Wm Morrison Supermarkets plc

COMPETITION COMMISSION

Market Investigation : Retail Grocery Supply in the UK

Main Party Submission

Introduction:

This submission will possibly be the shortest you receive from one of the "Big Four". Why? Because we simply want to get on and be allowed to develop our business in a straight-forward, commercial manner. We do not flex prices in that, other than fuel prices, our retail selling prices are the same UK wide. We do not operate convenience stores, given that our Mission is to be "The Best Grocer in Town" and as such we need a minimum of 15,000 sq. ft. of sales area to give our customers an attractive and comprehensive grocery offer. We do not have a land bank because we buy land to build a grocery store and, as soon as we have all the necessary legals in place, we get on and build the store in order to commence earning a return on our investment.

At Morrisons we work to a reasonably simple business model. We seek to contain our cost base whilst offering our customers a wide choice of food products at good value. We do not operate the size of store which would allow us to offer a wide range of either specialist non-food products (such as high priced electrical items) or a full range of clothing. Our aim is to satisfy as many people as possible with our food offer and be recognised as "The Best Grocer in Town". However, our offer does include regularly purchased items of non-grocery products, which we believe customers are happy to buy (and expect to be available) on their frequent visits to their supermarket. We also offer a seasonal range of non-grocery items such as gardening and leisure products in spring and summer.

Our food specialism is supported by a number of pack-houses and factories from where we deliver to our shops fresh food products which we choose to prepare for sale in-house rather than purchase from a third party. This gives our customers very fresh products and gives us a point of difference.

We operate 5 major fresh produce pack-houses and Farmers Boy – a fresh food factory producing primarily meat based products such as bacon, sausage, burgers, and pies, along with pizzas and cheese. We also operate two major abattoirs with associated meat packing facilities to break down meat carcasses into primal cuts for final in-store butchering.

We also prepare, or finish, many fresh food products in-store to add to our reputation as a food retailer and to offer our customers a retail experience that has some theatre and is that little bit different from other supermarkets. This in-store fresh food offer is branded as "Market Street".

In summary, we are what we told the Competition Commission we wanted to be in 2003 – a very good food retailer giving customers from Inverness to Penzance a wide variety of food products from which to choose. We clearly stated we wanted to be different from our major competitors – especially Tesco and Asda – in remaining primarily a retailer dedicated to food, and this is what we are focussed on delivering nationwide.

The Issues:

1. (a) Grocery Retailers relationship with their suppliers

The majority of the supply base to the grocery industry is reasonably common across the retail and wholesale customer base – especially, of course, the supply of branded products. At Morrisons we work on the premise that we need good suppliers as much as we need a good, loyal and growing customer base. Relationships with suppliers are critical to the totality of our in-store offer and therefore, whilst we expect strong support and loyalty from our suppliers, we also generally need them as much as they need us. We are, of course, demanding of them, just as our customers are of us, but we know that they will only continue to support us if we deliver to them relative to our supply agreements.

The knowledge of how other major customers deal with their suppliers is only available to us "second-hand" via trade gossip and the media. If the latter was correct in reporting how Asda, in spring 2006, were demanding huge sums of money from their supply base to support their P&L position, this would be a negotiating stance we would not recognise. Similarly, we have heard of unilateral decisions by competitors to extend payment terms to their supply base. This again is not something that we believe is acceptable as we clearly understand that payment terms are an element of cost prices and the supply agreement.

We believe that each supply agreement at a single point in time is the ongoing summary of one-to-one negotiations between this Company and the supplier in question. It is an evolving partnership – usually over many years – and one which we believe should encourage our supply base to have confidence in business tomorrow, in addition to business today.

Whilst, since we acquired Safeway, we have been through a period of integration which has involved both forced and voluntary store sales (and therefore reduced combined volumes), we have now returned to “business as usual”. In supply chain terms this means working hard with efficient and innovative suppliers to grow our business by better serving our joint customers, the ultimate consumer. Indeed our supply base is generally supportive of our aim to be the best grocer in the (approx) 360 locations where we are now established and from where we intend to grow our business. Our suppliers indicate their clear desire to have four major customers with whom they can also expect to grow their sales.

A year ago they were fearful because all their growth was coming from Tesco and this, as far as they were concerned, was an unhealthy position from which they had, perhaps, suffered. Now they are seeing growth from ourselves and a recovering Sainsbury’s. This they see as a more balanced position.

However, it is obvious that Tesco’s 30% market share must enable them to be much more demanding of their suppliers – especially major branded suppliers – in terms of buying prices. Few suppliers – whether national or international – could contemplate not having distribution of their products through Tesco’s store network. Similarly, in terms of buying strength, the addition, over the recent past, of many smaller stores has added very measurable volume to Tesco’s total purchasing strength – as, indeed, has their large store development programme through the past 3 years. During this time we have been very involved in integrating Safeway with our core business, and Sainsbury’s have needed to concentrate their people on stabilising their business and getting onto the recovery road.

1. (b) Market Definition

In 2000, and also confirmed in 2003, the Competition Commission defined the grocery market as being split into two. The primary market for one-stop grocery shopping was served from stores of at least 15,000 sq. ft. of sales area and a secondary market where consumers topped-up their grocery needs from smaller stores. In 2000 the major players were generally operating from larger stores (15,000 sq. ft. plus) and were rarely involved in running smaller stores. The latter were generally operated by the smaller multiple retailers (e.g. Co-op and Budgens), symbol groups such as Spar and Londis, and a host of independent convenience store operators. We believe that the market definition was correct at that time.

Over the past few years the grocery retail market has continued to evolve – influenced by two major factors. The first is the continuing development of major (15,000 sq. ft. plus) supermarkets mainly built and operated by the “Big Four”, and secondly scale entry into the smaller/convenience store grocery market by Tesco and, to a lesser extent, Sainsbury’s. The reach of the major stores has extended as those store numbers have increased and the product offer in the smaller stores has widened and improved as Tesco and Sainsbury’s have developed their skills through their smaller store estate.

There is, therefore, now not the distinction there was – especially for people in major conurbations – between primary and secondary grocery shopping. They will top-up in a larger store as they would in a smaller store simply because of availability and convenience of larger store locations due to their growing numbers. Alternatively they may carry out a big basket shop in a large Tesco near the weekend and top up in a smaller Tesco on a Monday or Tuesday.

Therefore the increase in major conurbations of larger stores, plus the spread of recognisable fascias across the spectrum of store sizes, has had a "blurring" effect on the market so that the strict definition agreed in 2000/03 is now much less the case. The prime catalysts for this were Tesco's acquisition of T&S stores and the rapid growth in large store numbers (primarily fuelled by Tesco) in the past 5 years.

In more rural areas, with low population densities, the market still operates in a similar way to 2000/03 in that people need to travel to a larger store, perhaps once a week or once a fortnight, on a major grocery shopping trip and top up locally (particularly for fresh/perishable items) during the intervening time.

A further "blurring" of the market has resulted from the introduction of the home delivery services provided by some major grocery retailers in some parts of the UK. The use of such services falls into two major categories – those people short of time to shop in the normal manner, and those people who want the bulky/heavy groceries delivered home and who will then shop separately for fresher foods – either in a supermarket, a smaller store, or a high street specialist.

1. (c) Competition

The grocery business at retail level remains very competitive and this has further intensified since we acquired Safeway in March 2004. Safeway over 2002 and 2003 had become in value terms very uncompetitive and resultantly Tesco, Sainsbury's, Asda and ourselves had all been taking business from them which should naturally have been theirs (i.e. people were by-passing conveniently located Safeway supermarkets to reach competitor outlets seeking better value).

However, since we lowered the prices in Safeway stores to Morrisons levels both prior to and since conversion, and as Sainsbury's have similarly become more competitive, we now have four consumer propositions which are all offering good value. Through a combination of our ongoing competitive pricing and the strongest promotional programme in UK grocery retailing we measure our value on a level with Tesco and Asda, with Sainsbury's not the distant fourth they once were.

With the Safeway brand gone and therefore fewer major players from which to take business, we seek to grow our market share by encouraging the return of those customers who had developed the habit of by-passing former Safeway stores now converted to Morrisons – and the much better value that this has brought.

The "Big Four" are all fighting for market share on a value platform, hence the reason why customers are benefiting from a very competitive market place.

Whilst value dominates the UK grocery retailing scene, value in Asda and (to a greater extent than in Sainsbury's or ourselves) in Tesco is dominated by price – particularly price on major national and international brands. Whereas value in Sainsbury's and ourselves centres on the overall in-store offer – including particularly the fresh food offer – and a combination of quality and price. Price perception is driven in our instance by ongoing competitive pricing and a very strong promotional programme throughout all our departments – particularly majoring on multi-save offers such as "buy one, get one free" and "two for the price of xxp". Our total value proposition comes from these two price perception factors plus the quality and value delivered by our fresh food offer.

Asda and Tesco are developing extensive non-food ranges especially in their Supercentres (Asda) and Extra Stores (Tesco). Asda, with the backing of WalMart, have even extended their non-food range in smaller stores by reducing the choice of groceries and the overall in-store space devoted to their grocery offer. At Morrisons, whilst we offer frequently purchased non-food items to our customers, we concentrate the use of our in-store space on our grocery offer and by doing so play to our strengths.

Our competitors have developed a financial services offer – to a greater or lesser degree – seeking to capitalise on customer footfall and perceived brand strength. Again, we have chosen not to do this at this time, believing that we should concentrate our efforts on achieving a very solid and growing grocery business from the merging of the best parts of the Safeway retail estate with Morrisons. Our strategy is therefore very clear – play to our strengths in grocery retailing and food processing. We seek to be acknowledged by consumers as "The Best Grocer in Town". A store where they know they will be well served, having shopped in an interesting and lively store, offering as wide a choice of food as the vast majority of consumers would want .

1. (d) Price Flexing and Loss Leading Prices

All our retail prices, throughout our main stores and also across the narrow product offer in our kiosks alongside our petrol filling stations, are exactly the same. (Due to the vagaries of the motor fuels market we do price motor spirit and derv according to local conditions and the competitive situation). This commonality of approach applies similarly to our strong promotional offer and to the various seasonal product ranges.

The only time you will find differences in retail pricing is where a store has to mark down the retail price due to excessive stocks as a "sell-by" date approaches or where one store has remaining stock of a manufacturer's special price marked stock (and other stores have cleared the latter and returned to standard pack at normal price).

Asda have a similar policy to that described above, whereas Tesco and Sainsbury's vary their prices nationally according to the format under which the store operates (the Tesco example would be: Extra, Supermarket, Metro or Express). Our three major competitors operate similar (flexible) pricing policies on motor fuels.

Reverting to 2000, our competitors would then also make retail pricing decisions based on the demographics of a particular geographical area and the extent of competition. This practice now appears to have ceased and retail pricing decisions are fascia/store size specific.

Safeway had many pricing levels according to store size and location. As we converted them to Morrisons they moved to our one single price file, resulting in much better value for our customers.

We only sell products below cost because we have to do so on certain products in order to remain competitive. It is not something we would choose to do were we not forced into it by the actions of others.

The resulting impact is that other prices in our stores are higher than they would be if we did not need to sell some products at a loss to remain competitive. This is because we require a budgeted gross profit mix relative to the costs of running our business and the requirement to make an acceptable return on sales and on the investment in our asset base. This gross margin requirement would not change were loss leaders unnecessary. The prices of the latter would, of course, be higher but other products would no longer require the higher gross margins to compensate for loss leaders.

2. (a) Impact of the Planning System on Competition in Grocery Retailing

The basic premise of planning in terms of food retailing is governed by The Town & Country Planning Act, and various national-level statutory documents such as PPGs (previously), and PPSs (now), both of which are basically similar. There are also a number of Ministerial Statements and, at a lower level, Unitary Development Plans or Local Plans (which are being phased out) and the Local Development Framework (being phased in). All of these dictate the framework of planning policy and it is under planning policy which all planning applications are judged and determined.

In essence the priority of planning policy and its implementation through development control is to protect the vitality and viability of existing city, town, district and local centres rather than promote competition between food retailers.

Although planning policy clearly states that it is not its intention to restrict competition between food retailers, its inability to distinguish between different fascias is a fundamental flaw. All food stores are treated generically in planning terms. There is no particular consideration given to a retailer promoting a new store within a catchment area in which it has no existing representation. Neither is there any restriction on a retailer with existing representation promoting a new store in the same catchment area, even if that means a single operator will control the only two stores in the area.

The two basic tests which now apply are those of "need" and the "sequential approach", the latter being determined on the basis of protecting the vitality and viability of existing centres by promoting new retail development as close as possible to existing centres.

There is no test allowed or envisaged within the planning system as to whether or not an individual operator considers that they can actually trade successfully in a particular location, and this is potentially anti-competitive.

To give an example – in a particular area there may be existing representation from (say) Asda, Sainsbury's, Tesco and thereafter Waitrose, Somerfield, the Co-op, and the discounters. In addition there may be one or more extant planning permissions which have not yet been implemented.

These are deemed to be "committed schemes" in planning terms even if they are without support from a named operator, or unlikely ever to be built for other reasons (e.g. land assembly difficulties or abnormal costs).

In any planning application we make we would be judged on whether, in light of the existing stores and commitments, there was a need either of a quantitative or qualitative nature which showed that a Morrisons store could be accommodated in the catchment area and whether the proposed site was sequentially close enough to the existing centre to promote its vitality and viability.

Our commercial view in applying for planning permission is that we could trade successfully in this particular location, notwithstanding the competition. The planning regime, however, could effectively create a barrier to entry and if the Competition Commission (as they did in 2003 with the Morrisons/Safeway merger) favour four fascias in any location, the planning system could well stop this, and potentially therefore is anti-competitive.

The remedy to this situation is not easy. At its extreme it would require an amendment to the Statute or Ministerial Statement, and it would be our view that any Ministerial Statement should incorporate a relaxation on the requirement to establish both the quantitative need and the sequential approach aspects of the planning regime.

Clearly, planners and legislators in the above have in their minds the issue of saturation when they refer to impact on vitality and viability. However, our argument is that we are food retailers primarily, and that food retailing should not be subject to the sequential approach. It is largely done by car-borne shoppers and is, of itself, a bulky goods operation – e.g. one or two weeks' shopping for a family of four is not something you can take home on public transport.

We would welcome a slight relaxation in the planning regime, but only in locations where such a relaxation would remove the barrier to entry to the fourth major fascia, thereby increasing competition.

2. (b) Land Acquisition and Disposal relative to Competition

We do not have a land bank and we never have had one. We acquire sites with the specific and only intention of developing them as soon after the grant of planning consent as practical.

We have never acquired a site with the intention of developing it and thereafter sold it on undeveloped to another operator. Equally, we have never acquired a site in a location where we already have representation with the intention of selling it on for an alternative use (whilst imposing a restrictive covenant prohibiting the sale of food).

In terms of acquiring sites on a long term basis (land banking), we are not aware of other operators having a policy of doing so. We have no experience of having been out-bid in a competitive situation for a site and thereafter the successful bidder leaving the site undeveloped for a long period of time.

What we do see from the interim or year end statements and press releases of other major players is that they have announced high numbers of developable sites, and they could not possibly open all the stores concerned in the particular period of time announced. We strongly recommend that the Competition Commission probes this situation and, if our major competitors have land banks in areas where four fascias are not already represented, there should be a mandatory divestment of those sites. This should be on the same basis that the Competition Commission found in the 2003 Inquiry using the same mechanics for disposal contained in the Undertakings which we and others agreed.

Summary:

Our response to "The Issues" in this submission is therefore summarised as follows:

- Customers are our life-blood, suppliers help us feed them. Without good suppliers we would not be in business.

- Food shopping is our business and the grocery market is more homogeneous than it ever has been.

- Competition is intense and the consumer is well served by the Grocery Industry. Tesco has capitalised over Sainsbury's period of relative weakness and our concentration on integrating and converting Safeway and they are now very dominant.

- Competitors flex prices by store format/size – we sell grocery and non-grocery products (excluding fuel) at the same prices nationwide.

- We do not encourage below cost selling – we would prefer not to have to do so but competition dictates necessity.

- The priority of planning policy, which seeks to protect vitality and viability of existing shopping centres, does not necessarily promote competition in grocery retailing – especially given its inability to grant a planning permission to a specific fascia.

- Once planning permission is granted for grocery retailing it should be mandatory that the store is developed within a (very short) specified time period. Otherwise the land and associated permission must be divested to others willing to develop the store.

Thank you for asking Morrisons to respond to the Issues Statement. Our response to the detailed questionnaire will follow.

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