PARETO RETAIL–QUESTIONNAIRE RESPONSE (Originally 20/8/06, revised 19/03/07)

Main submission

We would be grateful if you could address the following issues within your submission to the CC.

1. How has the nature and extent of competition in grocery retailing situation changed since 2000? Do you expect this situation to change over the next 3 years?

   Please give your reasons for your answers.

   Competition in grocery retailing since 2000 has been primarily influenced by the problematic process of consolidation (it being argued there is no overarching rationale for consolidation in an expanding or even stable market); which is in itself a function of an arguably fundamentally defective approach to the regulation of the forces of market/buyer power and concomitant price discrimination. It is also important to note that a strong contributory factor has been the failure of the local authority planning process (and related guidelines) to consider market concentration matters in assessing grocery retail 'need', as foreseen in the 2000 CC Inquiry report.

   It is recognized that the generally accepted measure of grocery market consolidation is the aggregate market share of supermarkets deemed to have market/buyer power and another the HHI index of concentration, and that both parameters in the UK currently indicate that the forces underpinning the consolidation process continue to gather momentum. It should however be noted that the consolidation process equally applies to the c-store wholesale supply sector for apparently related reasons, and that this 'tipping point' argument has recently become moot with the controversial, allegedly anti–competitive, Nisa-Costcutter merger proposal. Thus hitherto, it is conjectured too little consideration has been given to measuring the vitality of the small business aspects of the sector (including the rates of formation/growth and decline/failure); which represent the flip side to the market/buyer power led consolidation issue – and arguably the more important in determining the prospects for long term diversity and competition in the market place. (The author suggests that the core regulatory challenge is to determine the best possible balance between the pro-competitive and anti-competitive forces at work in U.K. grocery retailing and that in economic modelling terms this will entail resolving the competing big business versus small business sector arguments, particularly with regard to innovation)

   To be clear, Pareto retail believe that it is critically important that the current Inquiry, having a specific mandate to investigate C-store activity, leaves no stone unturned in applying best international practice / the 'scientific method' of evaluating the impact of the various anti-competitive forces operating in the UK grocery sector on all dimensions of competition including 'innovation' and related SME vitality measures (It is noted that the FSB undertake some work in this latter area but with insufficient focus on the grocery sector to be of specific relevance).

   The measure of regulatory dissonance (in a normative sense according to he determinants of vitality in the SME retail sector) could be argued to have reached its apotheosis with the OFT decision to waive through the Tesco acquisition of

T&S Stores. An acquisition that Tesco then used as a logistical beach head to leverage their supermarket buying power into C-stores (perhaps an initiative partially facilitated by a flawed earlier decision to consider big stores and little stores as operating in separate markets). It is noted that the only external party known to support the original acquisition decision, the Consumers Association, has apparently performed somewhat of a U-turn and is now a strong supporter of the rationales underpinning the current CC Inquiry.

One of the consequences of the Tesco T&S stores development was to persuade Londis executives to seek to exit the sector by cashing in their ultra generous share option incentive schemes. Thus in December 2003, having previously informed the Executives that they would be ill advised to proceed with their proposals, the correspondent was drawn directly into the trade consolidation debate as Deputy Chairman of the Londis Shareholders Action group. Whilst engaged in this corporate governance battle it was observed that Tesco appeared to be involved in a serious abuse of their market/buyer power in Withernsea. The fact that the OFT appeared not to consider the Tesco initiative in Withernsea as predation against Proudfoots; caused the correspondent great concern not just in regulatory and corporate governance terms (although the allegations are obviously somewhat graver when they involve a supposed 'blue chip' company that is the dominant retailer of groceries in the UK), but also because of the implications for the future prospects of larger independent retailers in the UK. More generally, the cumulative effect of the various nugatory regulatory reviews of the sector since 1981 on the vitality of the small business sector, has been to signal to the vast majority of independent retailers that they should favour an exit mentality as the rational strategy.

Naturally, as a small retailer one anticipates that if the current Inquiry is as comprehensive as suggested; considering all the empirical data on a scientific basis, it will come to appreciate that the pendulum of regulatory impact should be swung vigorously to the opposite end of the spectrum. It is argued that this epiphany will need to be sustained despite political and big business lobby pressure to allow the practice of price discrimination to continue unfettered, with the obvious implication that the majors market power should be allowed to extend into every niche of the UK grocery market, eliminating virtually all significant independent competition and nascent innovation – (a phenomenon amply foreshadowed by Tesco's attempted predation in Withernsea). Some would say that the big business lobby, is premised on the fallacious argument that big business guarantees optimal long term consumer welfare, through higher efficiency and lower retail price inflation. In reality the facts speak otherwise and one need look no further than Tesco's 'One Stop' stores pricing practices to observe one of the many weaknesses in their argument. Again it is strongly recommended that empirical data should be interrogated to verify the degree to which the vitality of the SME sector might have a positive determining impact on the long term competitive equilibrium and structure of the U.K. grocery market.

As indicated it is hoped that current inquiry will signal a real determination on the part of regulators to facilitate conditions that nurture long term competition, allowing the small business formation process to re-establish itself as a vital force in the sector, ultimately reinstating the ladder to allow for the 'de novo' entry of independent convenience store operators as the innovative supermarket operators of the future (The law of averages applied to the UK convenience sector suggest that this might be termed the 'Patel Supermarkets plc test?')

The next two or three years will be crucial, but without such a break through the independent supermarket sector is fundamentally moribund and the prospects for real long term innovation and competition in the UK grocery market appears problematic.

Regulators, should also be wary to ensure that they take matters in the round – The UK grocery market is the sum of its parts at the local, regional levels and even national levels including Wales; Scotland and Northern Ireland. Clearly, consolidation at the local and regional levels in many instances is already far in excess of the danger level so it is critically important that regulators/government direct Local Planning Authorities to address concentration at the local level; measuring both aggregate dominance on the part of supermarkets with market/buyer power (with the initial conjecture being that 80% is an absolutely critical threshold) but also the degree of 'counter balancing vitality' of local independent retailers. The author would conclude this section with the argument that portfolio risk theory indicates that there is an overarching duty regarding the national economic interest to ensure that markets of vital strategic importance are suitably diverse.

(Please also see author's papers of 9/5/05 and 5/4/06 appended to Pareto Retail's main submission letter of 19/8/06).