

THE COMPETITION TEST: A FURTHER SUBMISSION BY TESCO

(8 JUNE 2007)

Purpose of this supplementary submission

1.1 The issue of a “competition” test has been raised by a few interested parties who appear to favour this form of regulation, including three of our major competitors, and the matter is in the public domain. So far we have made only limited comments on this issue in response to Emerging Thinking¹, as it is clearly inappropriate to consider remedies at this stage of the process. Nonetheless, given that these representations have been made, what follows are some brief comments on what we have seen so far² (were the Competition Commission (the CC) to wish to pursue this discussion, we would of course have a great deal more to say on the subject). Self-evidently, a “competition” test is an extreme form of regulation of competition, whereby an incumbent is placed under controls that disable it from engaging in competition for new space and/or increased share and thus in the market for grocery retailing. It would stifle competition, cause detriment to consumers and make markets work less effectively, not just in grocery retailing.

Why is the test being advocated?

1.2 The “competition” test is misconceived, and is in any event a misnomer. It suggests something benign and beneficial to customers, a remedy which is supposed to deal effectively with a situation that is anti-competitive and to produce something regulated and better. This would not be the effect. Trying to establish some series of local markets in which no single firm can have more than a certain number of stores or a fixed share cannot be expected to work in the interests of customers.

1.3 Proposals by rivals for such a test seem to us to be nothing less than an attempt to seek to recover a position that certain players have lost through their own inactivity. This attempt seems to be based purely on a general concern that Tesco is currently trading better than they are: it is certainly not substantiated by any evidence of an adverse effect on competition (an *AEC*). As Sainsbury acknowledged in its response to the CC’s Emerging Thinking, Tesco’s recent growth has been “*during a period when its competitors did not respond*”. Against such a backdrop, by its own admission, a competition test therefore cannot be necessary. Sainsbury has also described the market as “*largely competitive*”³, and it is common ground that consumers have gained significantly from the competitive rivalry evidenced in the grocery retailing sector. The concern voiced by these competitors, therefore, is surely not one to be remedied by the CC but by their own efforts – competing on the merits for entry against others⁴.

¹ See for example our overview response at paras 6.17 to 6.22.

² We have seen very little on the issue. If the parties advocating such a test have submitted more evidence to the CC than has been published, then this should be put to us in order to allow us a right to reply. If what has been published is the extent of the arguments made, then there is even more reason for this to be dismissed as the rhetoric that we believe it to be.

³ See *Overview of Sainsbury’s position* (20 October 2006), page 1.

⁴ This is happening. TNS data shows Wal-Mart/Asda growing ahead of all other retailers in recent weeks. Morrison is now performing very well again having successfully absorbed all of its former Safeway stores, Sainsbury has a stronger offer than for many years and in its response to Emerging Thinking describes the significant steps it is taking to raise its own competitiveness (and of course has attracted bid interest – demonstrating the attractiveness of the sector) and M&S is resurgent.

The test is unnecessary

1.4 Those proposing a “competition” test would have to demonstrate that it was necessary. We are not aware of any evidence being put to the CC - no evidence that there are parts of the country where competition concerns might arise (and even if the CC were to come to the conclusion that such areas might exist, it would have to demonstrate that these would not otherwise be remedied by the market), and no evidence that consumer detriment would be forthcoming in those areas. On the contrary, as recognised by the CC in its *Coordination Working Paper*, retailers compete all over the country and the evidence that we have provided to the CC demonstrates that the market is functioning effectively, and that there have resulted significant and widely recognised customer benefits. We do not believe therefore that any case has been made to justify a so-called “competition” test.

The evidence points to an effectively functioning market

1.5 The CC has recognised in its *Coordination Working Paper* that the market is competitive. By contrast, those seeking a competition test have provided no evidence that there are competition issues in local areas sufficient to warrant such a test. This is unsurprising. There have been many important developments since the CC’s report following the 2000 Groceries Inquiry. The first is that, in aggregate, there has been a substantial increase in the number of new stores, with the CC reporting 565 stores over 1,400 sq metres being opened by the major retailers since June 2001⁵. The second is that, even under the CC’s isochrone “rules”⁶, 94 per cent of the population have a choice of at least three supermarkets within their local areas. Using SSNIP, it is clear that the average number of stores in any properly defined local area is no less than 23. The third, highly relevant to a consideration of the “competition” test, is that in areas where the CC found a concern about high levels of concentration there has been significant new entry⁷ (contrary to Waitrose’s assertion⁸). The CC itself finds 70% of new floorspace since 1999 in such areas has been opened by retailers other than the one with the strong existing position⁹. In other words, the market remedied the CC’s fears in 2000 about land shortages, and competition continues to ensure sufficient choice to meet consumer demand. Moreover, these developments should be set against a backdrop of significant land being available for development¹⁰.

1.6 Of course, in some areas of the country, the population is low and only one or two different grocery outlets can be supported. This, however, is a simple economic fact and there is nothing harmful or anticompetitive about it. While we have seen assertions that there exist “*areas of restricted choice*”¹¹ we have seen no evidence from any of those proposing a “competition” test that there are areas of the country

⁵ *Barriers to Entry* working paper, paragraph 36.

⁶ See the CC’s *Safeway Report* (2003).

⁷ While we do not agree with the CC’s methodology, we revisited the 53 postcode areas where Tesco was found to have a ‘share’ of more than 25%. In 98% of these areas, at least one competitor has opened a store, and in 70% of the areas three or more competitors have opened stores.

⁸ See Waitrose’s *Response to Emerging Thinking* (16 February 2007).

⁹ *Barriers to Entry* working paper, paragraph 41.

¹⁰ Other retailers are making the most of this. For example, Wal-Mart/Asda plans to open 18 new stores in 2007 and Sainsbury plans to open 20 new superstores over 18 months.

¹¹ See, for example, *Asda Response to Emerging Thinking* (28 February 2007), para 2.1.

where a competition concern could *potentially* arise, and certainly no evidence that there are any areas where an AEC *does* arise.

1.7 This is because, even where one retailer is prominent in a particular area and/or there is high concentration, there is no evidence of any reduction of competition. This flows from the fact that competition is conducted at a national level. But even at the local level there is positive evidence of challenge to existing positions across the country where the economics of new entry are favourable. We have demonstrated as well that there is no further advantage gained by retailers already present in an area¹². Planning applies equally to all retailers; local economies of scale are immaterial; bidding incentives do not favour incumbents; and access to finance is available to all. Nor does Tesco seek to protect local positions (other than through competing fairly on the merits). Since 2000 a majority of our new superstores have been in a different location¹³ to existing stores. We are focused on growing our own business rather than engaging in practices with a view to restricting the entry of others. We buy land to open new stores in order to take our offer to customers who want to shop in Tesco. We develop sites as quickly as reasonably practicable. We do not waste time objecting to competitors' proposals and we have imposed restrictive covenants in respect of very few disposals of land parcels.

1.8 Finally, the planning regime already makes provision for qualitative need to be considered in gaining permission for new stores or extensions. PPS6 makes clear that local planning authorities should provide for "*genuine choice to meet the needs of the entire community*"¹⁴. This policy is reasonably new, and is only beginning to work its way through the planning regime (although – according to the CC's survey of LPAs – 45% of LPAs already consider the choice of grocery retailers available when reviewing planning applications¹⁵). It should be given time to bed down and, in light of this, further regulatory intervention is clearly unnecessary.

1.9 Indeed, since it is now clear from the Planning White Paper (May 2007) that Government is proposing to implement significant and relevant policy changes to the existing system, it would be inappropriate and premature to introduce another layer of complexity. The aim of the White Paper is to simplify planning policy and procedure. Indeed, the White Paper criticises the over-complexity brought about by multiple consent regimes (in the context of major infrastructure and generally)¹⁶. It would scarcely be in keeping with streamlining the planning process and making it more efficient¹⁷, to introduce a separate competition test.

There is no consumer detriment

1.10 In addition to demonstrating an AEC, those advocating a competition test would have to demonstrate that local areas with 'high' concentration caused consumer

¹² See our submission *No Local Incumbency Advantages*, dated 4 December 2006.

¹³ In other words, a different isochrone as defined by the CC in the *Safeway Inquiry*.

¹⁴ See, for example, PPS6, para 2.35.

¹⁵ See *Results from the Local Planning Authority survey on retail planning issues*, para 20.

¹⁶ Planning White Paper e.g. at paras. 1.34, 1.36, 5.8, 5.16- 5.18, 9.23-9.24. There are also proposals to simplify the complex new development plan system introduced in the Planning & Compulsory Purchase Act 2004: see Chapter 8 pp. 124-131.

¹⁷ Planning White Paper paras. 14.0-1.41 p. 20.

detriment. Again, they have apparently presented no evidence of this¹⁸, and the CC has put no evidence of this to us. On the contrary, the national strategies of the main players mean that customers in local areas get the benefit of the full force of national competition, even in those rare cases where there is a high degree of local concentration.

1.11 We have analysed over 125 different combinations of PQRS, local catchment definitions and measures of concentration. That analysis established (on a statistically sound methodology) that customers do as well in respect of all aspects of PQRS in areas of relatively high concentration as they do when fascia choice is higher¹⁹. These results are not surprising. They simply prove what we have been saying – that our product, and that of our main rivals (including those apparently in favour of a competition test), is a national product, where it would be irrational to deviate on the basis of the number of competitors adjacent to a particular store. A retailer would suffer damage to its brand and thus to its business across the country - due to the intense scrutiny that the sector is under (by both customers and interest groups) - were it to introduce what would be tantamount to a postcode lottery by providing a worse offering in some local areas. There is no reason to assume that this will change in the future.

1.12 Not only is there no evidence of consumer detriment, but the intense competitive rivalry in the market has led to significant and widely-recognised customer benefits: prices have fallen as part of a long-term trend, and certainly since the 2000 Groceries Inquiry; quality, range and service have improved; and innovation is a tremendously powerful dynamic. These benefits have occurred in every single location in the country. These facts cannot be overlooked in this Inquiry, although they have been ignored by those proposing a “competition” test.

1.13 A Provisional Finding that there is no AEC flows from the evidence. Those advocating a “competition” test have provided no evidence of either an AEC or consumer detriment. We and others have provided significant evidence that grocery retailing is an effectively functioning market and that customers are reaping the benefits of competitive rivalry, and the CC has recognised in its *Coordination Working Paper* that the market is competitive. Consequently, there is no need for any remedy, let alone the blunt and distorting intervention currently being proposed by, among others, three of our major competitors.

The test would be highly damaging

1.14 Even if those proposing a “competition” test could demonstrate that markets were not functioning effectively, and that customers were suffering (which we do not believe is possible), we would want to discuss with the CC the many and material reasons why a “competition” test is unworkable, entirely inappropriate and damaging.

1.15 In essence, such a test would place a barrier in the way of successful operators growing their business and would shield underperforming retailers from the full rigours of normal competition. If competition proved too tough for those given a

¹⁸ Wal-Mart/Asda has suggested some consumer detriment that *might* result from the Need Test (although no evidence has been presented that it *does* arise), but there is no logical connection between this, and imposing a “competition” test. If the Need Test is a concern, then it can be removed.

¹⁹ We will comment on the CC’s *Margin Working Paper* separately, but in the meantime would note that PQRS measures are the only relevant indicators of competition to the consumer.

“helping hand”, the test would stop the ordinary processes of competition by which popular retailers would extend their investment so as to meet increased demand for their services. Fewer stores that customers want would be opened, and fewer stores overall, as not all retailers are prepared to undertake certain types of development.

1.16 Such a test would also add inordinate complexity to an already complex planning regime. The test would require a detailed assessment of any particular locality in which a retailer wished to open a store. The relevant measure of concentration would have to be defined and measured. All of this would lead to business uncertainty. It would be impossible for any operator to know in advance whether the so-called “competition” test would apply, and would stretch the already pressed resources of the relevant regulator. And if the test was to be applied mechanistically, it may not – as a blunt instrument - be able successfully to measure competition, leading to perverse outcomes. It is clear, for the reasons set out earlier, that such a test would run wholly contrary to the core objectives of the recent Planning White Paper and its proposals to streamline the planning system in the light of the Barker Report.

1.17 We note that Sainsbury has proposed a market share test. If possible, this would be even more complex than one based on fascia choice, as it is unclear how retailers could be expected to measure their market shares in any particular area. It would also be innately unfair, as it would penalise those who make the best use of their floorspace and who have proven most attractive to customers, and would reduce the incentive of players to compete.

1.18 Nor would the impact be limited to sectors within the CC’s remit. For example, it would lead to reduced land values for land owners, as fewer retailers would be able to tender for sites, leading to a less competitive bidding market. This in turn would have major ramifications for property developers. Moreover, as much of our new space is designed for non-food, such a test would deny customers the pro-competitive benefits that Tesco and others have brought to non-food markets.

1.19 As a result of these, and a number of other significant concerns, we believe that such a test is just about the most anti-competitive measure capable of being taken by the CC in respect of UK grocery retailing.

Conclusion

1.20 The grocery retailing market is functioning effectively. Those arguing otherwise have not made out a case that an AEC is likely in any particular area, and have not been able to evidence any consumer detriment. Moreover, the arguments against a “competition” test, taking into account post-2000 developments and the legal framework introduced by the Enterprise Act 2002, put it at the extreme of regulatory intrusion. There is a high degree of probability that regulation of that kind would be far worse than a continuation of competition along the lines developed free of such regulation. As the Barker Report expressly cautions, planning issues do not lend themselves to “*silver bullet*” solutions²⁰, and had the CC intervened in 2000 when a similar test was proposed, many of the benefits of competition would have been lost. Nor should customers have their grocery retailer imposed on them by an inflexible rule imposed in a “*rush to regulate*”²¹. We believe that the facts of this

²⁰ See foreword to the *Barker Review of Land Use Planning*.

²¹ See CC’s *Submission to the House of Lords Select Committee on Regulators* (February 2007), para 33.

market and the tremendous customer benefits that competition has produced preclude the “competition” test from any further serious consideration in this Inquiry.

Submitted 8 June 2007