only recently obtaining a consensus to petition the OFT for a Competition Commission review of the entire grocery sector.

We must ensure that we succeed in obtaining a review. It is argued that the extent of change in the sector within the past few years, means that only a holistic review exercise can determine whether there is sufficient common ground between the real long term 'public interest' and the pre-requisites of a viable independent convenience sector, to justify future investment on the part of the retailer?

THE 5 CRITICAL COMPETITION REGULATION CONFIDENCE TESTS:

The current government has established the practice of setting 'economic tests' as a precursor to any major economic decision and it is argued that the practice should serve the independent retailer equally well. Viz:

1) Effective policing of alleged incidences of predation and price flexing
2) Restrictions on the aggregation of buyer and supplier power.
3) Action to ban general below cost selling.
4) Competitive wholesale supply networks
5) Minimization of barriers to entry

1.0 Effective policing of alleged incidences of predation and price flexing.

One of the key influences in the original development of Anti-trust law in the USA, was the need to stop large firms from systematically picking off smaller competitors in regional markets with predatory pricing campaigns.

There is a general lack of evidence of regulatory action against a supermarket group with market power in the UK for predation. Indeed public interest concerns about price flexing in the 2000 CC review of the sector although articulated ,were accompanied by the fragile assertion that - it was considered that 'any remedy would be worse than the disease'.

It is highly unsatisfactory that the OFT should chose to pay lip service to a complaint by the Proudfoot Group, at the beginning of 2004, that Tesco had engaged in a predatory pricing campaign against it's Withernsea store. It has recently been revealed that Tesco initiated their campaign against Proudfoot with a derisory unsolicited offer to purchase the store. As the demographics of Withernsea strongly suggest that there is only sufficient demand for one supermarket - how can the subsequent decision to build a new Tesco store in Withernsea and wage an intensive 40% discount couponing campaign against Proudfoots be viewed as anything other then predation; especially when applying recent developments in industrial organizational theory, as reference by John Vickers paper on Abuse of Market Power, in Sept 2004.

It is vitally important to continued confidence in the OFT's ability and willingness to regulate the grocery sector that they respond with real vigour to this transgression.

2.0 Restrictions on the aggregation of combined buyer and supplier power.

In 1998 OFT economists published a seminal discussion paper 'The welfare consequences of the exercise of buyer power.' The authors warned against a situation occurring in the retail sector where a firm managed to combine significant buyer and supplier power. Such 'original power'(Dobson and Waterman 1998) would enable the retailer to maintain a degree of supra-profitability that would cause considerable welfare loss to the consumer. It would appear that Tesco have realized precisely this scenario in the past 12 months with profits of ca £2 billion and margins significantly higher than the rest of the trade. Quite how the outgoing Director General of the OFT, Sir John Vickers, allowed this situation to obtain on his watch despite the dire prior warnings of his economists, as yet remains unexplained?

The OFT and/or CC will need to demonstrate how this situation can be retrospectively resolved.

3.0 General below cost selling

This practice is forbidden amongst most of our European peer group countries. There is a substantial body of evidence to suggest that not only is this practice against the public interest but that it inevitably leads to higher grocery prices overall. (Surrey University research etc)

As independent retailers we know that nothing adds to the illusion of low prices on the part of the supermarkets than their deep below cost discounts on certain KVI items.

The OFT continues to deceive itself that its extreme market liberal stance has lead to lower food prices in the UK. How much longer can it sustain this misrepresentation when regulated markets such as the USA, Germany and France have significantly lower aggregate food prices and flourishing independent convenience sectors. ?

It is argued that there is a general duty upon EU member states to facilitate economic convergence and that a ban on below cost selling is therefore long overdue.

4.0 Competitive Wholesale supply networks

It is interesting to note that the often wrongly maligned Robinson Patman Act in the USA has delivered a strong independent convenience sector; low food prices and yet still allowed Wal Mart to establish itself as the worlds largest company.

The Act regulates to ensure that retailers in any sector obtain fair buying terms relevant to their size. Hence, if the OFT are convinced that the convenience sector is distinct to the one stop sector of the grocery industry – then it would follow if the RP Act applied in the UK that Tesco would not be able to apply its supermarket buying power to convenience sector purchases – Thus an equitable situation would be obtained . We would simplistically call this a level playing field – equally, it is just not cricket for the OFT to allow Tesco to run amok in the convenience sector with a 10% plus buying advantage and yet expect the existing wholesalers to continue to service the unattractive rural fringes of the UK which Tesco scorns).

It would also be overly simplistic to assert that the solution lies in further consolidation in a wholesale sector already dizzy with the frenetic pace of change. It is beyond dispute that independent wholesalers and retailers compete aggressively for every customer and site. Short of regulating to force suppliers to allow pan European independent buying groups to aggregate their volumes for discounts - Tesco's buyer/supplier power advantage would appear unassailable.

5.0 Barriers to entry

It could be argued that the single most important pre-requisite of a thriving dynamic market is the ability of nascent companies to emerge and challenge the historic sector leaders.

We already have a one stop grocery sector where 4 firms account for ca 75% of the market. Under the circumstances any significant additional barrier to entry on top of the economies of scale issue must be a very bad thing.

There can be no doubt that the unregulated bidding war for good sites and small retail groups is a substantial barrier to the emergence of dynamic new grocery retailers from the convenience sector in the UK. It is therefore essential to the long term vitality of the market that normal competitive conditions return as soon as possible. It is difficult to contemplate anything that could resolve this situation more effectively than an immediate resolve for a full CC review of the sector.

A FINAL COMMENT

A recurring theme encountered in opposition to the development of a case for regulation of the convenience retail sector is that the OFT only has the capacity to regulate on competition policy and that many of the sectors arguments for 'fair competition' encompass political social policy issues. It is therefore perhaps interesting to note that the founding father of UK market liberal competition policy, Adam Smith, stated the following necessary pre-requisite for a successful market liberal regime:

"…in the race for wealth and honours and preferments…..may run as hard as he can, and strain every nerve and every muscle, in order to outstrip all his competitors. But if he should jostle or throw down any of them, the indulgence of the spectators is entirely at an end. It is a violation of fair play, which they cannot admit of." *Theory of Moral Sentiments (1790).*

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