

**MARKET INVESTIGATION: THE SUPPLY OF GROCERIES BY RETAILERS IN  
THE UNITED KINGDOM**

**WAITROSE RESPONSE TO COMPETITION COMMISSION MAIN PARTY  
QUESTIONNAIRE: AUGUST 2006**

**MAIN SUBMISSION**

**Market definition**

In general, Waitrose considers that the conclusions of the Commission on these aspects of market definition in the 2000 Supermarket Inquiry and the Safeway Merger Inquiry were correct and remain correct. Waitrose also continues to consider that the store-centred isochrone-based model for identifying and assessing relevant local markets is a useful one for competition analysis and provides a useful level of certainty for supermarket operators. As far as Waitrose is aware this methodology has gained broad acceptance amongst operators in the grocery sector and has not been seriously challenged.

In addition to its general experience as a one-stop shop grocery retailer, Waitrose has particular experience of the impact of the local competition rules for acquisitions. This experience has been reflected in the emphasis of this submission.

**The Geographic Market**

Waitrose continues to consider that the relevant geographic markets are local in nature. Consumers exercise their choice of stores for grocery shopping locally. Consequently, competition for specific customers takes place among the stores in their locality. The competitive success of a store depends upon its ability to attract and retain custom from its catchment area in the face of competition from other stores in that catchment. Evidence that competition is local can be found in the various activities that all stores engage in to a greater or lesser extent to enhance their local offering and win local market share. Examples of such activities, their relative importance varying by store format and by operator, include price variation, local discount and voucher schemes, the enhancement of stores through refurbishments, local advertising and the fostering of local community relations (see in particular Waitrose's answers to Questions 44 and 47 below) .

**Shopping patterns**

Waitrose continues to consider, as the Commission has concluded in previous inquiries, that one-stop shopping carried out in stores of around 1,400 sq metres (approximately 15,000 sq ft) or more constitutes a distinct economic product market. Hence, grocery shopping can be divided into two product markets based upon the shopping mission: one-stop shopping and secondary shopping.

The two types of shopping are distinguished by the different demand characteristics of shoppers engaged in the two types of shopping mission. For one-stop shopping, customers clearly demand a wider range of products and choice within each product category, together with ancillary requirements such as car parking. For secondary shopping, a narrower range of products is required with fewer ancillary requirements.

### **Store size - overall**

In reality, there is a continuum of appropriate store sizes for different shopping missions - no single size can be taken as a critical threshold. However, Waitrose continues to consider that a sensible way to translate the concept of the one-stop and secondary shopping markets into workable rules is on the basis of the size of the stores involved.

It is clear that most one-stop shopping takes place at large stores because of the range of products and facilities available at these stores - making them particularly suitable for one-stop shopping. It is from around 15,000 sq ft that Waitrose believes that stores are very much competing for one-stop shoppers.

### **Store size - one-stop shopping at smaller stores**

Waitrose continues to consider that 15,000 sq ft is a reasonable point to draw the boundary between the two types of store. Nonetheless, Waitrose recognises that, whatever thresholds used, a limited amount of one-stop shopping will take place in stores below this threshold. The Commission has, in its previous inquiries, accepted that a limited amount of one-stop shopping takes place in mid-range stores, particularly if there is no one-stop shop nearby. It does not consider that this competitive constraint on shopping in one-stop shops is enough to include mid-range stores in the same market as one-stop shops, although this constraint is reflected in the inclusion of mid-range stores in the competitor set for one-stop shops if they have a retail area of at least 75% of the relevant one-stop shop (the “75%” rule). Waitrose continues to consider that this is generally a reasonable approach.

However, the application of the 75% rule alone may underestimate the impact on the one-stop shopping level of the market of the movement by a one-stop shop operator into smaller formats in local markets where it also operates larger stores. Such smaller stores may exert more of an upward constraint on the one-stop shopping market under the ownership of such an operator than would otherwise be the case. This may be a result of a deliberate policy of such an operator, or as a result of consumer responses, or a combination of the two.

### **Store size - Secondary shopping in one-stop shops**

The Commission has, in its previous inquiries, found that secondary shopping takes place in all sizes of stores and that it may constitute a significant part of the business of even large one-stop shops. This is reflected in the inclusion of one-stop shops in the assessment of competition at the secondary shopping level. Again, this seems reasonable and tallies with Waitrose's experience that its customers have a wide range of basket values.

### **Urban/rural split and drive times**

Waitrose considers that the travel times set out in parts (i) and (ii) of the question are probably reasonable. In its recent inquiries, the Commission has used a split between urban

and rural areas to identify the appropriate drive times in drawing isochrones. Waitrose considers that such a split does correctly reflect a willingness of and need for customers in rural areas to travel further than those in urban areas.

Waitrose accepts that the exact criteria used to classify an area as urban or rural will always be somewhat arbitrary. The same applies to the specific travel times applied for urban and for rural areas. However, such clear criteria do have significant benefits in providing supermarket operators with clear guidance as to possible store acquisitions. Further, Waitrose considers that the criteria used to determine the urban/rural split and the travel times currently in use have generally given outcomes which are appropriate in identifying the geographic scope of local markets.

## THE NATURE OF COMPETITION IN THE UK GROCERY MARKET

### Waitrose's competitor set

Waitrose competes mainly (and certainly as regards one-stop shopping) with the other national supermarket operators: Tesco, Sainsbury, Morrisons, Asda and Somerfield. Waitrose also competes with Booths in those local markets in which both operators are present. Although Waitrose also faces competition from smaller stores (eg Aldi, Lidl, Netto, Iceland and Marks & Spencer) this is on a significantly lesser basis because their various offerings fall well short of a full one-stop shopping grocery range.

### Competitive Strategies

Of the one-stop shopping competitors identified above, each offers a core range of groceries allowing one-stop shopping to take place in their larger stores, and some a reduced range in smaller, non one-stop stores. The characteristics of each of these competitors are somewhat different.

Chart 1 shows the retail landscape before 1995. At that time UK grocery retailers tailored their offer to appeal to a certain section of the population and the market was principally segmented along demographic lines. At the quality end of the market, Waitrose and Marks & Spencer were serving the more affluent customers, Sainsbury and Safeway the mid market customers and Tesco and Asda the less affluent customers.

Chart 2 shows the retail landscape today with competitors seeking to differentiate their competitive strategies along two key axes: **the quality vs price trade-off** (ie from high quality and service offers such as Waitrose to offers focused on price) and **the product mix trade-off** (ie food specialists vs food-led general merchandisers). In Waitrose's view the grocery market is now polarised along food specialist/food-led general merchandiser lines and dominated by price-general merchandisers with a consequential reduction in choice for consumers for whom the quality and provenance of their food is important.

Another significant development in the market over the last decade has been the move of Tesco and Sainsbury into the secondary shopping market (and, in particular, the convenience market). Waitrose's understanding is that, whilst the exact offerings of each of its competitors varies between store formats, the various factors differentiating each operator from its competitors are the same for all formats. However, the move into smaller store formats has, in itself, become a factor differentiating the supermarket operators.

## **Current Nature and Description of Competition**

Waitrose does consider that there are ways in which competition is not working optimally within the grocery market. Like the OFT in its reference decision, Waitrose's key concerns are with local competition and the impact of the planning process.

### **Local competition**

Waitrose considers that the local competition rules developed by the Commission in the Safeway Inquiry have provided a useful framework for subsequent acquisitions by supermarket operators. The rules have provided a good approximation of the choice available to consumers and a high degree of predictability for the assessment of possible store acquisitions. As outlined above, Waitrose considers that the various thresholds and criteria applied within the local competition rules have been set at or around the right level. Waitrose also considers that the threshold for identifying a local competition problem of a fascia count to three or fewer is the right one.

### **The role of the planning process**

As the OFT noted in its reference decision and as the Commission noted in its statement of issues, the planning process and issues surrounding the general availability of sites are key to the way in which competition takes place in the grocery market. Waitrose considers that the planning regime continues to be fundamental to the structural problems in the UK grocery market because it restricts the availability of sites and does not take local competition issues (and, in particular, the qualitative aspects of consumer choice) into account.

Waitrose notes the need for an orderly planning process, even though this process inevitably creates a barrier to entry beyond the pure barrier of the limited number of appropriate sites. However, Waitrose considers that the planning process has a number of negative impacts on possible new entry, with the overall effect of significantly adversely affecting competition within the one-stop shopping market. Further, there are also negative impacts on the non-food market where retailers are located in high streets and town centres.

- (a) The difficulties of opening new one-stop shop sites give a significant advantage to incumbents which already have one-stop shop sites. This is particularly the case where an incumbent has an out-of-town one-stop shop, established before the planning guidelines changed to make such developments harder. Such out-of-town developments are generally the least expensive to operate, as well as now being the most difficult to obtain planning permission for.
- (b) The relative ease with which permission to expand an existing one-stop shop can be obtained reinforces an incumbent's advantage. Again, this is particularly the case where the incumbent has an out-of-town site, since such sites generally have space around them which can easily accommodate expansion.
- (c) The "sequential test" in the current planning guidelines means that a would-be new entrant is generally only able to consider a site closer to the town centre. Such sites generally have significantly higher property costs (rent/purchase

price per sq ft) than an out-of-town site, and the development costs of the site are also likely to be higher (eg because improved access roads may need to be built). Their generally smaller size also limits the scale of the shop that can be built and reduces the efficiency of the operating model with a consequential adverse impact on profitability.

- (d) Where an incumbent is already in a particular area, it may have more of an economic incentive to acquire a new site. This is because, in addition to any further contribution to the incumbent's profits that the site may itself make, acquiring a site can serve as a strategic barrier to entry. It may be economically rational for an incumbent to acquire a site for which it believes it will not receive planning permission simply in order to keep out a rival. The planning process itself can take several years and, even if permission is granted, there is no obligation on the purchaser to develop the site promptly, or at all.
- (e) This land bank approach can sometimes be on the basis of acquiring whole sites. However, it is not always necessary for an operator to acquire full title to a site in order to prevent a new entrant from developing the site. Operators are able to obtain much the same effect by acquiring an option over a site, which they can exercise in the event that a rival wishes to acquire it. Similarly, an operator may acquire a small piece of land within a larger site with potential for development as a one-stop shop, preventing development of the site as a whole.

Waitrose does not have access to any details of the size of the land banks, whether held for planned future developments or purely as a strategic barrier to entry, of any of the other one-stop shop operators. Waitrose is pleased to note that each of the OFT's reference decision, the Commission's Statement of Issues and the Questionnaire reflect the fact that the planning process and access to potential sites can also be manipulated to act as a deliberate barrier to entry.

## **CHANGES SINCE 2000 AND PREDICTIONS FOR THE NEXT THREE YEARS**

### **Structural changes**

The period since 2000 has seen a large volume of disposals/acquisitions of stores. Key amongst these is the acquisition by Morrisons of Safeway. Waitrose assumes that the Commission is familiar with these changes.

Given the difficulties with developing new sites, Waitrose considers that the disposal and acquisition of stores will continue to be an important feature of the grocery market over the next three years. Given the concentrated nature of the market at a national level, Waitrose considers it unlikely that any existing national supermarket operator would seek to acquire the whole of another national supermarket operator's estate of stores, since the Commission's conclusions in its 2003 Report on the bids for Safeway would suggest that such an acquisition would be blocked. Waitrose considers that any wholesale acquisitions of a national supermarket operator are more likely to involve an acquisition by a financial or overseas buyer. This has already happened with Somerfield.

## **The growth of Tesco**

The other key development on a national scale has been the continuing growth of Tesco. In its 2000 Report the Commission found that Tesco had a 23.0% share of all grocery sales. In its 2005 report on the acquisition by Somerfield of stores from Morrisons, the Commission found that Tesco's share had grown to 29.5% of all grocery sales.

## **Movement of one-stop shop operators into smaller formats**

The other key change in the market since 2000 has been the continued expansion into smaller formats, including convenience stores, by some of Waitrose's competitors. This move has impacted not only on smaller shops (of which Waitrose has limited experience), but also, to some degree, on one-stop shops.

## **The growth of non-grocery sales**

Waitrose is a food specialist; it has not introduced non-grocery sales to any significant extent in the vast majority of its stores and does not have any plans to do so.

As noted in the charts at *MPQ2*, a number of Waitrose competitors have moved significantly into selling non-groceries. Recent press speculation suggests that Tesco will be the biggest retailer in the UK of non food as well as food by the end of 2006. Waitrose considers it likely that (and a number of one-stop supermarket operators have declared their intentions so to do) those of its competitors currently selling non-groceries will expand this side of their business still further, but does not have any information on individual competitors' plans in this area. These points are further dealt with in the response to Question 6 below.