WORKING PAPER ON RETAIL COMPETITION

Introduction

1. The focus of this working paper is on retail-level competition between grocery retailers, and in particular, the structure of local markets for groceries and the conduct of grocery retailers and consumers in those markets. Our inquiry is also considering the groceries supply chain and whether there are features of the supply of groceries to retailers that give rise to adverse effects on competition. These supply chain issues are not covered in this paper, although they have been discussed in recent working papers (eg Working Paper on Supply Chain Practices and the Supermarkets Code of Practice).

2. The paper draws together a number of aspects of retail competition that the inquiry has considered. These include the results of our margin-concentration analysis and entry analysis, our assessment of barriers to entry, including land holdings and planning issues, and our consideration of the waterbed effect, pricing practices and possible co-ordination between grocery retailers. We have had a substantial amount of feedback from parties on the working papers that we have published on these subjects. This paper, insofar as is possible given that we continue to receive submissions, takes this feedback into account and in a number of areas presents modified versions of our previous work.

Summary and overview

3. The paper reviews recent trends in outcomes for UK grocery consumers, such as grocery prices, product range and innovation. These trends suggest that, to the extent that there are market features that constitute an adverse effect on competition, they are not, at present, causing a national-level deterioration in prices, product range or levels of innovation when compared to the position reviewed by the

Competition Commission in its 2000 investigation of supermarkets. Other indicators of market outcomes, such as product and service quality, are harder to measure objectively, but at present, we see little evidence of widespread consumer detriment with respect to product and service quality.

4. While these national-level indicators give a reasonable sense of the scale of the impact on UK consumers of any possible competitive problem, the positive trends that are observed do not mean that there is an absence of features that have an adverse effect on competition. It is possible that national-level outcomes for consumers could be even better than we currently observe. Further, there may be localised effects that are obscured in national-level statistics. Finally, we will have regard to the interests of future consumers, and whether it is reasonable to expect that certain features of the current market may lead to detrimental outcomes in the future.

5. Consistent with the findings of the CC's investigation of supermarkets in 2000, it appears that in some areas of the UK, some consumers have a limited choice of supermarket fascias (see paragraphs 76 to 79) and this could be reducing the extent of competition in grocery retailing in these areas. This, in turn, may be flowing through to both an inferior retail offer for consumers in those areas where competition is weaker (ie the localised effects referred to in paragraph 4) and, given factors such as uniform national pricing, a poorer outcome for consumers more generally (ie as mentioned in paragraph 4, national-level outcomes might be even better than we currently observe).

6. There appear to be barriers to entry to grocery retailing markets (see paragraphs 80 to 92), which may be making it difficult for competing retailers to open new stores in

areas of high local concentration, thus allowing a limited choice of fascias to persist in some areas and contributing to continued weak competition in those areas. This may arise partly from the way the planning system is designed and applied, and partly from the way in which land suitable for development is acquired and held.

7. The structure of this paper is as follows:

- first, we review developments in grocery retailing in the UK since the CC's previous market investigation into supermarkets reported in 2000;
- second, we briefly review our work to date on market definition and set out the resulting context for our analysis of retail competition;
- third, we examine retail competition between larger stores;
- fourth, we assess retail competition in the convenience sector; and
- finally, we consider the issue of possible coordination between grocery retailers.

Developments in grocery retailing in the UK since 2000

8. This section reviews developments in grocery retailing in the UK since 2000, focusing on two key areas. First, changes in the landscape of retail competition in terms of both consumer shopping behaviour and the way in which grocery retailers operate. Second, changes in market outcomes in terms of prices, product range, innovation and store choice.

Retail competition landscape

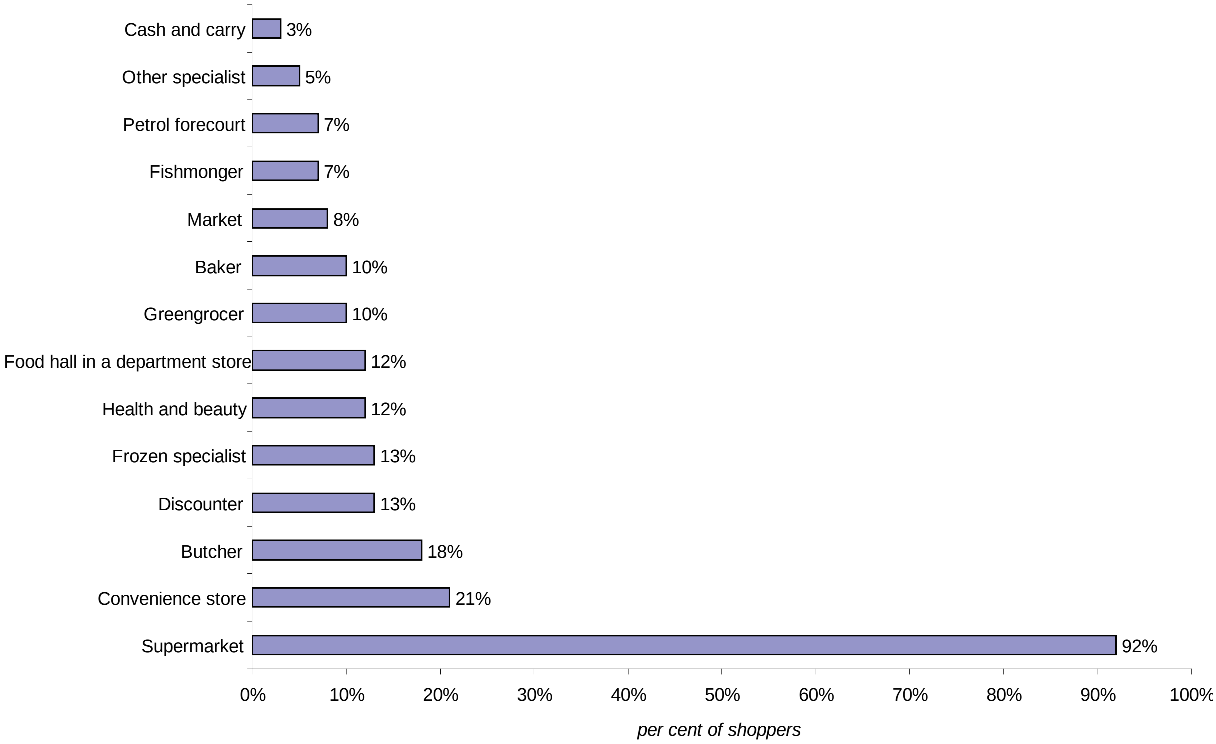
Consumer shopping trends

9. The major trends in consumer shopping behaviour, observed since 2000, have been a decline in the prevalence of the weekly shopping trip combined with an increase in the volume of convenience or top up shopping undertaken by households. Nearly 59

per cent of consumers reported shopping once a week in 2007[1] compared to 70 per cent in 2000.[2] Further, 24 per cent of consumers reportedly shopped more than once a week in 2007[3] compared with 16 per cent in 1999.[4]

10. Consumer research suggests that demographic changes and an increased emphasis on healthy eating are supporting these changes in shopping habits.[5] Households are becoming smaller, with more elderly and single people leading to growth in smaller shopping missions with more tendency to top-up. The increased emphasis on health and healthy eating may also be driving more frequent shopping, spread among more retailers, as shoppers purchase more fresh and chilled food.

FIGURE 1 Shoppers using different outlet types for food and grocery shopping



Source: IGD *Shopper Insight*, 2004.

1 IGD Shopper Trends in Product and Store Choice, 2007.
2 CC, Supermarkets: A report on the supply of groceries from multiple stores in the United Kingdom, CM4842, October 2000.
3 CC, Supermarkets: A report on the supply of groceries from multiple stores in the United Kingdom, CM4842, October 2000.
4 IGD Shopper Trends in Product and Store Choice, 2007.
5 Tesco Insight Unit, Express Brand Review 2005: what customers tell us, August 2005.

11. Supermarkets continue to be the most commonly used outlet for the purchase of groceries. More than 90 per cent of households use a supermarket for grocery shopping compared to 21 per cent that use convenience stores, 18 per cent that use a butcher, and 10 per cent that use a greengrocer (see Figure 1).

12. Shopping behaviour is discussed further in our Working Paper on Grocery Shoppers' Characteristics and Behaviour.[6]

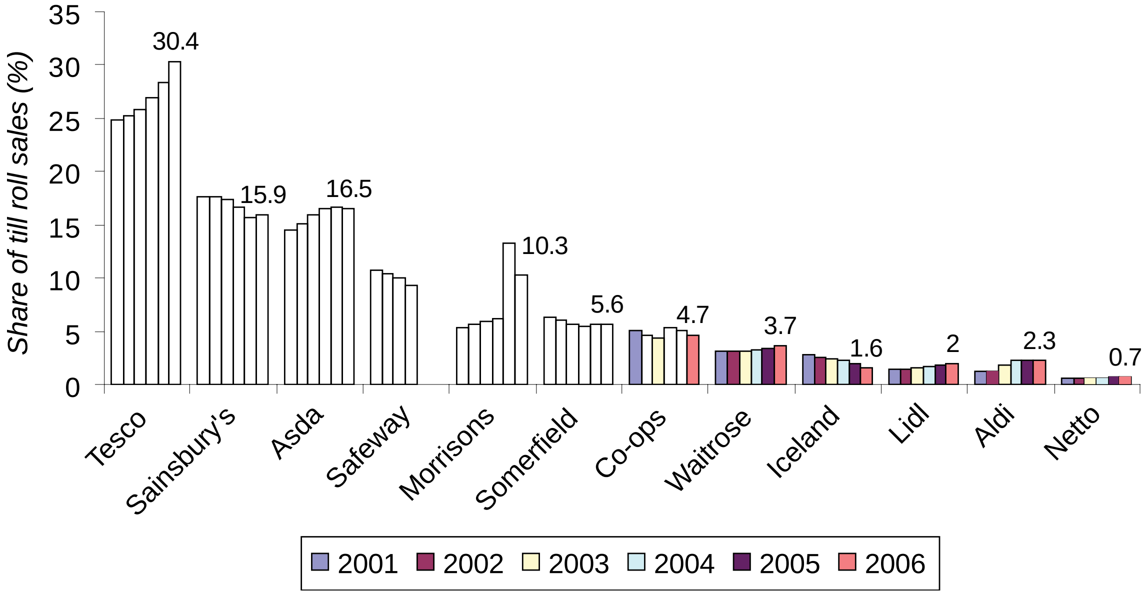
Retailer profiles and store numbers

13. Since 2000, non-tobacco grocery sales have increased by 15 - 20 per cent in real terms to £101.7 billion[7], while at the same time the real price of food has declined by around 7 per cent. This growth in sales has been seen at both supermarkets (26 per cent) and convenience stores (19 per cent). However, sales at specialist grocery stores such as butchers and greengrocers have only increased by 1 per cent in real terms over this period.

14. In the period since 2000, Asda, Morrisons and Tesco each increased their share of all grocery sales at supermarkets and convenience stores, with the major increase by Morrisons stemming from its acquisition of Safeway. Sainsbury's lost sales share over this period (see Figure 2).

[6] See www.competition-commission.org.uk/groceries.html/
[7] IGD, *UK Grocery Retailing*, September 2006, UK Grocery Market – Breakdown of Sales by Category in 2006. This number differs from that quoted in Emerging Thinking which also included non-grocery and tobacco sales.

FIGURE 2 National sales shares by grocery retailer, 2001 to 2006



Source: IGD Grocery Retailing 2005 and 2006, quoting TNS total till roll data, for 52 weeks ending February of the relevant year.
Note: National sales shares exclude sales at specialist grocery retailers and other grocery outlets.

15. Major changes in the strategy of UK grocery retailers over the period since 2000 include:

- Morrisons' acquisition of Safeway in 2003 and its subsequent sale of a number of ex-Safeway stores to other grocery retailers;
- entry by Tesco and Sainsbury's into the convenience store format through the acquisition of a number of convenience store chains;
- consolidation within the Co-operative group of companies, including Co-operative Wholesale Society's merger with Co-operative Retail Services in 2000 and the currently planned merger of the resulting Co-operative Group (CWS) Limited with United Co-operatives;
- the ongoing exit by Co-operative Group (CWS) Limited from the larger store format and a number of substantial acquisitions in the convenience sector;

- significant expansion by M&S into the food sector through the development of the Simply Food format so that it now operates 205 standalone Simply Food stores compared to only 23 in 2000.
- the expansion by Waitrose's into the north of England and Scotland, primarily through the acquisition of a number of ex-Safeway stores from Morrisons;
- Somerfield's purchase of 115 ex-Safeway stores from Morrisons in 2004 and its sale of the Kwik-Save chain in 2006; and
- Kwik-Save's recent entry into administration.

16. Further details of these and a number of other transactions in the grocery retail sector are provided in Table 1. A brief profile of individual grocery retailers is provided in Annex A.

TABLE 1 Grocery retailer merger and acquisition activity, 2000-07

2000	Somerfield sells 46 stores to Co-Operative Group (CWS) Limited, Asda, Sainsbury, Tesco, Waitrose and Morrisons.
	Co-operative Wholesale Society merges with Co-operative Retail Services (500 outlets worth £4.7bn) with 1,100 food outlets post-merger.
	T&S stores acquires 98 Day & Nite Stores Ltd (£25.5m).
2001	Costcutter acquires 30 Alldays stores.
2002	Co-Operative Group (CWS) Limited acquires 600 Alldays convenience stores.
	Tesco acquires 870 T&S stores.
2003	Morrisons acquires Safeway.
	Ripplegen Ltd acquires 121 Tesco-supercigs & Tesco-supernews stores.
	Co-Operative Group (CWS) Limited acquires 114 Balfour stores.
2004	Waitrose acquires 19 Morrisons stores (14 ex-Safeway) and an additional 5 in 2005.
	Sainsbury's acquires 14 Morrisons, 114 Jacksons, 6 Beaumonts, and 54 Bells stores.
	Somerfield acquires 115 stores from Morrisons (ex-Safeway).
	Tesco acquires 45 Adminstore stores including Europa, Harts and Cullens and 10 Morrisons stores (ex-Safeway).
	Musgrave (Budgens in the UK) acquires Londis (wholesaler to 1,947 outlets) worth £115m.
	Asda acquires 4 Morrisons stores (ex-Safeway).
	Co-Operative Group (CWS) Limited acquires 64 Conveco stores.
2005	Sainsbury's acquires another 9 Morrisons stores (ex-Safeway) and 5 stores from SL Shaw Ltd.
	Asda acquires 12 Morrisons stores (ex-Safeway).
	Tesco acquired 21 petrol stations from Morrisons (ex-Safeway/BP).
	Oxford, Swindon, Gloucester and West Midlands merge to create Midcounties, the UK's fourth-largest co-op.

2006	Waitrose acquires 6 stores from Morrisons.
	Somerfield sells 248 Kwik Save Stores (171 to BTTF).
	M&S acquire 28 Iceland and 12 Somerfield stores.
	Ilkeston and Midlands co-ops merge; Ipswich & Norwich merge with Colchester & East Essex to create East of England Co-op; Brixham and Plymouth & South West co-ops merge.
2007	Kwik Save Limited (previously BTTF) is placed in administration, 101 stores closed and remaining 56 to be transferred to Fresh Express.
	Midcounties Co-op acquires Stars News shops with 150 stores; Leeds and Sheffield co-ops merge with United Co-operatives Limited; East of England buys Anglian Convenience stores with 20 stores.
	Merger between Co-Operative Group (CWS) Limited (1700 outlets) and United Co-operatives Limited (621 food outlets).

Source: Main parties, OFT.

Note: The list in this table is not exhaustive. For example, Tesco's acquisition of a former Co-Operative Group (CWS) Limited store in Slough in 2003 is currently the subject of a separate merger investigation by the CC.

17. In addition to this merger and acquisition activity, there has been a significant program of new store development amongst UK grocery retailers over the period since 2000. In this period, the major grocery retailers have opened 613 newly built stores larger than 280sq metres and 357 of less than 280 sq metres (see Table 2). This information should be seen in the overall context that the total number of grocery outlets has declined since 2000.[8] [9]

[8] Emerging Thinking, Table 1. Note that since that publication we have gathered additional research that indicates further levels of refinement are appropriate for this statement. The original statement was based on an interpretation of data obtained from IGD which has now been added to by Experian GOAD data. This point is discussed further in this paper at footnote 78.
[9] The number of new builds in Table 2 comes from a summary of responses by industry retailers and does not reflect store closures nor distinguish significant expansions that have required a temporary store closure for a period (and been recorded as a new store opening by the retailer).

TABLE 2 New builds and acquisitions June 2001 to June 2006

	New Builds (greater than 280sq m)	Acquisitions (greater than 280sq m)	New Builds (less than 280sq m)	Acquisitions (less than 280sq m)
ASDA	[✂]	[✂]	[✂]	[✂]
Cooperatives	[✂]	[✂]	[✂]	[✂]
M&S	[✂]	[✂]	[✂]	[✂]
Morrisons	[✂]	[✂]	[✂]	[✂]
Sainsbury's	[✂]	[✂]	[✂]	[✂]
Somerfield	[✂]	[✂]	[✂]	[✂]
Tesco	[✂]	[✂]	[✂]	[✂]
Waitrose	[✂]	[✂]	[✂]	[✂]
Lidl	[✂]	[✂]	[✂]	[✂]
Aldi	[✂]	[✂]	[✂]	[✂]
Netto	[✂]	[✂]	[✂]	[✂]
Others	[✂]	[✂]	[✂]	[✂]
Total	**613**	**1,028**	**357**	**1,779**

Source: CC Analysis of MPQ responses

18. In the convenience sector, the entry by Tesco and Sainsbury's and the expansion by the Co-operative Group (CWS) Limited, has been accompanied by a substantial shift into various symbol groups by non-affiliated independent convenience stores, such as Spar and Premier. In our Working Paper on Entry and Exit of Small and Specialist Stores we further discuss trends in convenience store numbers and ownership.

19. Total grocery retailing sales area has increased 13.7 per cent by since 2000 (see Table 3). Consistent with Table 2, the biggest increases in retail sales space have been by Morrisons, Asda and Tesco.

TABLE 3 Major UK Grocery Retailers, UK sales area 2000-2006

UK Sales Area sq m 000s (000s sq ft)	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	Change Over (%) 1 yr	5 yrs
Tesco	1,632 (17,564)	1,734 (18,667)	2,025 (21,800)	2,155 (23,200)	2,287 (24,615)	2,408 (25,919)	5.3%	47.6%
Sainsbury's	1,246 (13,413)	1,307 (14,067)	1,412 (15,199)	1,465 (15,770)	1,521 (16,370)	1,575 (16,957)	3.6%	26.4%
Asda	943 (10,153)	983 (10,584)	1,050 (11,300)	1,133 (12,200)	1,179 (12,688)	1,396 (15,024)	18.4%	48.0%
Safeway	952 (10,249)	957 (10,304)	977 (10,514)	996 (10,718)	n/a n/a	n/a n/a	n/a	n/a
Somerfield	1,030 (11,087)	1,014 (10,914)	995 (10,710)	949 (10,220)	989 (10,642)	907 (9,767)	-8.2%	-11.9%
Morrisons	364 (3,917)	383 (4,120)	394 (4,241)	420 (4,526)	1,158 (12,468)	988 (10,633)	-14.7%	171.5%
Marks & Spencer	1,156 (12,440)	1,136 (12,229)	1,147 (12,349)	1,187 (12,782)	1,198 (12,896)	1,216 (13,093)	1.5%	5.2%
Waitrose	220 (2,364)	222 (2,386)	246 (2,650)	251 (2,707)	294 (3,166)	329 (3,543)	11.9%	49.9%
Iceland	344 (3,700)	344 (3,700)	339 (3,645)	336 (3,613)	344 (3,701)	311 (3,343)	-9.7%	-9.7%
Total	**7,883** **(84,847)**	**8,096** **(87,142)**	**8,585** **(92,408)**	**8,894** **(95,736)**	**8,969** **(96,546)**	**9,130** **(98,279)**	**1.8%**	**15.8%**
Morrisons + Safeway	1,316 (14,166)	1,340 (14,424)	1,371 (14,755)	1,416 (15,244)	1,158 (12,468)	988 (10,633)	-14.7%	-24.9%

Source: IGD, *Grocery Retailing 2006*

Note: conversion to sq m from sq ft was undertaken by the CC

20. In the future the major grocery retailers intend to continue their expansion. Tesco has stated elsewhere that, over the course of the current financial year, it expects to open a further 85 Express stores in addition to the 15 it has already opened, representing more than a 10 per cent expansion in the Tesco Express network.[10] Sainsbury’s has reported that it plans 30 new supermarkets, 75 extensions to existing stores, and 100 new Sainsbury’s Local stores by 2010.[11] Asda has told us that its five year real estate plan envisaged it being able to open approximately [✂] new stores per annum including acquisitions.[12] Waitrose has stated that its ten year plan is to double its network to around 400 stores.[13] M&S also plans [✂] new

[10] Statement by Paul Ritchie “TESCO Express boosts expansion in UK” Planet Retail 6/7/07.
[11] J Sainsbury plc Annual Report 2007.
[12] Asda MPQ Response at paragraph 123.11.
[13] Statement by Mark Price “WAITROSE boss stresses expansion plans” Planet Retail 9/7/07

franchise stores in BP forecourts, a further [✂] franchise stores in other locations, and [✂] Simply Food stores this financial year.[14]

Changes in grocery retailing outcomes for customers since 2000

21. A sense of the effectiveness of competition in the grocery retailing sector can be gained through reference to the outcomes the industry has delivered to customers nationally on price, quality of products, range of products and service levels (ie the PQRS factors discussed in Emerging Thinking and other Working Papers). While not all of these variables are readily amenable to objective measurement at an aggregate level, we discuss trends in a number of these areas, particularly prices, product range, product innovation and store choice, in the following paragraphs.[15]

Food prices

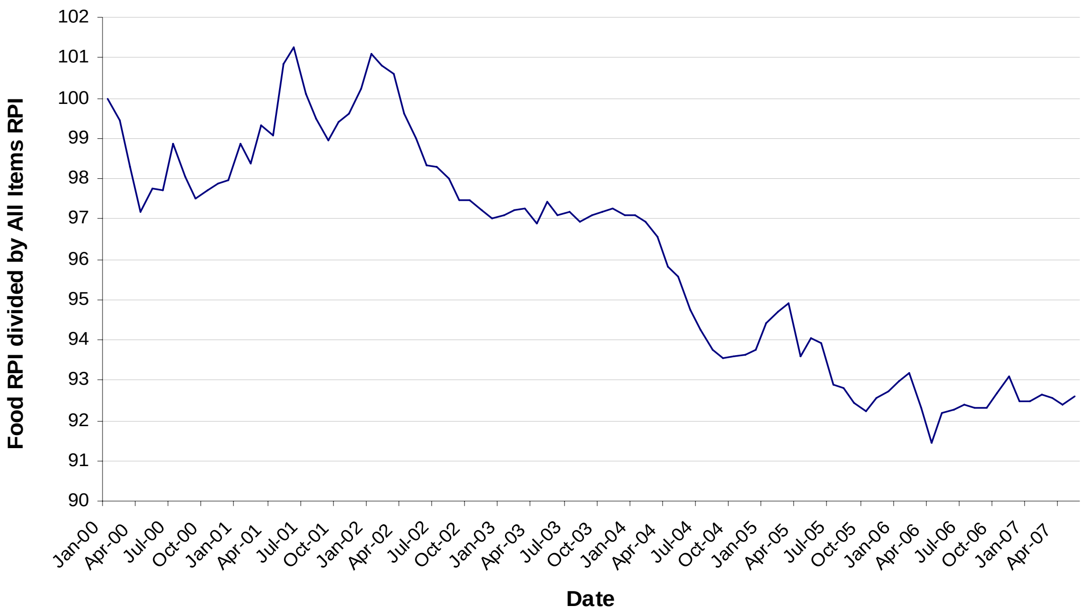
22. An approximate 7 per cent reduction in real food prices has occurred since 2000 (see Figure 3) and this continues the trend observed in the 2000 investigation.[16] This is likely to have delivered significant benefits to grocery shoppers as shopping bills for the same basket of goods would be lower than would otherwise have been the case.

23. However, in recent months the downward trend that has been observed since 2000 has largely levelled off. This is most likely due to increasing prices for food commodities such as cereals and the knock-on effect in areas such as meat

[14] M&S 2nd hearing Transcript 7 June 2007, lines 6-13, page 30.
[15] Trends in these market outcomes, while providing a useful indication of the effectiveness of competition, cannot provide a definitive answer, however. We must also be concerned with whether performance might be better than that which is observed, whether there are local variations that need to be considered, and whether the trends that are currently observed are likely to continue into the future.
[16] CC, Supermarkets: A report on the supply of groceries from multiple stores in the United Kingdom, October 2000, par.1.4(i).

production.[17] There is some concern being expressed from major food manufacturers that "significant and long-lasting" food price inflation is likely.[18]

FIGURE 3 Changes in real food prices



Source: CC Analysis based on ONS RPI data

24. Some concerns have also been expressed about the pace of food price increases in the UK compared with other EU countries.[19] However, a number of grocery retailers have challenged the accuracy of the CPI measure and told us that UK food price increases are in reality closer to 2-3 per cent.[20] We were also told that the grocery supply chain in the UK is particularly competitive with perhaps smaller retail margins than other EU countries. Given the small retail margins, we were told that increased costs in the supply chain, such as rising energy prices, are likely to be more quickly reflected in food prices than in other EU countries.[21] A further factor in food price inflation may be the recent growth in demand for premium food products that

[17] Cereal prices are increasing due to factors such as increased demand in countries such as China and India where dietary patterns are changing, and due to the increased demand for certain cereal crops for bio-fuel production.
[18] Financial Times 6 July 2007, "Nestlé chief fears 'significant and long-lasting' food price inflation, p1.
[19] Specifically, that an increase of 2-3 per cent in food prices in other EU countries should be compared to an approximately 6 per cent increase in food prices in the UK. See "Food price inflation is hard to stomach", *Scotland on Sunday,* 3 June 2007.

consumers are substituting for lower priced goods.[22] More generally, international price comparisons may provide another means of assessing price outcomes for UK grocery retailing. However, there are a number of problems associated with this kind of comparison, such as differing property rents, planning regimes and comparability of the retail offer. As a result, we have not pursued this approach in this investigation.

Product range

25. Data provided to the OFT by the four major grocery retailers indicate that in 2004-05[23] there was an average of 41,500 lines stocked by these retailers, an increase of 40 per cent over five years (see Figure 4). Grocery retailers have also told us of the large numbers of new lines that have been introduced in recent years. In most cases, this amounts to at least 2,000 new products each year for each of the four largest grocery retailers.

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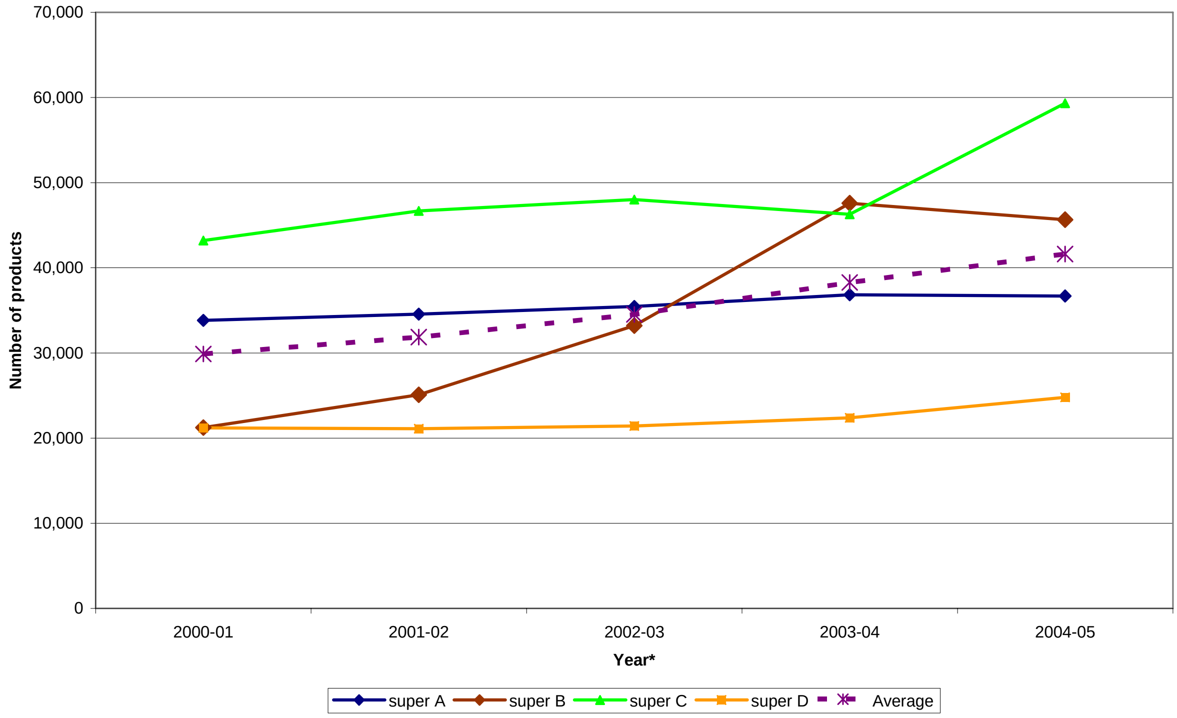
[20] See Co-operative Group (CWS) Limited Transcript – 2nd Main Party Hearing 19 June 2007, page 86, lines 16-20, Tesco Transcript – 2nd Main Party Hearing 20 June 2007, page 8, lines 29-34.
[21] [✂]; Morrisons Transcript – 2nd Main Party Hearing 19 June 2007, page 23, lines 2-12.
[22] Morrisons Transcript – 2nd Main Party Hearing 19 June 2007, page 23, lines 13-23, Tesco Transcript – 2nd Main Party Hearing 20 June 2007, page 8, lines 9-14.
[23] We are in the process of updating the figures in this chart.

FIGURE 4 Supermarkets' choice of product lines in all groceries



Note: * Years may not correspond exactly between supermarkets
We are in the process of updating this figure.
Source: OFT calculations based on data provided by the four largest supermarkets.

26. Own-label products form an important part of this product range. In 2006, sales of own-label food and drink products were an estimated £30.0 billion, representing more than one-third of total food and drink sales.[24] The share of own-label sales in the UK is amongst the highest in Western Europe.[25]

Product innovation

27. A substantial volume of evidence points to a healthy level of product innovation, new product development and expenditure on research and development in the grocery supply chain, although we note that concerns have been raised regarding whether

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[24] Own-label food and drink sales in 2006 were estimated at £30.0 billion in Mintel, *Own-label food and drink intelligence*, (October 2006), while total food and drink sales in 2006 were estimated at £82.6 billion in IGD, 2006. The British Brands Group estimates the share of own-label products in total UK grocery sales (not just food and drink) at 43 per cent.
[25] See J Steenkamp, I Geyskens, K Gielens and O Koll, *A global study into drivers of private label success*, report commissioned by AIM, the European Brands Association, 2004, for cross-country comparisons and explanations of the prominence of own-label products.

we might expect this level of innovation to continue in the future.[26] We have also been told of various innovations in service delivery by grocery retailers, such as the development of self-scanning checkouts and infra-red technology for the management of checkout staffing levels.

Store choice

28. Store choice is one area where the high level statistics are not as reassuring as those in other areas. In 2000, the CC stated that it had concerns that in some areas of the UK some consumers had a limited choice of supermarket fascias for one-stop grocery retailing (ie stores operated by different supermarket groups). In particular, the CC was concerned that any further local concentration could weaken competition in some areas.

29. One of the factors that has emerged in public debate since the 2000 inquiry has been concern about so-called "Tesco Towns", such as Bicester and Inverness (ie urban areas where Tesco has a high concentration of stores). In a number of these towns the increased presence of Tesco stores has resulted from its rapid expansion in the convenience sector. This issue is discussed further at paragraphs 64 to 76 below.

30. In our Emerging Thinking we noted that only 35 per cent of the urban population in the UK has a choice of at least three different grocery outlets larger than 1,400 sq metres within a 10 minute drive time of their house. In rural areas 24 per cent of the population has a choice of at least three different grocery outlets larger than 1,400 sq metres within a 15 minute drive time.[27]

[26] A selection of this evidence is contained in our Emerging Thinking, January 2007.
[27] In 2000, the CC investigated the choice of supermarkets available to consumers locally. It considered that it was not feasible to investigate the competitive conditions of almost 2,000 individual stores, so undertook a screening exercise to establish whether there were significant numbers of areas where the choice of supermarket fascia appeared to be limited. Please see Paragraph 76 for our analysis using these criteria.

31. Further, in our Working Paper on Barriers to Entry we noted that areas of high concentration (at the postcode level identified in the 2000 Inquiry) appear to continue to be areas of high concentration now, despite some entry by competing retailers in these areas. We discuss in paragraphs 72 to 75 the impact of local concentration on store margins, and by implication, the retail offer to consumers in those areas.

32. The argument has also been put to us that store choice is something that should be valued in its own right, not just because of its impact on the behaviour of grocery retailers. In general, access to a range of different stores, including large supermarkets and convenience stores, as well as specialist grocery retailers, is valued by a significant number of consumers.[28] Consumers may also place a significant value on the presence of complementary fascias that provide a choice of different products and different price points (eg a mainstream supermarket and a discounter).

33. However, in other cases, choice of fascias may be less important. For example, the research[29] indicates that consumers place a significant value on the presence of a convenience store within 5 minutes, but it makes little difference whether it is independent or owned by a major grocery retailer – even in those areas where the nearest convenience store and large supermarket are both owned by the same retailer.[30]

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[28] Advanced Institute of Management Research (AIM), Are consumers getting what they REALLY want?: Initial Findings from a Major Survey of Consumer Satisfaction with their Local Selection of Grocery Stores. Presented at a Workshop on 15 June 2007. See http://www.competition-commission.org.uk/inquiries/ref2006/grocery/pdf/third_party_submissions_other_org_advanced_institute.pdf

[29] Ibid.

[30] On 3 August 2007 the ACS made a submission that supports the conclusions reached in the Advanced Institute of Management Research. However, in direct contrast to the finding summarised at paragraph 33 above, the ACS also considered that this research shows that an independent store contributes the most to consumer satisfaction, ahead of both Tesco Express and Sainsbury convenience stores. In our view, the research shows only a marginal distinction and in any event the conclusions reached in the paper are unambiguous when it is stated small store facia makes little difference to consumer satisfaction with assortment.

Market definition and retail competition

34. Our work to date on market definition has focused on store size and fascia in terms of the product market. With regard to fascia, our analysis to date indicates that:

    i. Asda, Morrisons, Sainsbury's, Tesco and Waitrose all compete in the same product market;

    ii. M&S stores impose a sufficient competitive constraint on the stores listed in (i) to warrant its inclusion in that product market; but

    iii. there is insufficient evidence to warrant the inclusion of the LADs (ie Aldi, Lidl and Netto) and Iceland in that product market at present, though we note that this may change in the future.

35. We are continuing to assess the extent to which other fascia should also be included in the same product market as those discussed above. Many of these fascias, such as Somerfield and the Co-operative Group (CWS) Limited operate significantly smaller stores than many of those operated by Asda, Morrisons, Sainsbury's and Tesco.

36. Looking specifically at store size, our margin-concentration and entry analyses to date indicate that:

    i. as a general rule, large stores impose a competitive constraint on smaller stores, but smaller stores do not impose a similar competitive constraint on larger stores;

    ii. there is a valid distinction in competitive terms between stores larger and smaller than 280 sq metres in net sales area given the regulatory constraints that operate at this store size threshold; but

    iii. the distinction that the CC has previously drawn between stores larger and smaller than 1,400 sq metres in net sales area may no longer have any great significance.

37. While we consider that the specific distinction between stores larger and smaller than 1,400 sq metres in net sales area may no longer be significant, we do not consider that stores throughout the size distribution above 280 sq metres impose an equal competitive constraint on each other. As we note above, larger stores appear to constrain smaller stores. We also consider that smaller stores above 280 sq m are, in some cases, able to impose a competitive constraint on larger stores sufficient to justify their inclusion in the same product market. We have previously mentioned the possibility of a 75 per cent threshold in relation to assessing relative constraints. But, it is unlikely that such a threshold would operate uniformly across the entire size distribution of grocery retail outlets. We are still assessing whether there are one or more points within the size distribution of stores larger than 280 sq metres where a distinction can be drawn in terms of the competitive constraint that smaller stores are able to impose on larger stores.

38. In this regard we continue to undertake relevant quantitative analysis as well as examining factors such as the distribution of various store facilities (such as the availability of at-store parking) and in-store counters (such as deli and fish counters, and in-store bakeries) across different store sizes and the distribution of store fascias across different store sizes.[31]

39. For the purposes of the analysis of retail competition in this paper, however, we have, in large part, grouped together all stores above and below 280 sq metres. We recognise in our analysis that some factors, such as various barriers to entry, may impact differentially on stores larger than 280 sq metres. To the extent that we consider that a useful distinction can be drawn between stores larger than 280 sq metres, then this will be reflected in any subsequent analysis that we conduct.

[31] We refer to these store facilities and counters collectively as "store features".

40. With regard to geographic market definition, in order to capture the geographic scope of the relevant markets, we have identified in our analysis to date that the most significant competitive constraints for a particular store is exercised by stores within 10-15 minutes drive-time around that store. The extent of competition in an area will, of course, vary according to factors such as population density and local topographic features.

41. We continue to adopt an assumption of local geographic markets for the purposes of the analysis in this paper. The majority of parties to the inquiry agree that competition in grocery retailing is characterised by local geographic markets, while also noting the national aspects of competitive interactions between grocery retailers. However, we continue to receive submissions from one major grocery retailer, in particular, that the relevant geographic market is national or that if markets are local, the majority are at least 30 minutes wide in terms of a drive-time.[32] We continue to look at the analysis and arguments that have been submitted in relation to this. In the event that our view on the scope of the geographic market changes as a result of our consideration of these arguments, then this will be taken into account in our consideration of retail competition.

Competition between larger grocery stores

42. This section discusses the nature and extent of retail competition between operators of larger grocery stores (ie stores larger than 280 sq metres in net sales area).

- First, we discuss the way in which operators of large grocery stores compete in terms of taking steps at a national as well as at a local level. In doing so we set out how national competitive initiatives, in areas such as pricing, could still be consistent with local geographic markets.

[32] Please see Paragraphs 60 to 62 for a discussion of the interaction of national and local competition.

- Second, we review the link between local concentration and competitive outcomes at both a local and national level.
- Finally, we discuss barriers to entry and how these may enable local areas of concentration to persist over time.

Competitive initiatives at the national and local level

43. Many aspects of the retail offer at any individual store operated by a grocery retailer are set centrally, and will apply uniformly across the grocery retailer's store network. Any variations of the retail offer will, in large part, be a response to factors such as store size and local demographics, rather than local competitive conditions. [33]

44. Pricing, in particular, has limited variation across the store network for most grocery retailers. Nearly all of the main parties set national prices, such that prices are uniform across all stores of a particular format and fascia. For retailers such as Tesco and Sainsbury's, there may be a price variation between their smaller convenience and larger supermarket format stores. However, they have told us that these price variations reflect the higher operating costs of smaller stores rather than the local competitive conditions that these stores face.[34]

45. The Co-operative Group (CWS) Limited is the one grocery retailer that operates a pricing policy that is significantly different to that outlined above, and explicitly takes into account local competitive conditions. The Co-operative Group (CWS) Limited's pricing system does not involve the setting of prices individually at a store level, but

[33] For example, Tesco told us that its store managers are able to make a limited number of range selections in order to ensure customers have the best possible choice of products. The ranging of products according to local demographics can be seen with the Tesco World Foods Price News leaflet, which lists the 25 Tesco stores that sell the selection of products shown. [Annex A] Tesco also told us that it may also operate an additional four to five promotions each week in those stores that are identified as being in low-income areas. [MPQ response to Q11] At the second hearing, Sainsbury's told us that it would consider putting in a fish counter at a store where the local population were slightly older and tend to consume more fish. [page 24]

utilises a system of price bands.[35] The price band to which a store is allocated depends on store format (convenience or not) and will also depend on local competitive conditions.

46. Somerfield defines price tiers for its stores according to the cost to serve, local demographics and competitor intensity. It has a system of determining or varying the format of a store according to these conditions: any store facing highly competitive conditions defaulted to the 'standard' format whilst stores in less competitive areas that were expensive to service or operate (eg the Scottish Highlands and Islands) might become 'premium' or 'convenience' formats.[36]

47. This greater uniformity of pricing at the national level for most grocery retailers has, we understand, been introduced in large part since 2000. Prior to 2000, we understand that grocery retailers engaged in a greater degree of localised price flexing. Vouchering is another means by which grocery retailers might adjust prices locally, and we discuss this further in paragraph 51 below.

48. Other competitive initiatives that are taken centrally by a grocery retailer and applied almost uniformly across the store network are promotions, product range, product placement planning (ie development of planograms), marketing and advertising (which in large part is fascia rather than store-specific), and staffing levels. For the most part these initiatives are determined centrally and applied to each store to take account of its characteristics, such as store size and local customer preferences:

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[34] We note that Tesco sets higher prices in their smaller store formats and that Sainsbury's sets higher prices for certain types of product in their smaller store formats. We have been told that the higher prices reflect higher costs associated with operating these stores. Tesco also puts some of its Metro stores on more expensive formats because of the higher costs of operating in some areas. Finally, we note that prices are generally uniform across fascia but not retailer – Tesco charges higher prices at its One Stop stores than at its Tesco Express or Metro stores.

[35] The Co-operative Group (CWS) Limited told us that 98 per cent of its stores are placed in one of four bands. Additionally, Northern Ireland has a discrete band and there are two pilot bands. Of the four principle bands, three are designed for convenience stores and separate 'core estate' from acquisitions which are in the course of transitioning to the lower pricing of the core estate.

[36] Other local price adjustments are described in our Market Definition Working Paper (January 2007). http://www.competition-commission.org.uk/inquiries/ref2006/grocery/index.htm

i. Promotions: ASDA has a national price file and generally rolls out promotions [✂].[37] Sainsbury's has a national promotional programme that is set centrally.[38] Tesco plans product promotions centrally for all its stores. Each of these stores will run promotions from a national promotions list according to the size of the store and the range of products stocked.[39]

ii. Product range: ASDA selects the number and choice of products stocked in a store from the total range available according to [✂], though it will review the range available in a store when [✂].[40] Sainsbury's determines the range of products available in a store to take account of store size, region, affluence and ethnicity.[41] Tesco has a central system to provide a variety of ranging options for each group of products that are located together in-store. It uses a menu of ranging options to allocate shelf space for stores of different sizes and layouts.

iii. Product placement planning: With regard to product placement planning, ASDA develops different planograms to take account of [✂].[42] Sainsbury's develops planograms for two formats, supermarkets and convenience stores. Tesco allocates shelf space in store to products from its national product list on the basis of "ideal" store layouts that are adjusted for the physical characteristics of the store and consumer research.[43]

[37] ASDA MPQ response 4.9. and 11.5 and 12.3.
[38] Sainsbury's MPQ response 11(b).
[39] Tesco MPQ response Q29.15.
[40] ASDA MPQ response 11.9.
[41] Sainsbury's MPQ response 23(a).
[42] ASDA MPQ response 12.3.
[43] Tesco MPQ response 11.32 (d).

iv. Staffing levels: Tesco determines a proportion of its levels of staffing by a detailed consideration of the characteristics and needs of the store in question. This includes an assessment of [✂].[44]

49. The majority of the factors that affect the competitive position of an individual grocery retail outlet reflect, for most grocery retailers, centralised decisions that are applied with a substantial degree of uniformity across the store network. Grocery retailers will also take account of store-specific initiatives that reflect the local competitive position of that store. These store-specific initiatives include vouchering, localised leafleting and marketing, store refits, improved product ranges, ensuring product availability and increased or improved staffing.

50. Many examples of store-specific initiatives that have been provided to us by grocery retailers are in the context of responding to the opening of a new store, or an extension or refurbishment in the local area by a competitor. Some of these initiatives may be one-off in nature, but others will provide an ongoing improvement to the competitive position of the incumbent store, and thus the retail offer to local customers.

51. Asda, Morrisons, Sainsbury's, Tesco and Waitrose have all told us that they engage in local vouchering activities.

- ASDA told us that it uses voucher schemes on a regional or local basis and issues vouchers at [✂]. ASDA may also [✂].[45] The extent to which Asda engages in local vouchering has, [✂].
- Tesco, while stressing what it considers to be the *de minimis*[46] nature of its local vouchering, has told us that it spent nearly [✂] on local vouchering between June

[44] Tesco MPQ response 11.34.
[45] ASDA response to the MPQ, 12.6

2003 and June 2006. The majority of the local vouchering is associated with the opening of a new Tesco store or the extension or refurbishment of an existing Tesco store.[47]

- Sainsbury's told us that it sometimes offers vouchers when a large new competitor store opens.[48]
- Morrisons told us that it sometimes supports new store openings with vouchers or a similar incentive to encourage people to visit a new store.
- M&S, while using very limited vouchering, will respond to local entry by offering a special promotion on, for example, wine.
- Waitrose told us that it sometimes uses vouchers to support individual stores, especially leading up to, or soon after, a store opening, extension or refurbishment.[49]

52. Store refurbishments that improve the offering of a local store seem a common response to entry by a competing retailer. A number of retailers, including [✂],[50] M&S,[51] Morrisons[52] and Waitrose[53], told us that the opening of a new store by a competitor would often cause them to re-prioritise the refurbishment of their own store in the area. The Co-operative Group (CWS) Limited told us that entry by a competitor would cause it to review a number of aspects of the offer at a local store, including initiatives such as increased stocking of fresh produce, which would

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[46] We discuss the significance or otherwise of local vouchering and other local competitive initiatives in paragraphs 60 to 62. However, we would note that Tesco's average annual expenditure on local vouchering over the period 2003 to 2006 was, for example, greater than Sainsbury's annual expenditure on national television advertising [✂]. Source: Sainsbury's second main party hearing, page 32.
[47] Tesco told us that much of the local activity between June 2003 and June 2006 was associated with [✂].
[48] Sainsbury's MPQ response, Q29. Sainsbury's also told us that local voucher promotion activity is carried out at its convenience stores when a new store is opened, a store is re-branded or refurbished and if there is a specific and significant competitive threat from a multiple – for example, the opening of a Tesco nearby.
[49] Waitrose MPQ response Q12 Waitrose provided some examples of a number of non-price store based incentives that it had undertaken at the beginning of 2006 to support some new and refurbished stores. These examples included direct mail of vouchers.
[50] Other factors include [✂]. ASDA response to the MPQ, 12.7 and 12.8
[51] M&S MPQ response 38.
[52] Morrisons MPQ response Q12.
[53] Waitrose MPQ response Q23

contribute to store costs in terms of running costs for additional fridges as well as increased product wastage.[54]

53. Counter initiatives to improve the retail offer are also more likely to be implemented in stores that face more intense competition. Sainsbury's told us that competition from a Waitrose store might be the "tipping point" in the decision to add a fish counter to a store, but that it makes the decision to add a fish counter based on the demographic profile of customers, whether or not a Waitrose is present.[55] M&S told us that in response to the recent entry by Whole Foods Markets, it has upgraded the bakery counter in its Kensington store, as well as a redesigned patisserie counter.[56]

54. Improved staffing at local stores may also be implemented as a localised response to increased competition. M&S told us that the opening of a new competitor might result in it appointing a more experienced store manager to the store in question. The new store manager would generally have a higher salary than the previous incumbent. M&S also told us that it might respond to new entry by increasing staffing levels and the seniority of staff more generally.[57] Sainsbury's told us that to compete locally, it "lines up […] resource where competition is toughest".[58]

55. There are other examples of retailers taking steps to improve the offer of individual stores that a face a particular competitor in a local area. For example, Sainsbury's told us that it has recently developed some trials to improve the retail offer in stores that directly compete with Waitrose. These trials are intended to address customer feedback that Sainsbury's offer does not compete with Waitrose with regard to range,

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[54] At the second main party hearing, Co-operative Group (CWS) Limited told us that in a store refit, it would almost invariably put in more fresh food and that this would increase store running costs. Page25.
[55] Justin King, Sainsbury's second main party hearing, page 24
[56] Letter from M&S following second main party hearing.
[57] Letter from M&S following second main party hearing.
[58] Justin King, Sainsbury's second main party hearing, page 24

store environment and staff capability.[59] Waitrose told us that, wherever possible, within its national strategy it would take account of the features and characteristics of local markets. For example, the local competitor set, services such as the availability of bag packers, opening hours, and local/regional ranges and refurbishment cycle.[60]

56. M&S told us that where it feels that a response to a new competitor opening is necessary, it will consider its range, possible store refurbishments, or promotional activity, depending on the identity of the competitor. For example, if the competitor focuses on fresh produce standards, M&S will respond in kind, whilst with other competitors, M&S is more likely to undertake some form of promotional activity.[61]

57. Tesco told us that it undertakes a limited amount of short-term local marketing in response to investments by local competitors, such as the refurbishment of a rival store. Tesco will undertake this type of marketing when it identifies competitor activity that it anticipates will have a negative effect on sales at their existing store of more than [✂] per cent or £[✂] sales per week. In addition, Tesco distributes its leaflets "Price News" that are targeted at promoting low price products and messages in areas around stores identified as "price sensitive". In some cases the leaflets are distributed to postcodes that lie between those stores and other retailers with strong price offers (typically ASDA, Sainsbury's and Morrisons).

58. Finally, Tesco also occasionally runs additional promotions in stores to meet the offers of specific competitors. [✂]. These promotions typically involve an average of

[59] Sainsbury's MPQ response Q23(e)
[60] Waitrose MPQ response Q23
[61] [✂]

[✂] product lines and in the first 26 weeks of the 2006 financial year, Tesco expenditure on these competitor-facing promotions was around £[✂].[62]

59. Other localised competitive initiatives, of which we have been told, include the [✂],[63] and increases in the number of home delivery vans in an area.[64]

National competitive initiatives and local geographic markets

60. It has been put to us that the prevalence of nationally set, and largely uniform, aspects of the retail offer for grocery stores indicates a national rather than a local geographic market. This is not necessarily the case, however. While grocery retailers may not systematically vary their entire retail offer in each store according to the extent of local competition, the extent of local competition may nonetheless be an important input into national decisions regarding pricing and other competitive variables.

61. To illustrate, consider a simple example where two competing retailers each have a 50 per cent share of national sales. In the first scenario, both retailers have an equal share of sales in each local area. In the second scenario, each retailer has 100 per cent share in half of the local areas. Competition between the two retailers will clearly be less intense in the second scenario, and it is reasonable to expect that national prices will be higher under this scenario.

62. Consistent with this, ASDA told us that the extent to which it faced its competitors in different local markets across the UK had a clear impact on its national strategy (including price). At the first main party hearing, ASDA told us that "to the extent there is a lack of local competition, we believe that is reflected in two ways. One,

[62] Tesco MPQ response Q29.20

[63] For example, [✂]. ASDA second main party hearing page 21.

where PQRS are set locally, that is likely to be reflected locally. Secondly, to the extent PQRS are set nationally, we think that the aggregation of the local competition conditions will be reflected in the way those strategic parameters, if you like, were set nationally. So we think that local competition feeds through in both of those ways."[65]

63. It seems clear that as any one retailer increases its market share across local areas, constraints on its national prices may be weakened. That is, less intense local competition is likely to result in higher national prices. Even though many aspects of the retail offer and price in particular, are set nationally, the extent of local competition remains important in determining outcomes for customers.

Local market outcomes

64. Our review of developments in UK grocery retailing since 2000 in paragraphs 8 to 33 pointed to what appears to be quite positive developments for customers in terms of pricing, product range, and innovation. We also noted in those paragraphs concerns regarding the weak competition in some local areas in the UK and the limited choice of stores (or fascias) in these areas.

65. In paragraphs 60 to 62 above, we describe how a weakening of competition in local areas could feed into a more general loosening of the competitive constraint on a grocery retailer in terms of its ability to adjust nationally set competitive variables, particularly prices. To the extent that there are areas of weak local competition, this implies that grocery prices in the UK may be higher than would otherwise be the case notwithstanding the overall decline in real prices for groceries that has been experienced in recent years.

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[64] Letter from M&S following second main party hearing.
[65]Source: Asda hearing, Friday 6 October 2006.

66. In order to quantify the possible changes in retailer profits generated by variation in local market structure, as indicated by our margin-concentration analysis, we are measuring the impact on retailers' profits if they were to face a more competitive environment. The experiment consists of measuring, for each store, the change in margin (and therefore in profit) of turning one other store operated by the same fascia within a 10 minute isochrone into a rival fascia.

67. The following paragraphs review the evidence in relation to whether weaker competition in local areas leads to less attractive market outcomes for consumers in those local areas.

68. Tesco submitted an analysis contending that there is no meaningful relationship between local concentration and a range of PQRS variables. Tesco looked at 134 different measures of individual components of PQRS at Tesco stores and found that they did not vary with the number of fascias over 1,400 sq m in the local area. As we have previously explained, see Working paper on Market Definition (May 2007), Tesco's analysis may not capture the possibility of various combinations of PQRS variables acting in concert to vary the retail offer in accordance with local competitive conditions; because the analysis focuses on the link between individual PQRS variables and local concentration.[66] In any event, we are not sure that adjustments to Tesco's modelling approach would capture the relatively small effects that our own analysis (discussed below) suggests are present.[67]

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[66] Tesco told us that it believes that PQRS measures are a more appropriate measure than margin. It also believes that it would be more difficult to draw conclusions about the exercise of local market power from a composite measure of PQRS because it may hide actual correlations by combining and possibly offsetting different measures. Tesco told us that it does not consider that a composite measure would show a relationship when the individual measures do not, unless lower levels of concentration led to statistically insignificant increases in PQRS measures individually, but a statistically significant increase collectively. To test this, Tesco joined together the two measures of PQRS that improved with local concentration (sales per member of staff and stock availability), which were individually statistically insignificant and told us that the joint measure was also statistically insignificant. Source: letter from Tesco 14th March 2007

[67] Furthermore, we have some technical concerns regarding this analysis. First, we note that the original scatter plots appear to show that PQRS measures vary considerably across stores, however, this variation is not explained by the regressions. Second, the estimates are likely to be biased due to omitted explanatory variables that are correlated with the number of

69. The GfK local case studies also showed very little difference in the retail offer of supermarkets according to the degree of supermarket concentration in the location, though range was marginally better in supermarkets which faced no other supermarket in that location. However, the studies did not include promotions and was limited to only 14 products, and we note that the small price variations found in the study may be more significant given the frequency with which consumers purchase these products.

70. A store's retail offer is difficult to measure given the multi-dimensional nature of the retail offer. We discuss in paragraph 72 the difficulty of objectively measuring factors such as quality and service levels. Store margins, however, reflect the profitability of changing any one or more aspects of the retail offer at a store, and thus can be used as a proxy for changes in the retail offer once appropriate adjustments are made to allow for the impact of factors such as fixed costs.

71. The use of store margins as a proxy for the retail offer across stores also addresses the issue raised above in relation to Tesco's analysis of variations in PQRS across stores. This is because in response to a change in local competition a retailer may decide to improve store management in one location but offer vouchers to customers in another location. This would be reflected in store margins, but would not necessarily show up in an analysis of the separate relationship between vouchers or labour costs and local competition.

72. Our analysis of store margins, initially published in the Working Paper on Margin Concentration Analysis and extended in our Market Definition Working Paper (May

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competitors. The included control variables are unlikely to alleviate this bias sufficiently. Moreover, some of these additional variables may be endogenous or causally related to PQRS and may thus pick up the effect, leading to an insignificant finding for the concentration measure. Third, we do not think that the finding of an insignificant estimate can be interpreted as a rejection of the hypothesis that there is a relationship between PQRS and concentration. An insignificant estimate implies that

2007), shows that outcomes (store profitability) of the four largest retailers vary with the extent of local competition. The results of further analysis of store margins are included in Appendix 2 of the Quantitative Analysis Working Paper (July 2007)

73. There seems to us to be a clear link between many of the local competitive actions that grocery retailers have told us about in paragraphs 46 to 59 and our observation of lower store margins in areas where competition is more intense. In particular:

i. local vouchering reduces store revenue (although there may be an offsetting effect from higher spend by existing customers and new customers);
ii. store refurbishments or product re-ranging will impose one-off and ongoing costs that will lower store margins (eg increased electricity consumption to operate more chiller cabinets for fresh food, increased product wastage from greater fresh food availability);
iii. leafleting and local marketing increases store variable costs and reduce margins; and
iv. increased staff quality and quantity will increase costs and reduce margins.

74. Tesco has submitted that there are technical shortcomings with our margin-concentration analysis which means that the observations that we are capturing simply reflect the impact of fixed costs that have not been adequately removed from our measure of store variable costs. We are continuing to examine the issues that Tesco has raised in relation to this analysis.

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on the basis of this analysis the hypothesis that there is no relationship cannot be rejected, but equally the hypothesis that the relationship is characterised by any non-zero number within the estimate's confidence interval cannot be rejected either.

75. Sainsbury's, however, has submitted that our margin-concentration analysis may understate the true extent of local competition. It suggests that x-inefficiency[68] at stores that face less intense competition is likely to offset partially the positive effect on margins of facing less competitors.[69] As a result, these factors may dampen any variation in store margins in relation to the extent of local competition, and thus our analysis may understate the true relationship.[70]

Areas of high concentration

76. We are currently developing criteria that will identify any local areas in the UK where an individual grocery retailer has a strong presence. We consider that this might be indicative of the areas where local competition is not effective and where consumers may not benefit from intense local competition. We also consider that, to the extent that we identify areas of weak competition, this may indicate the degree to which national prices may be higher than they would otherwise be if local competition were more intense.

77. As a first step we have undertaken an analysis to identify the number of stores which face 0, 1 or 2 competitors in their local market. This will be subject to further

[68] X-inefficiency is managerial slack that may come about because the employees of a firm with market power do not perceive that they need to maximise effort, but can instead enjoy a "quiet life".

[69] In its response to Geographic Market Definition in Grocery Retail, RBB, on behalf of Sainsbury's, also made this point: "We would observe that the margin-reducing effect of more intense local competition may be partially offset by countervailing x-inefficiency. This x-inefficiency arises where a manager of a store faces less intense local competition he will face less pressure to control costs, which will tend to reduce margins at stores facing limited competition. On the other hand, where there is less competition, less money need be invested in genuine improvements in the store in order to maintain sales, which will tend to increase margins. The countervailing effect on margins of x-inefficiency will therefore tend to dampen the positive impact which a lack of local competition may have on store margins. Hence, any analysis of the relationship between local competition and margins may unavoidably understate the true effect that local competition has on a store's performance." Paragraph 4.1.1

[70] It is likely that the analysis further understates the true relationship because, other than in the monopolist/non-monopolist analysis, it is assumed that there is a linear relationship between store margin and the number of competitor stores or fascia. Therefore, it is assumed that the first additional store (or fascia) affects incumbent store margin in exactly the same way that the second and third additional stores (or fascia). The results of the monopolist/non-monopolist analysis indicate that this assumption is likely to understate the impact of additional stores (or fascia) in areas where there are few stores (or fascia).

refinement.[71] A similar exercise using different criteria in terms of fascia and store size was undertaken for the CC's 2000 investigation.[72]

78. For each ASDA, Tesco, Sainsbury and Morrison store above 280 sq m we counted the number of different competing fascias above 280 sq m within a 10- and a 15-minute isochrone around the store (regardless of the number of stores that each competitor had).[73] The findings are summarised in Table 4.

Table 4 Isochrone analysis of stores with few competitor fascias

Drive-time isochrone	Number of competing fascias	Number of stores with few competitor fascias
10-minute	0	98
	1	286
	2	391
15-minute	0	31
	1	104
	2	155
Total number of stores in analysis		***2150***

Source: CC analysis.

79. We find that 98 stores out of 2,150 stores operated by ASDA, Sainsbury, Morrisons or Tesco have no competitor fascias[74] within 10-minutes drive-time of the store. Of these, 31 also faced no competitor fascias within 15-minutes drive-time. There were also 286 stores which faced one other competing fascia at 10 minutes, of which 104 also only faced one other fascia at 15 minutes. This means that about 36 per cent of

[71] For example, we will need to take into account the likelihood of future entry, the size of the local population and also the degree to which stores of different size constrain each other.
[72] See http://www.competition-commission.org.uk/ for the 2000 report.
[73] We only include stores with a net sales area in excess of 280 sq m. For the purpose of this analysis, the following fascia were included: Asda, Tesco, Sainsbury, Morrisons, Waitrose, Somerfield, M&S, Coop, Spar, Booths, Proudfoot, Costcutter and Budgens.
[74] There may be another store within the same fascia, or another store outside the fascia set used, present in the isochrone.

stores (775 stores) operated by ASDA, Sainsbury's, Morrisons or Tesco have no more than 2 competitor fascia within 10 minutes travel time of the store.

Barriers to entry

80. The weaknesses in competition in local areas that seem to give rise to the local variations in competitive outcomes that are discussed above, as well as potential adverse impacts on competitive outcomes nationally, would be of much greater concern if they persisted over time. This will only be the case if there are barriers to competitors entering local markets.

81. There is limited evidence on the persistence of strong local market shares over time. To the extent that we have been able to undertake a comparison with data from the 2000 investigation, this has been at a substantially broader geographic level than our analysis indicates is relevant for the analysis of competitive effects. The evidence from this comparison is, in any event, mixed. ASDA, Morrisons, Sainsbury's and Tesco have each expanded their share of sales more in those areas where they were relatively weak in 1999 than in those areas where they were strong. However, these retailers have also increased their share of sales in areas of strength in 1999, though at a slower rate.[75]

82. We also note that since 2000, for the most part, only grocery retailers with a national chain of stores have built large new stores.

83. Our analysis of possible barriers to entry (see Working paper on Barriers to entry), however, has identified two potentially significant barriers to entry into local areas for existing national or regional grocery retail chains that may allow areas of limited

[75] See also Paragraph 31.

competition to persist over time. These are the planning regime and strategic conduct by incumbent grocery retailers related to land and planning issues.[76] [77]

84. We also consider that regional cost advantages in distribution might constitute a barrier to entry to a potential entrant with no retail presence in the UK, and also to the expansion of a regionally-focused operator. We note, however, that it is not clear that barriers to entry based on cost advantages harm consumers because they may allow provision where there would otherwise be none.

85. In our analysis we distinguished between national or regional grocery retail chains that already have an established network of stores within the UK, such as Tesco or Somerfield, smaller retailers that have a number of stores but not national brand, and international grocery retailers with large established networks of stores but which are not present in the UK. We focused on the possible barriers facing existing national or regional grocery retail chains because the existing size and coverage of their network of stores make these retailers the most likely entrants in any given area.

86. In relation to planning, we recognise the important role of the town centre first policy, in terms of ensuring that development occurs in a way that meets a range of social and urban planning objectives. In competition terms, however, this policy is, likely to have impeded the entry of new grocery stores capable of providing an effective competitive constraint on existing larger stores, by forcing entrants to build new stores in smaller, more centrally located sites. Second, the “need” test may be a

[77] We also consider that regional cost advantages in distribution might constitute a barrier to entry to a potential entrant with no retail presence in the UK, and also to the expansion of a regionally-focused operator. We note, however, that it is not clear that barriers to entry based on cost advantages harm consumers because they may allow provision where there would otherwise be none.

potential barrier to entry in edge-of-town and out-of-town locations, and may be an actual barrier in around 40 per cent of Local Authority Areas (LAAs).[78] [79]

87. In response to our Working Paper on Barriers to Entry, Tesco told us that whilst the planning regime is complex and inefficient, it does not distort competition.

i. Retailers who are flexible in their approach to the sequential test can open successful, sequentially compliant stores which constrain larger stores. Further, the sequential approach has not prevented Tesco and others from building large town centre stores. [Paragraph 4.1(a)]

ii. The evidence in relation to need is based on a very small sample of Local Planning Authorities (LPAs). [Paragraph 4.1(b)]

iii. In its submissions to the CC, ASDA was unable to identify any areas where inability to prove need has prevented entry. Tesco told us that this was consistent with its own detailed review of recent planning applications that showed that there was no case in which need had been the sole criterion for rejecting a planning application.[80] [Paragraph 4.1(c)]

88. We recognise that Tesco and others have been able to build some large town centre stores but, in many cases, the town centre first approach may have led to greater focus on the development of smaller stores that provide a limited competitive constraint on large stores. While we also recognise that the planning regime is intended to promote many important aspects of town planning and wider social policy objectives rather than competition policy, we nevertheless consider that in some

[78] We note that the true extent of this barrier is unknown because most LAAs do not have an up-to-date need assessment.
[79] In relation to planning, to put our analysis in context, it is worth noting that neither the primary nor sole objective of the planning system is to promote or otherwise influence competition in grocery retailing. As a result, any analysis of the costs and benefits of the planning system in terms of its impact on competition in grocery retailing can only be a partial analysis of the overall benefits and costs of the planning system.
[80] Although ASDA has provided analysis that it believes shows that the need test has prevented entry it has not as yet identified any applications that have failed solely due to need issues. That said, both ASDA and Sainsbury's have identified LPAs that have said there is no need for additional convenience floor space for a period into the future.

locations it may act to impede the development of new stores that could compete effectively with existing large stores.

89. On land holdings in general, we note that the future development of these land holdings into stores may be cause for concern if individual grocery retailers' shares of national sales increase as a result. In particular, such an increase could augment those retailers' with buyer power. We are considering this further in relation to our supply chain analysis.

90. Concerning strategic conduct in relation to land holdings and the planning system, there is some evidence that grocery retailers may, in some locations, be using their control over various land sites and their interaction with the planning system to frustrate entry by competitors. On controlled landsites, including land controlled through the use of restrictive covenants, we have identified a small number of large stores that have a high share of local sales and where a controlled land site nearby may be frustrating entry by a competitor. We are exploring the nature of these controlled land holdings further with the grocery retailers.

91. We note that in some locations, grocery retailers have reached agreements with local authorities that appear to have the effect of discouraging entry by competing retailers. In particular, we have received submissions regarding arrangements in Sheringham and Worcester that may have this effect.

92. ASDA has told us that, [✂]. We look forward to hearing the outcome of this review and, without pre-judging the findings of our investigation; we would encourage other grocery retailers to consider similar action.

93. The time taken by grocery retailers to develop land sites into stores appears to have increased in recent years. Tesco has submitted that it buys pipeline land in order to develop it into trading stores, and it has no financial incentive not to develop land holdings into stores as quickly as possible. However, we consider that there may be situations in which the impact of a new store on sales at an existing store may make development less attractive, but the relevant retailer has an incentive to retain the land in order to prevent a competitor from opening its own store on the site.

Competition in the convenience store sector

94. In this section we consider competition issues in relation to stores with a net sales area smaller than 280 sq metres (referred to in this paper as "convenience stores"). As set out in our discussion of market definition in paragraphs 34-41 above, these stores do not constitute a completely separate market from stores larger than 280 sq metres. We consider that stores larger than 280 sq metres are able to impose a competitive constraint on these smaller stores, and as a result, need to be taken into account in our analysis.

95. Unlike larger grocery stores, there are few concerns regarding possible weaknesses in local competition concerning convenience stores. Barriers to entry in the sector are low due to the ease of finding retail space from which a convenience store might operate, and the comparative lack of planning restrictions associated with opening a convenience store. (Northern Ireland may be different in this respect due to the impact of licensing arrangements, which limit the number of licenses that may be granted to convenience stores to sell alcohol.)

96. There may, however, be isolated incidents of anti-competitive conduct in relation to local competition in the convenience store sector. In particular, we have had drawn

to our attention the activities of the Co-operative Group (CWS) Limited in Northumberland, and its apparent efforts to purchase and close down convenience store outlets that compete with its own stores. This is a matter that we have raised with the Co-operative Group (CWS) Limited.

Interaction between larger grocery outlets and convenience stores

97. Of greater concern in the convenience store sector is the nature of the competitive interaction between operators of larger grocery outlets and convenience store operators. The two issues of particular concern that have been drawn to our attention are (a) the possible "waterbed" effect, and (b) below cost selling.

98. In relation to the "waterbed" effect, the conclusion of our Working Paper on the Waterbed Effect was that any such effect is likely to be of limited impact in the markets that are the subject of the present investigation. In addition, we concluded that there is no evidence that UK grocery consumers have been adversely affected as a result of any possible such effect. The ACS has provided several responses to this paper, and raised three main points in response to our concerns regarding the assumptions of its model of the waterbed effect[81]:

   i. In response to our concern that the model did not allow for competition upstream, the ACS has noted that the model does allow people to switch to produce the goods for themselves, rather than acquiring those goods from third-party suppliers. However, we consider that this does not address our concern that the model should take account of different degrees of competition in upstream markets.

   ii. We expressed concern that the ACS model did not include a wholesale sector or buyer groups. In response, the ACS has told us that it has addressed the role of

[81] The ACS has made several detailed submissions on the waterbed effect over the course of our inquiry. These submissions are continuing to be considered in the context of developing our provisional findings.

the wholesale sector in its discussion of the model's results, but we see no formal analysis of this sector in their model.[82]

iii. In response to our concern that the ACS model assumes linear pricing, the ACS has told us that the accompanying paper considers two-part tariffs. However, the ACS has not modelled these non-linear prices, so our concerns remain.[83]

Below cost selling

99. In relation to below-cost selling, the conclusion in our Working Paper on Pricing Practices was that below cost selling could disproportionately affect convenience and specialist retailers. These retailers typically sell fewer products and those products that are often sold below cost are a particularly important source of revenue. We concluded that this practice could have both intended and unintended consequences for convenience and specialist retailers and have continued to assess them.

Unintended consequences of below cost selling

100. Regarding unintended consequences, in our Working Paper on Pricing Practices, we found that some grocery retailers may exit from the market because of below cost pricing strategies. To the extent that changes in the composition of grocery retailing outlets in local areas reflect consumer preferences, it is not clear that these changes represent adverse consequences for consumers as a whole.

101. In order to assess the impact of supermarkets' pricing practices on independent convenience and specialist stores we have analysed the impact of supermarket entry on these stores. If below cost selling by supermarkets has unintended, adverse,

[82] The ACS told us that it had considered the role of the wholesale sector in its analysis of the dynamic model of the waterbed effect and that wholesalers could be taken into account in the static model. The ACS considers that the inclusion of a wholesale sector would not minimise nor eliminate the waterbed effect.
[83] We note that in response to our concerns the ACS told us that it recognises that manufacturers make payments to retailers that are more of a lump-sum nature than a reduction in unit costs, but that the ACS considers that lump sum payments play an important role in long-term price formation and represent part of the competitive advantage of larger retailers.

consequences for these retailers we would expect that entry of a supermarket into the local area would cause an increase in the decline of these stores.

102. The analysis, published in our Working Paper on the Entry and Exit of Small and Specialist Stores, indicates that entry by a supermarket into an area appears to result in an increased rate of net exit for greengrocers, markets and bookshops. In contrast, the net rate of exit of bakeries declines with local entry by supermarkets. Independent convenience stores also experienced growth in the reviewed locations between 1999 and 2006. Noticeably, net entry rates for independents are more pronounced than with multiple convenience stores and, in most years we looked at, there is a clear increase in net entry when a supermarket enters. This may indicate that the pricing practices of supermarkets do not adversely affect independent convenience stores.[84]

Alcohol

103. We have heard concerns particularly with regard to the effect of below cost selling of alcohol on off-licences. The ACS noted the large discounts offered at the time of the World Cup in 2006. We gathered evidence from the largest four grocery retailers of their World Cup offers on alcohol and found:

[84] In our Working Paper, we noted that there is some inconsistency between the evidence from the Experian GOAD data and the Knowledge Store data reported in IGD publications in relation to trends in convenience store numbers. The GOAD data shows growth in the number of convenience stores, including independent convenience stores, in the locations that it covers, while the Knowledge Store data is showing decline in total convenience store numbers (and, in particular, numbers of independent convenience stores) at a national level. In our Working Paper we concluded that, given the data collection methodology employed by GOAD, we are confident that its dataset is robust. We also presented a number of possible explanations for the differences observed in these two data sources and noted that we will continue to explore this issue.

Table 5 Below cost sales of alcohol during the World Cup by the four largest retailers

	ASDA	Morrisons	Sainsbury's	Tesco
Beer and lager				
Number of SKUs	5	2	16	9
Volume (millions of units)	1.8	0.1	0.8	2.1
Value (£ million)	12.9	0.7	5.3	15.1
Wine and spirits				
Number of SKUs	0	0	13	1
Volume (millions of units)	0	0	0.6	0.0
Value (£ million)	0	0	1.9	0.1

Source: CC analysis

Note:
1. This table has been updated since its original publication to better match the time period of the sales between retailers. The period of sales, covered by this table, is based on the period of the World Cup but is not exactly matched between each retailer due to individual financial reporting techniques.
2. The value quoted is the difference between average selling price and average gross cost of the SKU over the relevant period.

104. In our analysis of the entry and exit of small and specialist stores, we found that where supermarket entry is observed there is generally a greater exit and a greater entry rate of off-licences. Since 2002, the net exit is higher with supermarket entry than with no supermarket entry. Although this might indicate that supermarket below cost selling of alcohol has an adverse effect on off-licences, it may also be consistent with competition. In particular, as noted in our Pricing Practices Working Paper, entry and exit is part of the normal competitive process and when a firm exits an industry because it is unable to make positive profits at current (non-predatory) prices, we would not normally expect consumer harm to result.

Fuel

105. The ACS has raised concerns that the practice of grocery retailers offering vouchers linking the price of groceries to the price of fuel distorts competition because it encourages consumers to shop at supermarkets rather than other grocers. We have gathered evidence from the four largest grocery retailers to assess the extent of fuel

vouchering. We found evidence to indicate that some grocery retailers use fuel vouchers in this manner, but, as noted in our working paper on pricing practices, we consider that temporary promotions to attract consumers to the store and to increase total sales (commonly referred to as loss leading) may be efficient pricing for grocery retailers. Competition between grocery retailers on the total value proposition of the store may result in a lower average price for a basket of products.[85] This may be particularly true given the nature of these products and because, typically, buying fuel at the same time as buying groceries is convenient for consumers because it reduces their travel costs.

Intended consequences of below cost selling

106. Regarding the intended consequences of below cost selling, in our Working Paper on Pricing Practices, we noted that the allegations we have received have been quite general in nature, and also that the OFT dismissed in 2004 the one allegation that was made against a major grocery retailer. We have been told of specific examples of "aggressive" vouchering by [✂]. We gathered evidence from [✂] on their expenditure in these short-term campaigns between March 2003 and June 2006.[86]

i. [✂]

107. Some of these examples are high relative to Tesco's average expenditure of £[✂]per store for a local vouchering campaign. However, given the general nature of the concerns, we have seen no evidence to date to indicate that these vouchers were issued systematically with any intention beyond that of normal local competitive behaviour.

[85] Please see Working Paper on Pricing Practices.
[86] [✂]

Coordination

108. In March 2007, we published a Working Paper on Coordination. In this section, we present a brief summary of the findings of that paper together with our response to comments received since March 2007. We conclude that whilst we see no evidence to indicate that coordination is currently an issue in the groceries sector, we are concerned that many of the facilitating factors necessary for successful coordination appear to be in place in this sector and may be of concern going forward.

109. In our Working Paper we considered two possible forms of coordination:

i. Coordination whereby grocery retailers refrain from competing on all prices or on prices of particular items such as known-value-items; and

ii. Coordination whereby grocery retailers refrain from competing directly with each other in local areas. This might involve only bidding for store sites in particular parts of the UK.

110. We found evidence that does not support the hypothesis of current coordination with respect to either prices or sites. However, some structural features that are conducive to coordination are present:

i. Transparency and adjustable prices: Grocery retailers interact with one another repeatedly and prices are transparent. For example, “The Grocer” publishes weekly price comparisons, and there are several price comparison websites. Retailers all intensely monitor each others’ prices. We note that prices are more transparent and monitoring is far easier where there is national pricing. Although supermarkets typically sell many thousands of products, there is a smaller set of “known value items” whose prices are known to consumers and which could be monitored with relative ease.

ii. National concentration: The grocery retailing market in the UK is highly concentrated at the national level. The four largest grocery retailers account for 75 per cent of grocery sales through chains. Also, chains operate in many localities across the UK, but tend to set prices nationally. Finally, each of the four largest grocery retailers has a share of national sales of more than 10 per cent and the next largest is Somerfield with 5.6 per cent.

iii. Long-term financial commitment: Continued investment in sites for new stores and product and service innovation in grocery retailing indicates a long-term financial commitment.

iv. Steady demand and frequent sales: Demand for groceries is fairly stable, and purchases (and price changes) are very frequent.

111. In response to our working paper, Sainsbury's told us that[87]:

i. Non-price factors (such as quality) are less transparent than price; and,

ii. Unilateral, rather than coordinated, effects are the issue.

112. Although Sainsbury's does not believe there is any significant risk of coordinated effects arising in the UK grocery industry, it is concerned that the growing asymmetry in the one-stop shopping market gives rise to unilateral effects.

113. Tesco notes that the CC's guideline contains a long list of factors that it would need carefully to consider before coming to a conclusion that the structure of the market is such as to facilitate coordinated effects.

114. Since the publication of our working paper on coordination, we have gathered information on the retail prices of the four largest grocery retailers over time, in order to assess whether there is evidence that prices are converging. If retailers' prices

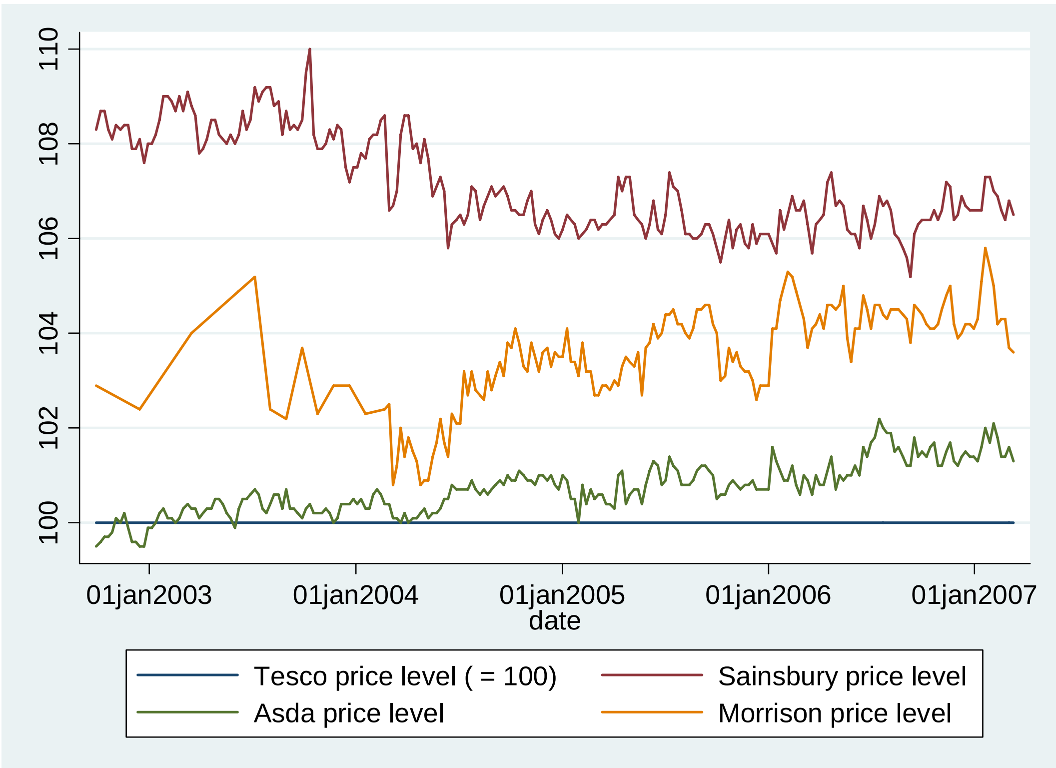
are becoming similar, an optimal focal price may become more apparent. Figure 5 shows an index of national retail prices of Tesco, Morrisons, ASDA and Sainsbury's, relative to the market average, based on the retailer set monitored at the time. This data has been collected [✂]. The composition of the index and products monitored has varied over this period, so we present here the data since October 2005 to ensure consistency. The chart shows that Sainsbury's prices appear to have moved down, whilst Tesco's have increased relative to the market average, and Morrisons and ASDA are largely unchanged. Figure 6 shows an index of national retail prices of the same retailers that has been collected weekly by Tesco since September 2002. The index is measured relative to Tesco and is based on their weekly competitor price check. The chart shows that although Sainsbury's prices appear to have moved closer to Tesco's prices, ASDA and Morrisons' prices seem to have drifted up. This information does not appear to indicate a significant convergence of retail prices of the four largest grocery retailers over this period. However, we interpret this with some caution as we note that ASDA and Tesco each have a different view of the relative cheapness of their products.

[87] Letter of 30 March 2007

Figure 5: Retail prices of the four largest grocery retailers [✂])

Source: CC analysis of data [✂]

Figure 6: Retail prices of the four largest grocery retailers (Tesco price monitoring data)



Source: CC analysis of data collected by Tesco

Notes:

1. Tesco index of national prices covers Sainsbury, Asda, Morrison (and Safeway) measured relative to Tesco prices for each period. We have excluded Safeway from the graph.
2. Tesco calculates these indices using their weekly competitor price check and bases them on a sales weighted combination of the prices of all comparable products. Tesco has told us that the basket is based on about 23,000 products.

115. In conclusion, we note that the essential factors necessary for successful coordination is present in grocery retailing. We also note some observers have expressed concerns over the apparent convergence of prices of the four largest grocery retailers in recent years, though this is not indicated by Tesco's price index. Price convergence would be consistent with strong retail competition and also with increased convergence of the retailers that might make coordination more likely to occur in the future. We also note that the largest grocery retailers meet in many different local markets and interact with one another very frequently. Therefore, while there is no evidence of current coordination, we are concerned that such behaviour may be more likely to occur in the future.

ANNEX A

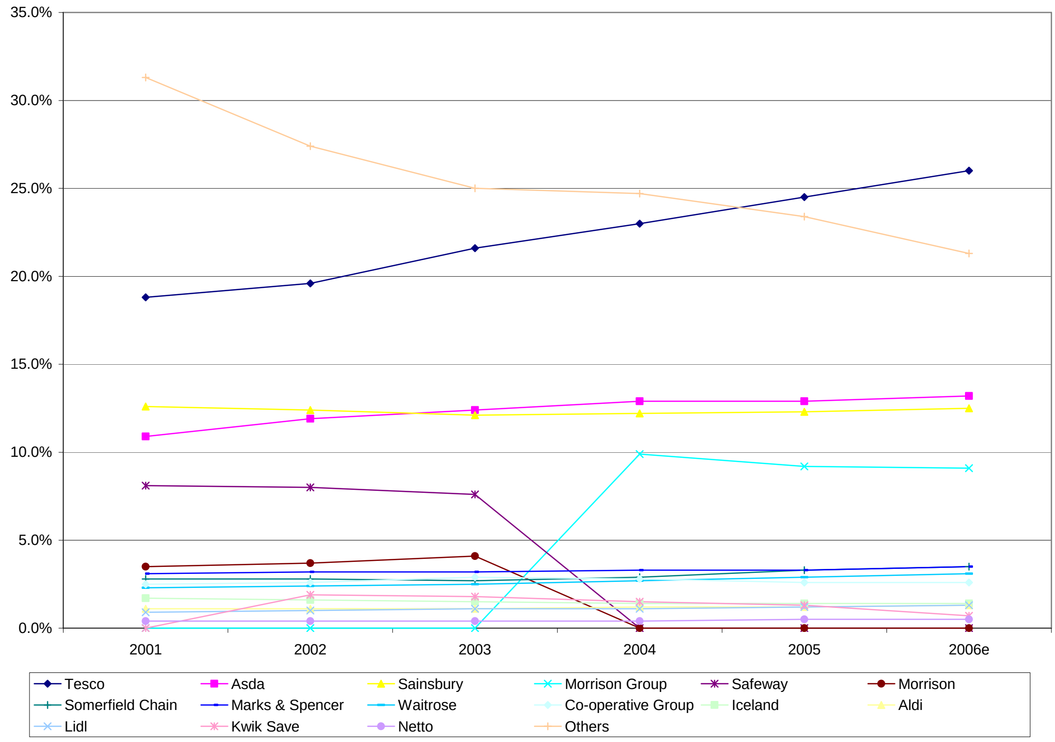
Market share of UK Grocery Retailers

	2001	2002	2003	2004	2005	2006e
Tesco	18.8%	19.6%	21.6%	23.0%	24.5%	26.0%
Asda	10.9%	11.9%	12.4%	12.9%	12.9%	13.2%
Sainsbury	12.6%	12.4%	12.1%	12.2%	12.3%	12.5%
Morrison Group	0.0%	0.0%	0.0%	9.9%	9.2%	9.1%
Safeway	8.1%	8.0%	7.6%	0.0%	0.0%	0.0%
Morrison	3.5%	3.7%	4.1%	0.0%	0.0%	0.0%
Somerfield Chain	2.8%	2.8%	2.7%	2.9%	3.3%	3.5%
Marks & Spencer	3.1%	3.2%	3.2%	3.3%	3.3%	3.5%
Waitrose	2.3%	2.4%	2.5%	2.7%	2.9%	3.1%
Co-operative Group	2.5%	2.6%	2.9%	2.8%	2.6%	2.6%
Iceland	1.7%	1.6%	1.5%	1.4%	1.4%	1.4%
Aldi	1.1%	1.1%	1.1%	1.2%	1.2%	1.3%
Lidl	0.9%	1.0%	1.1%	1.1%	1.2%	1.3%
Kwik Save	0.0%	1.9%	1.8%	1.5%	1.3%	0.7%
Netto	0.4%	0.4%	0.4%	0.4%	0.5%	0.5%
Others	*31.3%*	*27.4%*	*25.0%*	*24.7%*	*23.4%*	*21.3%*
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Source: Verdict, UK Grocery Retailers 2007, December 2006

Note: Department stores and M&S' market share relate to food sales only

Market share of UK Grocery Retailers



Source: Verdict, *UK Grocery Retailers 2007*, December 2006

ANNEX B

Product Range and Volume Throughput by Company

Company	% of Total Throughput	Annual Case Throughput	Total Warehouse Space (sq ft)	% Share of Total	Product Range	FMG	SMG	Frozen	Non-Foods	BWS	Produce	Chilled & Fresh Meat
Alliance Boots*	N/A	1,114,300,000	2,778,732	15.00%	35,000			92.00%				8.00%
Asda†	21.50%	1,300,000,000	9,090,000	16.30%	65,000	26.60%	9.50%	3.80%	25.20%	4.50%	8.50%	21.90%
Budgens	0.70%	32,900,000	297,000	0.60%	6,600	42.00%	7.00%	3.00%		6.00%	9.00%	33.00%
Co-operative Group	6.00%	287,966,380	2,805,016	12.50%	15,201	26.43%	16.38%	6.24%	0.44%	7.16%	11.73%	31.62%
Iceland Foods	2.50%	118,400,000	960,000	2.50%	3,420	32.40%		30.50%	5.30%	3.80%	5.30%	22.70%
Londis‡	0.70%	33,454,262	392,000	1.90%	6,300	69.80%				16.40%		13.80%
M&S (Food) §	3.40%	172,284,000	858,000	4.40%	5,000	28.70%		1.70%			69.60%	
Nisa-Today's	2.00%	95,300,000	875,000	1.90%	12,900	20.30%	27.70%	7.10%	1.20%	14.80%	1.00%	27.90%
Palmer & Harvey McLane	3.80%	185,013,000	1,117,000	9.40%	12,000	82.53%	3.05%	4.93%	1.78%	3.61%	0.05%	4.05%
Sainsbury's¶	18.10%	875,000,000	5,612,000	13.10%	26,000	30.00%	20.00%	4.00%	1.40%		12.00%	33.00%
Tesco	37.10%	1,785,532,000	8,966,987	17.50%	44,000	30.70%	9.40%	4.70%	11.20%	5.50%	13.30%	25.10%
Waitrose	4.20%	202,000,000	1,659,000	5.00%	24,500	31.50%	3.50%	2.30%	9.70%	5.30%	19.40%	28.30%
Total	**100%**	**4,902,149,642**	**35,410,375**	**100.00%**	**255,921**	**31.60%**	**11.00%**	**4.90%**	**10.50%**	**4.30%**	**13.10%**	**24.70%**

Source: IGD Research, *Retail Logistics 2007*, December 2006

Notes:

FMG Fast Moving Grocery Lines

SMG Slower Moving Grocery Lines

BWS Beers, Wines and Spirits Lines

* Alliance Boots volumes are single unit throughput and has been excluded from the total figure

† ASDA volumes include grocery and non-food, but exclude clothing units

‡ Londis FMG includes SMG lines too

§ M&S FMG includes both SMG and BWS lines; Product range is between 4,500 and 5,000 food lines

¶ Sainsbury's BWS is included within FMG and SMG lines

ANNEX C

SUMMARY PROFILES OF UK GROCERY RETAILERS

Asda

A1. Asda categorises itself as a one-stop supermarket operator. It carries the groceries range that all supermarkets carry (see Table 1). In addition, it sells a wide range of non-grocery products. Sales space is allocated primarily to grocery products.

TABLE 1 Asda Sales Mix

Product Category	**%**
Ambient groceries	18
Grocery non-foods	4
Tobacco	4
Chilled	7
Frozen	7
Meat and Fish	7
Produce	8
Bakery	3
Delicatessen	2
Beer, Wines and Spirits	8
Sub total	**68**
Clothing	8
Health and Beauty	7
Other non-food	8
Sub total	**23**
Petrol	8
Café	1
Sub total	**9**
Total	**100**

Source: Verdict, *UK Grocery Retailers 2007*, December 2006

A2. Asda generally operates a large store format (see Figure 1). Asda also operates a small internet sales operation and a financial services business. Notwithstanding the problems generally associated with the development of a one-stop-shop in town centre locations, Asda does open stores in town centre locations where possible. Nearly [✂] per cent of its stores are located in town centres (and just over [✂] per cent are in district centres) and five of the nine stores that it plans to open this year are in town centres. Fewer than [✂] per cent of Asda's stores are in edge of centre locations, [✂] per cent are out of centre, and less than [✂] per cent are out of town.[88] Consistent with its difficultly of obtaining new sites with planning permission,

[88] Asda transcript of second hearing, 4 July 2007, page 49, lines 18-19 and page 51, lines 13-18.

there has been a relatively modest number of new Asda stores over the period since 2000 (see Table 2). However, sales area has experienced consistent growth as a proportion of its overall sales area.

FIGURE 1 Asda store distribution

[✂]

Source: CC analysis of MPQ

TABLE 2 Asda store profile 2000-2006e

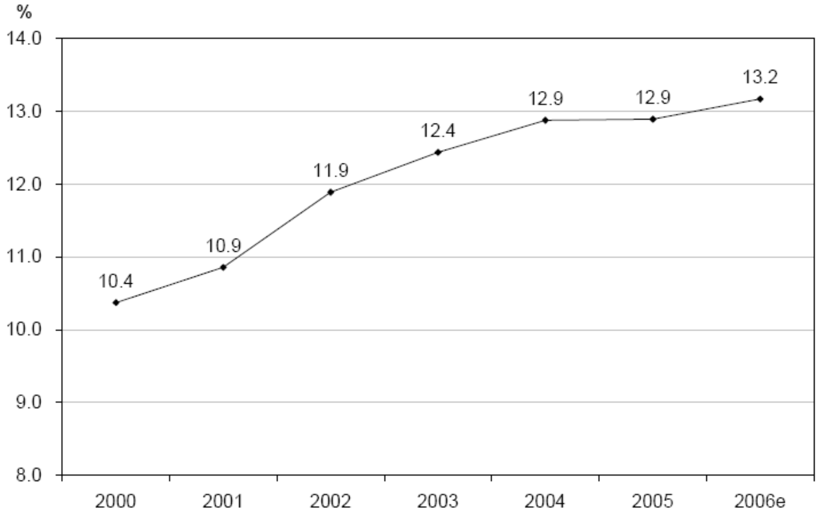
Year to Dec	Store Numbers	Sales Area 000 sq m (sq ft)	Y-o-Y Change %	Average Size 000 sq m (sq ft)	Sales / sq m £ p.a. (sq ft)
2000	241	954	7.6%	3.96	£10,592
		(10,267)		(42.60)	(£984)
2001	250	1,010	5.8%	4.04	£10,936
		(10,867)		(43.50)	(£1,016)
2002	258	1,065	5.5%	4.12	£11,754
		(11,462)		(44.40)	(£1,092)
2003	265	1,112	4.5%	4.20	£12,239
		(11,974)		(45.20)	(£1,137)
2004	271	1,194	7.3%	4.40	£12,422
		(12,850)		(47.40)	(£1,154)
2005	300	1,298	8.8%	4.39	£11,926
		(13,976)		(47.20)	(£1,108)
2006	315	1,345	3.6%	4.38	£12,034
		(14,473)		(47.10)	(£1,118)

Source: Verdict, *UK Grocery Retailers 2007*, December 2006 and updated by Asda

Note: conversion to sq m from sq ft was undertaken by the CC

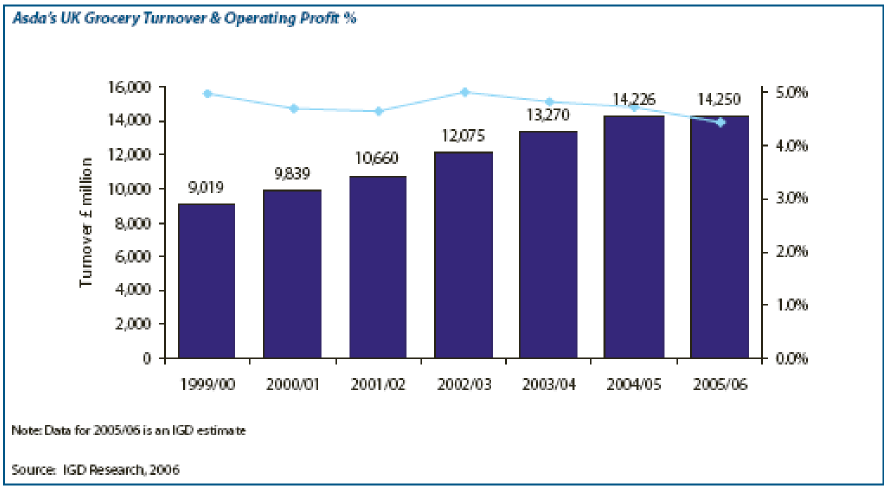
A3. Asda aims to be the market leader on price and value. The company operates an every day low price/every day low cost (EDLP/EDLC) strategy, which involves offering constantly low prices across the range of products. Asda's market share has grown over the period since 2000 and been maintained more recently (see Figure 2). This is reflected in Asda's turnover over the period (see Figure 3).

FIGURE 2 Asda grocery market share



Source: Verdict, *UK Grocery Retailers 2007*, December 2006

FIGURE 3 Asda UK turnover and operating profit



Source: IGD Research, *Retail Logistics 2007*, December 2006

Note: these figures include non-grocery and petrol sales.

Co-operative Group (CWS) Limited

A4. The Co-operative Group (CWS) Limited is the largest co-operative food retailer in the UK. The majority of its outlets are convenience stores and this is reflected in its sales mix (see Table 3).

TABLE 3 Co-operative Group (CWS) Limited food division sales mix 2005/06

	%
Chilled food	16
Impulse grocery	13
Beers, wines and spirits	12
Tobacco	14
Produce	7
Grocery non-food	5
Ambient edible grocery	7
Meat and poultry	5
Bakery	6
Frozen food	3
Newspapers and magazines	4
Delicatessen	1
Health and Beauty	3
Other non-food	4
Total	**100**

Source: Verdict, *UK Grocery Retailers 2007*, December 2006

A5. The Food Retail division of the Cooperative Group (CWS) Limited intends to create a more robust and profitable food retail business, with a core chain of shops between [✂] and [✂] sq m (see Figure 4). This reflects a long-held core strategic aim to be market leader in convenience and top-up shopping. The merger in 2000 between Co-operative Wholesale Society with Co-operative Retail Services resulted in a total of 1,100 food outlets. After further rounds of acquisitions, the Co-operative Group (CWS) Limited now has around 1,650 outlets and merged on 29 July 2007 with United Co-operatives Limited to add approximately 600 additional food outlets (see Table 4).

FIGURE 4 Co-operative Group (CWS) Limited store distribution

[✂]

Source: CC analysis of MPQ

TABLE 4 Co-operative Group (CWS) Limited store profile 2000-2007 (excluding United Co-operatives Limited)

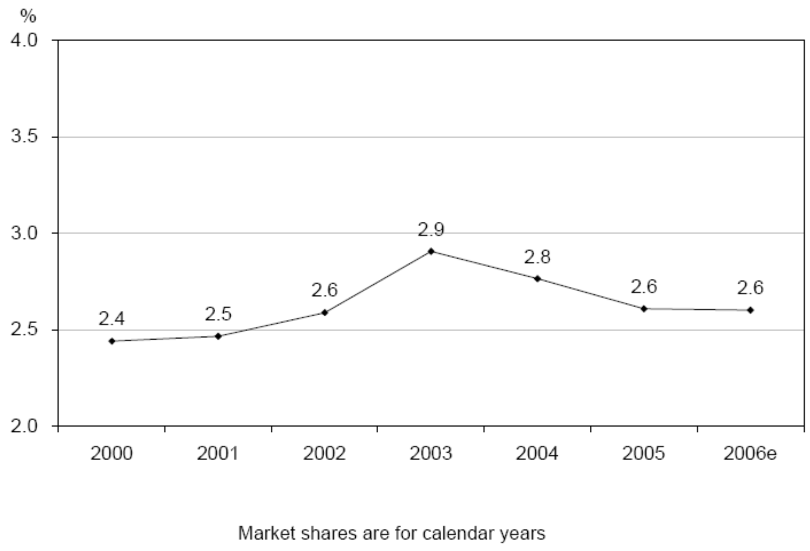
Year to Jan	Store Numbers	Sales Area 000 sq m (sq ft)	Y-o-Y Change %	Average Size 000 sq m (sq ft)	Sales / sq m £ p.a. (sq ft)
2000	640	294	-2.9%	460	£4,768
		(3,166)		(4,947)	(£443)
2001	1,084	509	73.0%	469	n.a
		(5,476)		(5,052)	
2002	1,071	481	-5.4%	449	£4,865
		(5,178)		(4,835)	(£452)
2003	1,720	558	15.9%	324	£5,048
		(6,002)		(3,490)	(£469)
2004	1,719	586	5.1%	341	£5,382
		(6,311)		(3,671)	(£500)
2005	1,764	590	0.6%	334	£5,177
		(6,350)		(3,600)	(£481)
2006	1,713	537	-8.9%	314	£5,296
		(5,785)		(3,377)	(£492)
2007	1,659	526	-2.0%	317	£5,748
		(5,667)		(3,416)	(£534)

Source: Verdict, *UK Grocery Retailers 2007*, December 2006

Note: * Includes VAT
Conversion to sq m from sq ft was undertaken by the CC

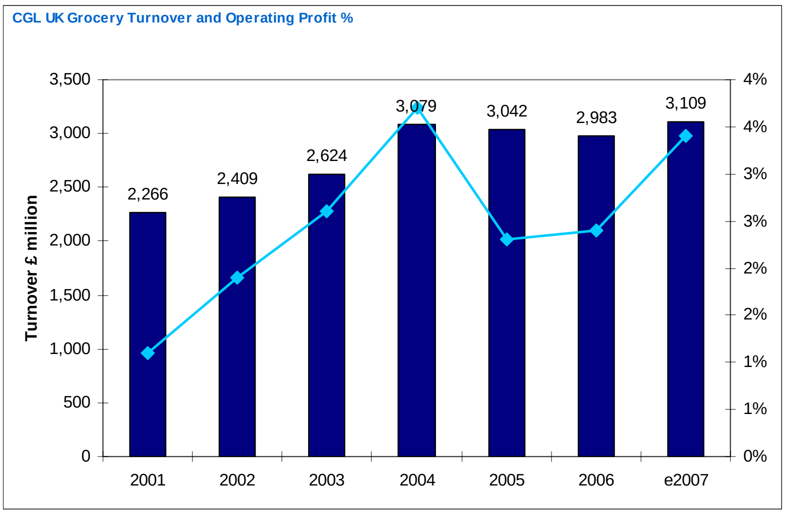
A6. The market share of the Co-operative Group (CWS) Limited peaked when a large number of stores were being acquired in the period 2002-04 (see Figure 5). [✂]. These same factors are reflected in the operating profit, on the back of relatively consistent turnover (see Figure 6). The recently completed merger with United Co-operatives Limited is expected to boost grocery turnover in the coming financial year to over £4 billion.

FIGURE 5 Co-operative Group (CWS) Limited grocery market share 2000-2006e



Source: Verdict, *UK Grocery Retailers 2007*, December 2006

FIGURE 6 Co-operative Group (CWS) Limited grocery market share 2000-2006e



Source: Verdict, *UK Grocery Retailers 2007*, December 2006
Note: This graph is not directly comparable to other similar graphs in this Annex because it has a different data source. However, it is expected that the trends are broadly comparable with the other graphs.

Iceland

A7. Iceland is a food retailer specialising in frozen food. Iceland's strategy is to be known as a good value frozen food specialist with a limited range of non-frozen products (see Table 5).

TABLE 5 Iceland sales mix 2006

	%
Frozen	37
Chilled/Fresh	29
Ambient Grocery	28
Beer, Wines and Spirits	3
Appliances	3
Total	**100**

Source: Verdict, *UK Grocery Retailers 2007*, December 2006

A8. Iceland does not operate internationally and its policy is to operate nationally through one facia and one store format. It has 667 stores that average 465 sq m of sales space (see Figure 7 and Table 6).

FIGURE 7 Iceland store distribution

[✂]

Source: CC analysis of MPQ

TABLE 6 Iceland store profile 2001-2007e

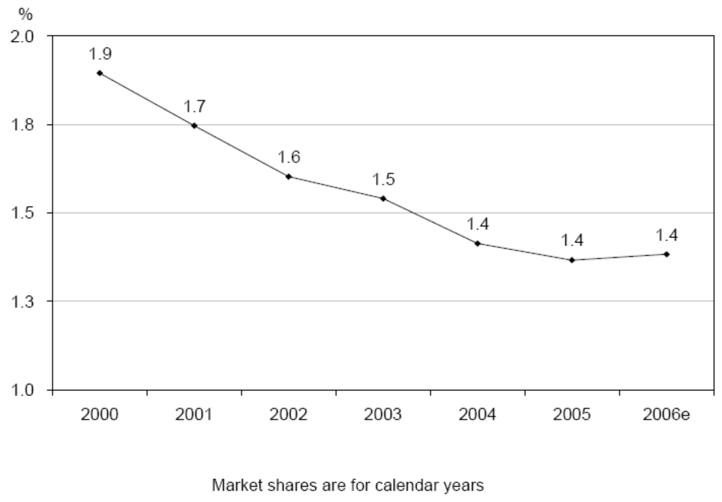
Year to Dec	Store Numbers	Sales Area 000 sq m (sq ft)	Y-o-Y Change %	Average Size 000 sq m (sq ft)	Sales / sq m £ p.a. (sq ft)
2001	766	341	0.9%	445	£4,844
		(3,669)		(4,790)	(£450)
2002	759	338	-0.8%	445	£4,682
		(3,639)		(4,795)	(£435)
2003	754	336	-0.7%	445	£4,478
		(3,615)		(4,794)	(£416)
2004	748	333	-0.9%	445	£4,618
		(3,583)		(4,790)	(£429)
2005	752	335	0.8%	446	£4,306
		(3,610)		(4,801)	(£400)
2006	667	300	-10.5%	445	£4,661
		(3,230)		(4,785)	(£433)
2007	670	309	3.0%	445	£5,188
		(3,326)		(4,785)	(£482)

Source: Verdict, *UK Grocery Retailers 2007*, December 2006 and updated by Iceland

Note: conversion to sq m from sq ft was undertaken by the CC

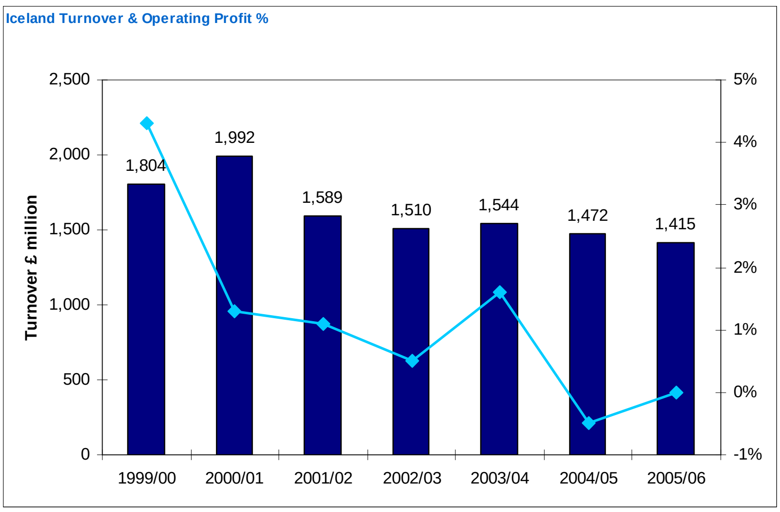
A9. Iceland has been experiencing falling market share since 2000 for a number of reasons. The main factors are that it now has fewer stores, and has had to compete for market share with strengthening offers from convenience stores. This can be seen in Figure 8 below. Falling operating margin and, to a lesser extent, turnover reflect the same trend seen in its market share (see Figure 9).

FIGURE 8 Iceland grocery market share 2000-2006e



Source: Verdict, *UK Grocery Retailers 2007*, December 2006

FIGURE 9 Iceland turnover and operating profit 1999-2006



Source: IGD Research, *Retail Logistics 2007*, December 2006

M&S

A10. The M&S Food Division is a grocer selling food, wines and non-food essentials. It aims to provide innovative products of the highest quality and freshness, which are ethically sourced and represent value to the customer, where 'value' denotes both quality and price. M&S considers that it now offers a similar range of the core grocery products to the main supermarkets (See Table 7). However, M&S does not offer the same variety within those product lines, as its products are exclusively own-label and not marketed with other brands.[89] M&S has approximately 7,000 product lines which provides a range across the key product segments. The strategy for the product range offered by M&S is to stock the single M&S brand for a product segment. This strategy can be contrasted with the other retailers which often offer up to six different versions of a product (and cite a much larger product range).

TABLE 7 Estimated M&S grocery sales mix 2005/06

Categories	%
Ready meals	22
Other chilled	20
Produce	16
Ambient groceries	15
Meat/fish	14
Beer/wines/spirits	8
Frozen	2
Sub total	**97**
Grocery non-food	3
Total	**100**

Source: Verdict, *UK Grocery Retailers 2007*, December 2006

A11. M&S operates 205 standalone Simply Food stores (including 61 franchised units), compared to 23 in 2000. The majority of its stores are 280sq m to 1,000sq m and all are less than 2,000sq m in size (see Figure 10 and Table 8). In general, M&S now intends to develop [✂] sites of [✂]sq m to [✂]sq m in contrast to its earlier strategy of [✂]sq m to [✂]sq m sites.

[89] Other than in BP stores, where they are sold alongside some branded products.

FIGURE 10 M&S store distribution

[✂]

Source: CC analysis of MPQ

TABLE 8 M&S store profile 2000-2006

Year to Mar	Store Numbers	Sales Area 000 sq m (sq ft)	Y-o-Y Change %	Average Size 000 sq m (sq ft)	Sales / sq m £ p.a. (sq ft)
2000	296	1139 (12,265)	2.6%	3.8 (41.4)	£5,759 (£535)
2001	302	1152 (12,400)	1.1%	3.8 (41.1)	£5,490 (£510)
2002	312	1133 (12,200)	-1.6%	3.6 (39.1)	£5,759 (£535)
2003	323	1139 (12,255)	0.5%	3.5 (37.9)	£6,189 (£575)
2004	367	1187 (12,782)	4.3%	3.2 (34.8)	£6,275 (£583)
2005	422	1198 (12,900)	0.9%	2.8 (30.6)	£5,899 (£548)
2006	451	1215 (13,080)	1.4%	2.7 (29.0)	£6,028 (£560)

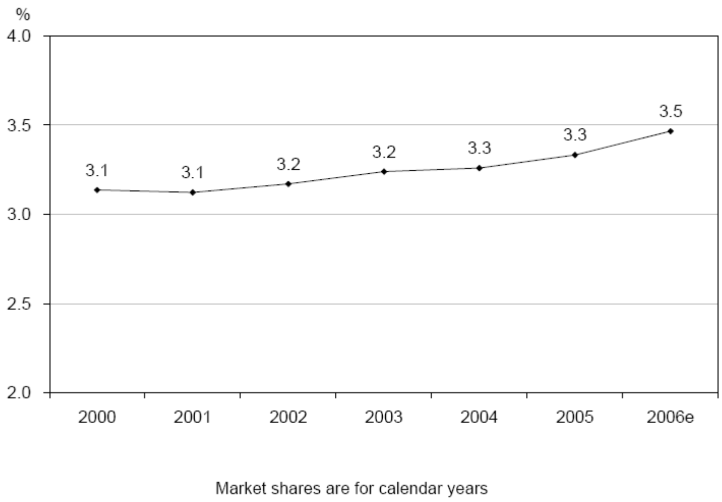
Source: Verdict, *UK Grocery Retailers 2007*, December 2006

Note: Store and sales data includes all UK M&S outlets including M&S Simply Food. Given that most of the space that has been added to the M&S store portfolio, since 2000, is grocery space, the growth rates above may be smaller than actual growth in grocery sales area.

Conversion to sq m from sq ft was undertaken by the CC.

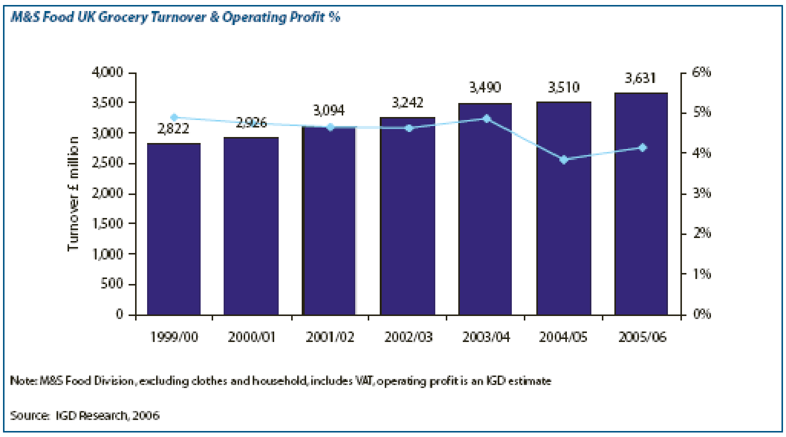
A12. M&S' grocery market share has been steadily increasing over the period, which is consistent with its high number of new store openings (see Figure 11). M&S has stated that local market shares now vary from <1% to as high as 15%. Internationally, product is sold in 219 franchise stores, in 34 territories around the world, predominantly in Europe, central Asia, Asia Pacific and the Middle East. In 2005/06, these stores, along with eight wholly-owned stores in Hong Kong, generated a turnover of £610 million and had an operating profit of £87.5 million. UK grocery retail turnover and operating profit is shown in Figure 12. M&S intends to develop its online shopping facilities and aims to have a limited grocery range available to at home shoppers by Christmas 2007.[90] Over the next five years M&S intends to double the number of Simply Food stores to more than 400, including franchise stores at stations, airports and motorway services. In addition, it will extend its partnership with BP by adding Simply Food stores at up to 200 BP Connect sites.

FIGURE 11 M&S UK grocery market share 2000-2006e



Source: Verdict, *UK Grocery Retailers 2007*, December 2006

FIGURE 12 M&S turnover and operating profit 1999-2006



Source: IGD Research, *Retail Logistics 2007*, December 2006

Morrisons

A13. Morrisons is a retail grocery business and also processes and packs various fresh food products for its own stores. Morrisons operates one-stop-shops and, where possible, has a petrol filling station alongside the supermarket. There is a single

[90] M&S Annual Report 2007

national pricing policy for all products sold (with the exception of motor fuel), and the product range is tailored to store size (see Table 9).

TABLE 9 Estimated Morrisons grocery sales mix 2005/06

Categories	%
Ambient Groceries	18
Grocery Non-food	4
Tobacco	4
Chilled	7
Frozen	5
Meat and Fish	9
Produce	7
Bakery	3
Delicatessen	2
Beers, Wines and Spirits	9
Sub total	**68**
Clothing	0
Health and Beauty	7
Other Non-food	5
Sub total	**12**
Petrol	18
Café	2
Sub total	**20**
Total	**100**

Source: Verdict, *UK Grocery Retailers 2007*, December 2006

A14. Morrisons ideal store size is a sales area of 3,250-3,700 sq m, although a substantial number of its stores are smaller than this (see Figure 13). Morrisons' strategy is to offer a full food proposition, at consistent value, throughout its 360 stores in the UK (see Table 10). Having adequate parking facilities and choice of goods is very important to its overall offer. The extent of the Morrisons' non-food offer is relative to store size.

FIGURE 13 Morrisons store distribution

[✂]

Source: CC analysis of MPQ

TABLE 10 Morrisons store profile 2000-2007e

Year to Jan	Store Numbers	Sales Area 000 sq m (sq ft)	Y-o-Y Change %	Average Size 000 sq m (sq ft)	Sales / sq m £ p.a. (sq ft)
2000	101	332 (3,572)	5.1%	3286 (35,366)	£9,171 (£852)
*2001	110	363 (3,907)	9.4%	3300 (35,518)	£10,075 (£936)
2002	113	375 (4,039)	3.4%	3321 (35,743)	£10,613 (£986)
2003	119	394 (4,241)	5.0%	3311 (35,639)	£11,151 (£1,036)
2004	125	420 (4,526)	6.7%	3364 (36,208)	£12,142 (£1,128)
2005	498	1158 (12,468)	175.5%	2326 (25,036)	n.a
2006	378	987 (10,622)	-14.8%	2611 (28,101)	£11,291 (£1,049)
e2007	370	972 (10,464)	-1.5%	2627 (28,281)	£12,561 (£1,167)

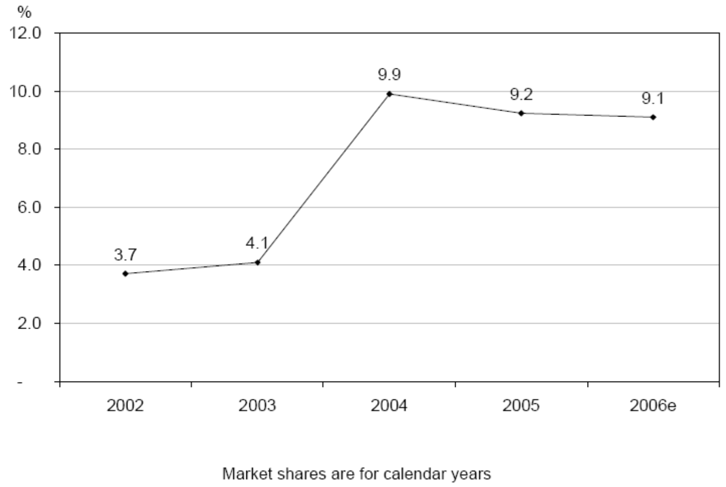
* 53 weeks

Source: Verdict, *UK Grocery Retailers 2007*, December 2006

Note: conversion to sq m from sq ft was undertaken by the CC

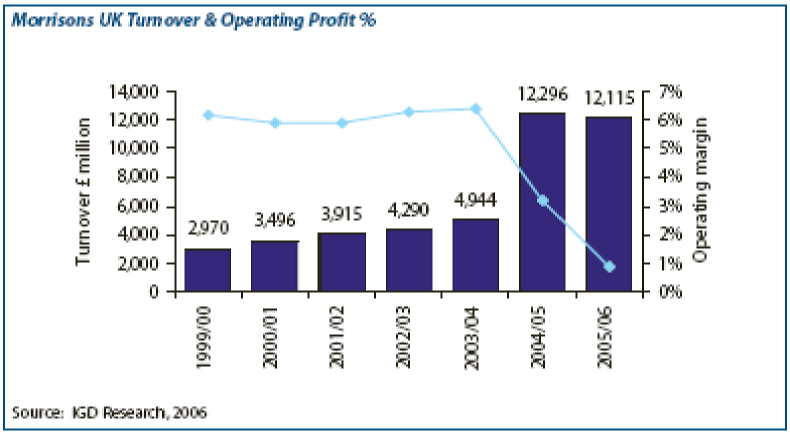
A15. Since the acquisition of Safeway, and its large market share increase (see Figure 14), Morrisons has been focussed on integrating “back office” functions, converting 220 stores to the Morrisons’ format and fascia, and divesting those stores which it was required to divest as part of the transaction, or which did not meet size or location requirements. It is currently seeking to increase profitability which has significantly decreased recently (see Figure 15), through volume of sales and business efficiency.

FIGURE 14 Morrisons UK grocery market share 2000-2006e



Source: Verdict, *UK Grocery Retailers 2007*, December 2006

FIGURE 15 Morrisons turnover and operating profit 1999-2006



Source: IGD Research, *Retail Logistics 2007*, December 2006

Sainsbury's

A16. Sainsbury's is in the business of UK grocery retailing (which includes the provision of general merchandise, clothing and fuel – see Table 11) through 490 supermarkets and 298 convenience stores (see Figure 16 and Table 12). Additionally, it operates a joint venture in retail banking (Sainsbury's Bank), with HBOS.

TABLE 11 Estimated grocery sales mix of Sainsbury's 2005/06

Categories	%
Ambient Groceries	17
Grocery Non-food	5
Chilled	9
Frozen	3
Meat/Fish	9
Produce	9
Bakery	4
Delicatessen	2
Beer/Wines/Spirits	8
Tobacco	3
Sub total	**69**
Clothing and footwear	1
Health and Beauty	7
Other Non-food	6
Sub total	**14**
Petrol	16
Cafe	1
Sub total	**17**
Total	**100**

Source: Verdict, *UK Grocery Retailers 2007*, December 2006

FIGURE 16 Sainsbury's store distribution

[✂]

Source: CC analysis of MPQ

TABLE 12 Sainsbury's store profile 2000-2007e

Year to Mar	Store Numbers	Sales Area 000 sq m (sq ft)	Y-o-Y Change %	Average Size 000 sq m (sq ft)	Sales / sq m £ p.a. (sq ft)
2000	432	1213	3.9%	2808	£10,376
		(13,055)		(30,220)	(£964)
2001	453	1,277	5.3%	2819	£10,387
		(13,746)		(30,344)	(£965)
2002	463	1,333	4.4%	2879	£10,602
		(14,349)		(30,991)	(£985)
2003	498	1,412	5.9%	2835	£10,140
		(15,199)		(30,520)	(£942)
2004	583	1,447	2.4%	2481	£9,946
		(15,570)		(26,707)	(£924)
2005	727	1,521	5.1%	2092	£10,053
		(16,370)		(22,517)	(£934)
2006	752	1,555	2.2%	2068	£10,226
		(16,737)		(22,257)	(£950)
e2007	787	1,597	2.7%	2029	£10,613
		(17,189)		(21,841)	(£986)

Source: Verdict, *UK Grocery Retailers 2007*, December 2006

Note: conversion to sq m from sq ft was undertaken by the CC

A17. Sainsbury's developed a convenience "Local" format in recognition of the change in consumer trends and the growing market for convenience retailing. This was added to in 2000 with the trial of "Local" sites on Shell forecourts, and was significantly expanded later in 2004 through its acquisition of Jacksons, Beaumonts, and Bells stores, and by the acquisition of Shaws stores in 2005. A store breakdown is provided in Table 13.

A18. Since 2004 Sainsbury's has turned around falling market share and has increased turnover (see Figures 17 and 18). Earlier overseas expansion was divested in 2004 (Shaw's in the USA) in order to return value to shareholders and reinvest in growing the UK supermarket business.

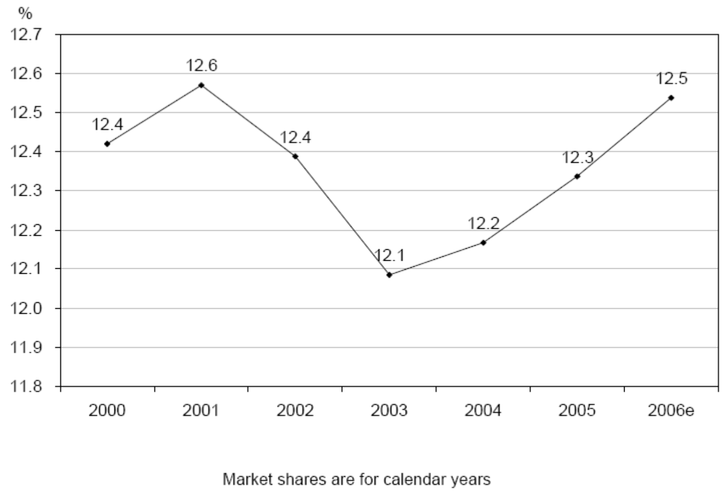
TABLE 13 Sainsbury's store breakdown

	Over 3,700 sq m	2,300 to 3,700 sq m	1,400 to 3,700 sq m	Under 1,400 sq m	Total
Convenience	-	-	-	298	**298**
Supermarket	178*	163	91	58	**490**
Total Stores	178	163	91	356	**788**

Source: J Sainsbury Annual Report 2007

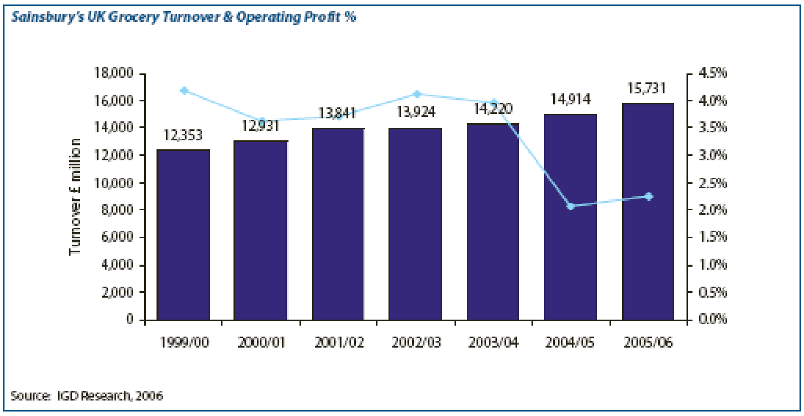
** This includes two superstores greater than 5,100 sq m.*

FIGURE 17 Sainsbury's grocery market share 2000-2006e



Source: Verdict, *UK Grocery Retailers 2007*, December 2006

FIGURE 18 Sainsbury's turnover and operating profit 1999-2006



Source: IGD Research, *Retail Logistics 2007*, December 2006

Somerfield

A19. Somerfield sells food, drink and household products to local people who shop in high street and local neighbourhood stores (see Table 14). Somerfield aims to provide products at reasonable prices, ensuring market-leading freshness and a high level of service. Somerfield sells only a limited range of non-grocery products and is reducing the size of this segment in future as management focuses on becoming a local grocery shopping chain.

TABLE 14 Estimated Somerfield grocery sales mix 2006

Categories	%
Ambient Groceries	25
Chilled	17
Produce	10
Beer/Wines/Spirits	8
Tobacco	8
Meat/Fish	7
Frozen	4
Grocery Non-food	5
Bakery	4
Delicatessen	4
Sub-total	**92**
Health and Beauty	5
Non-Food	2
Sub-total	**7**
Petrol	1
Total	**100**

Source: Verdict, *UK Grocery Retailers 2007*, December 2006

A20. Somerfield purchased 115 stores from Morrisons (ex-Safeway), re-branded 102 and sold 248 Kwik Save stores over the period. Most Somerfield stores are less than 1,900sq m (only 2 per cent being larger) (see Figure 19 and Table 15).

FIGURE 19 Somerfield Store Distribution

[✂]

Source: CC analysis of MPQ

TABLE 15 Somerfield store profile 2000-2007e

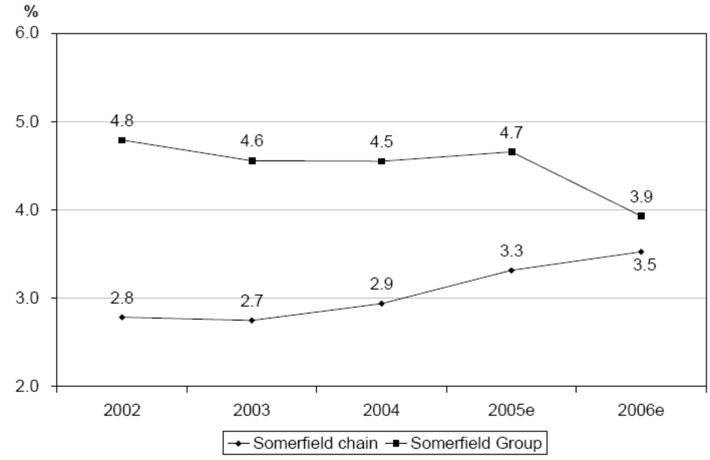
Year to Apr	Store Numbers	Sales Area 000 sq m (sq ft)	Y-o-Y Change %	Average Size 000 sq m (sq ft)	Sales / sq m £ p.a. (sq ft)
2000	1,371	1,073	-8%	783	£4,898
		(11,550)		(8,425)	(£455)
2001	1,319	1,030	-4%	781	£4,306
		(11,087)		(8,406)	(£400)
2002	1,306	1,018	-1%	780	£4,532
		(10,963)		(8,394)	(£421)
2003	1,269	980	-4%	772	£4,489
		(10,549)		(8,313)	(£417)
2004	1,268	949	-3%	749	£4,682
		(10,220)		(8,060)	(£435)
2005	1,308	988	4%	756	£4,822
		(10,640)		(8,135)	(£448)
e2006	1,048	732	-26%	698	£5,856
		(7,874)		(7,513)	(£544)
e2007	1,003	698	-5%	696	£5,608
		(7,509)		(7,487)	(£521)

Source: Verdict, *UK Grocery Retailers 2007*, December 2006

Note: * These figures include the Safeway, Texaco and Kwik Save fascias.
Conversion to sq m from sq ft was undertaken by the CC

A21. Somerfield has experienced a period of rationalisation that has reduced its share of the grocery market (see Figure 20). Turnover has fluctuated and profit margin has suffered, largely due to the effect of difficulties with the Kwik Save fascia (see Figure 21).

FIGURE 20 Somerfield grocery market share 2002-2006e

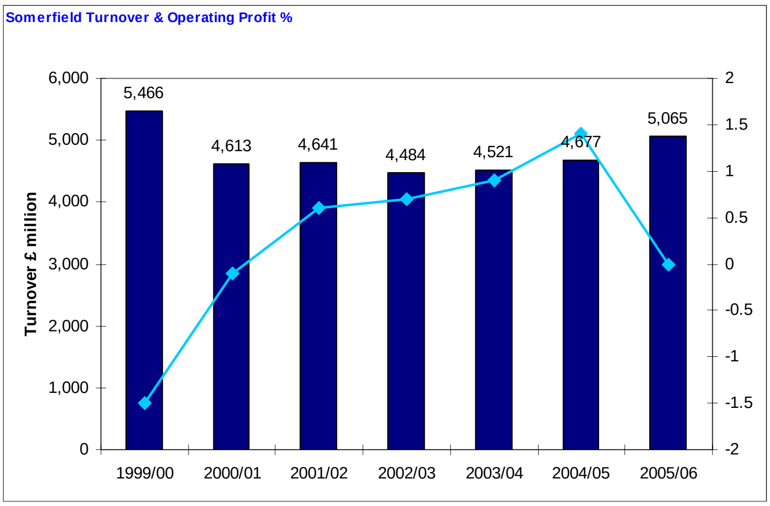


Notes: Somerfield chain includes forecourt stores purchased in 2005 still trading as Texaco

Market shares are for calendar years

Source: Verdict, *UK Grocery Retailers 2007*, December 2006

FIGURE 21 Somerfield Turnover and Operating Profit 1999-2006



Source: IGD Research, *Retail Logistics 2007*, December 2006

Tesco

A22. Tesco operates a large portfolio of stores in every segment of the grocery market (see Table 16). Tesco has a broad mix of store sizes (see Figure 22 and Table 17). Tesco has undergone significant expansion into the convenience store segment as shown by their purchase of 870 T&S/One Stop stores in 2003 and 45 Adminstore outlets in 2004. Tesco states that its sales of non-food are growing significantly faster than the rate of food. It opened 30 new Extra stores in the last financial year (generally by extending its existing Superstore format stores) (see Table 18) and plans to open 28 in the next financial year.[91]

TABLE 16 Estimated Tesco grocery sales mix 2006

Category	%
Ambient Groceries	17
Grocery Non-food	4
Chilled	8
Frozen	4
Meat/Fish	8
Produce	8
Bakery	4
Delicatessen	2
Beer/Wines/Spirits	8
Tobacco	4
Sub total	**67**
Clothing	3
Health and Beauty	9
Other Non-food	7
Sub total	**19**
Petrol	13
Cafe	1
Sub total	**14**
Total	**100**

Source: Verdict, *UK Grocery Retailers 2007*, December 2006

FIGURE 22 Tesco Store Distribution

[✂]

Source: CC analysis of MPQ
[✂]

[91] Tesco web site "Core UK Fact sheet" http://www.tescocorporate.com/publiclibs/tesco/CoreUK.pdf and additional submission 2 August 2007..

TABLE 17   Tesco store breakdown at the end of the 2005/06 financial year

Store type	Number	Description
Extra	120	(Approximately 5,575 sq m and above) The first Extra was opened in 1997. The one-stop destination store offers the widest range of food and non-food lines, ranging from electrical equipment to homewares, clothing, health and beauty and seasonal items such as garden furniture.
Superstore	444	(Approximately 1,860-4,645 sq m) Tesco began to open superstores in the 1970s. In recent years, a number of new non-food ranges such as DVDs and books have been introduced into superstores.
Metro	163	(Approximately 650-1,400 sq m) The first Metro was opened in 1992 to enter town and city centre locations. Metros offer a tailored range of food lines, including ready-meals and sandwiches.
Express	671	(up to 280 sq m) The first Express store was opened in 1994. These stores sell a range of up to 7,000 lines including fresh produce, wines and spirits and in-store bakery.
Total	**1,398**	

Source: Tesco MPQ response to Q54

Note: As at 1 June 2006.
The Group also has 508 stores under the One Stop fascia
Homeplus is a new store format (3,250 to 4,645 sq m), and there are currently 7 stores trading. These stores offer the widest range of non food, including clothing. Stores are standalone or on retail parks.

TABLE 18   Tesco UK store profile 2000-2007e

Year to Feb	Store Numbers	Sales Area 000 sq m (sq ft)	Y-o-Y Change %	Average Size 000 sq m (sq ft)	Sales / sq m £ p.a. (sq ft)
2000	659	1,570	5.8%	2,382	£11,011
		(16,895)		(25,637)	(£1,023)
2001	691	1,668	6.2%	2,413	£11,248
		(17,949)		(25,975)	(£1,045)
2002	728	1,749	4.9%	2,402	£11,603
		(18,822)		(25,854)	(£1,078)
2003	1,981	2,028	16.0%	1,024	*£11,894
		(21,829)		(11,019)	(£1,105)
2004	1,877	2,155	6.3%	1,148	£11,840
		(23,200)		(12,360)	(£1,100)
2005	1,779	2,248	4.3%	1,264	£12,325
		(24,200)		(13,603)	(£1,145)
2006	1,897	2,406	7.0%	1,269	£12,884
		(25,903)		(13,655)	(£1,197)
e2007	2,007	2,589	7.6%	1,290	£13,293
		(27,868)		(13,885)	(£1,235)

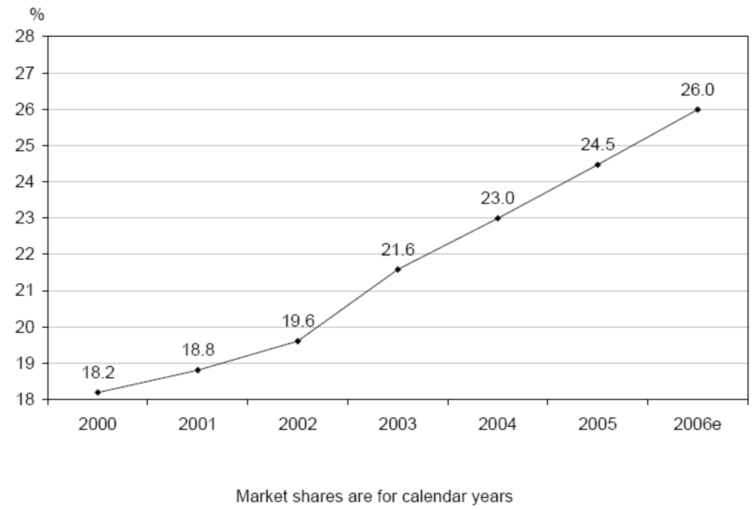
Source: Verdict, *UK Grocery Retailers 2007*, December 2006

Note: * Excludes T&S Stores in the calculation of sales / sq m for this year.
Conversion to sq m from sq ft was undertaken by the CC

A23. Tesco has been investing in new markets overseas since the mid 1990s and now operates in 12 countries outside the UK. Its international operations generate £7.6

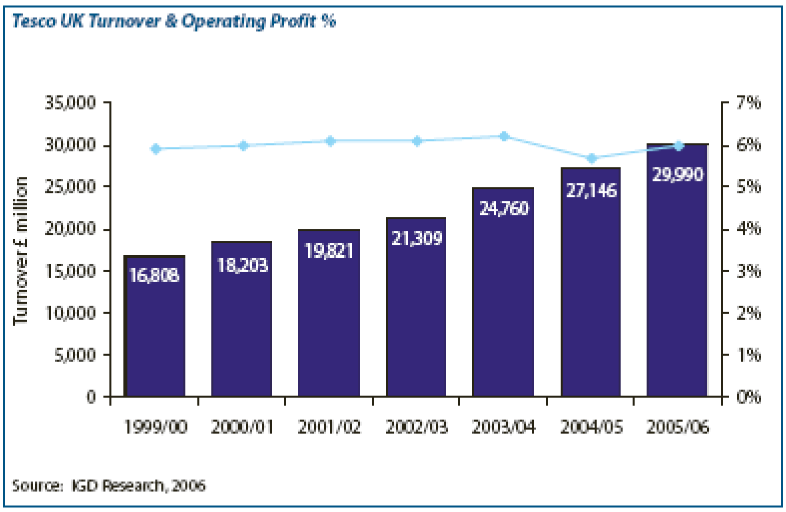
billion sales, £370 million profit, and accounts for over half of the group's total floor space.[92] Over the period since 2000, Tesco has significantly expanded its market share (see Figure 23). In the UK, Tesco has experienced rapid growth in turnover and maintained its margin through the period (see Figure 24).

FIGURE 23 Tesco grocery market share 2000-2006e



Source: Verdict, *UK Grocery Retailers 2007*, December 2006

FIGURE 24 Tesco Turnover and Operating Profit 1999-2006



Source: IGD Research, *Retail Logistics 2007*, December 2006

[92] Tesco web site "International Fact sheet" http://www.tescocorporate.com/publiclibs/tesco/International.pdf.

Waitrose

A24. Waitrose is a national one-stop-shop supermarket operator, operating stores exclusively in the UK grocery market. Waitrose also has e-commerce grocery businesses (WaitroseDeliver and a partnership with Ocado) and an export business. Waitrose exports its products to 23 territories, including Hong Kong, the Caribbean and India. It sells its products overseas through local supermarket chains, and there is an intention to expand this aspect of the business substantially. [✂].

A25. The Waitrose strategy is to give customers the choice of a genuinely differentiated offer in terms of a high quality product whilst remaining price competitive. 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 (see Table 19).

TABLE 19 Estimated Waitrose grocery sales mix 2006

Categories	**%**
Ambient Groceries	17
Grocery Non-food	4
Chilled	12
Frozen	7
Meat/fish	13
Produce	14
Bakery	5
Delicatessen	5
Beer/Wines/Spirits	12
Tobacco	2
Sub-total	**91**
Health and Beauty	5
Other Non-food	3
Sub-total	**8**
Petrol	1
Total	**100**

Source: Verdict, *UK Grocery Retailers 2007*, December 2006

A26. Waitrose has only purchased a limited number of stores since 2000 (see Table 20) and expects that its ability to open one-stop shops will continue to be seriously limited because of supply-side constraints and the bidding pressure of larger competitors. Waitrose generally has a large store format, which also makes it difficult for it to identify suitable building sites (see Figure 25). [✂]

i. [✂]

TABLE 20 Waitrose store profile 2000-2007e

Year to Feb	Store Numbers	Sales Area 000 sq m (sq ft)	Y-o-Y Change %	Average Size 000 sq m (sq ft)	Sales / sq m £ p.a. (sq ft)
2000	123	184	4.2%	1,520	£10,280
		(1,980)		(16,364)	(£955)
2001	136	212	15.2%	1,558	£10,592
		(2,280)		(16,765)	(£984)
2002	136	212	0.0%	1,558	£10,839
		(2,280)		(16,765)	(£1,007)
2003	140	229	7.9%	1,632	£10,990
		(2,460)		(17,571)	(£1,021)
2004	143	234	2.3%	1,635	£11,647
		(2,516)		(17,594)	(£1,082)
2005	166	288	23.3%	1,736	£11,324
		(3,101)		(18,681)	(£1,052)
2006	173	311	7.9%	1,797	£11,162
		(3,346)		(19,341)	(£1,037)
e2007	187	345	11.0%	1,846	£11,259
		(3,715)		(19,866)	(£1,046)

Source: Verdict, *UK Grocery Retailers 2007*, December 2006

Note: *Includes VAT
Sales Area, Average Size, and Sales / sq m are estimates.
Conversion to sq m from sq ft was undertaken by the CC.

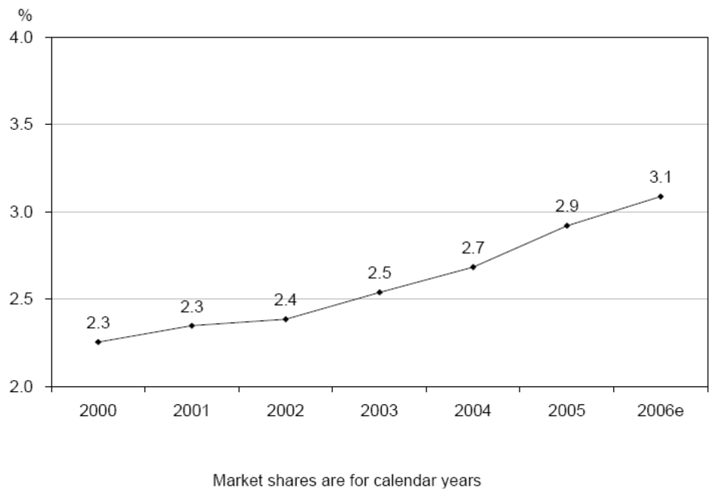
FIGURE 25 Waitrose Store Distribution

[✂]

Source: CC analysis of MPQ

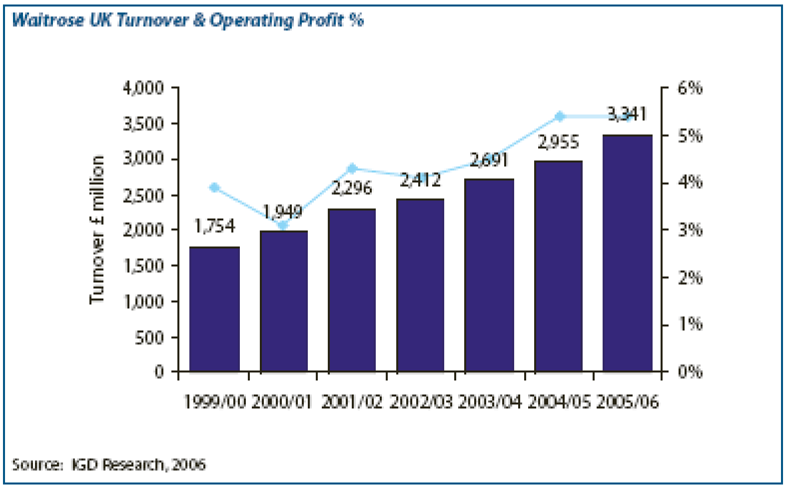
A27. Waitrose's market share has steadily grown over the period (see Figure 26). In addition, turnover and operating margin have steadily increased over the period (see Figure 27).

FIGURE 26 Waitrose grocery market share 2000-2006e



Source: Verdict, *UK Grocery Retailers 2007*, December 2006

FIGURE 27 Waitrose Turnover and Operating Profit 1999-2006



Source: IGD Research, *Retail Logistics 2007*, December 2006

Aldi, Lidl and Netto (discounters)

A28. Aldi's strategy is to operate a business model that is simple, efficient and effective, to meet the needs of customers by giving them the best quality grocery products at the lowest possible prices in clean, hygienic and well-presented stores. This strategy is implemented consistently at all levels in the UK. It has one fascia, one format and the same products in every store nationwide. Its has approximately 300 stores that are typically between 760 and 850 sq m in size, and a programme of store extensions is underway to increase the size of the majority of its estate to 1,000 sq m. In addition, Aldi has stated it intends to open 250 new stores in the UK and Ireland over the next 4 – 5 years which indicates a significant period of upcoming growth when compared to expansion since 2000 (see Table 21).[93]

A29. Lidls' core retail mission is to sell quality products at the best possible price. It has approximately 400 stores across the UK and has experienced steady growth over the period.

A30. Netto has 150 stores across the UK and all its stores generally have 280 to 1,400 sq m of sales area.

A31. Aldi and Lidl have slightly grown their market share over the period, while Netto has maintained its share (see Figure 28).

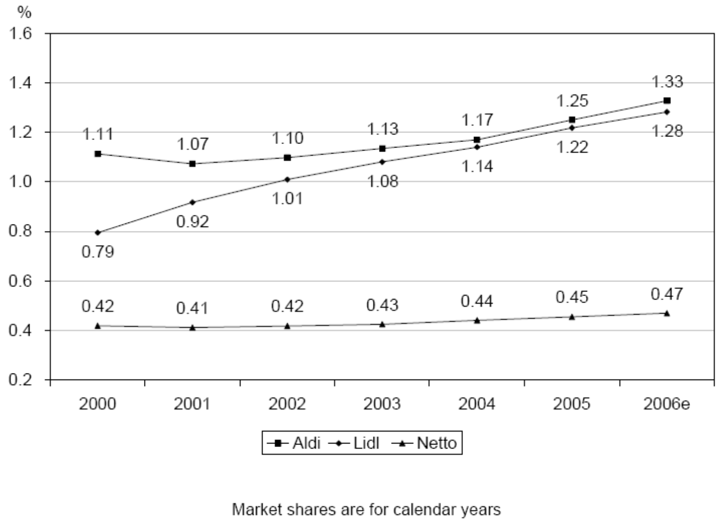
TABLE 21 Hard discounters estimated store numbers 1995-2007e

Year to	Aldi Dec	Lidl Jan	Netto Aug
2000	240	230	124
2001	250	250	125
2002	270	290	130
2003	273	315	135
2004	279	357	137
2005	295	370	147
e2006	320	387	169
e2007	—	406	182

Source: Verdict, *UK Grocery Retailers 2007*, December 2006 and updated by Netto where relevant

[93] Statement by Aldi UK and Ireland group managing director Paul Foley "ALDI on expansion offensive in UK" Planet Retail 06/07/07.

FIGURE 28 Aldi, Lidl and Netto grocery market share 2000-2006e



Source: Verdict, *UK Grocery Retailers 2007*, December 2006

Note: Netto also cites AC Nielsen data that indicates a market share of 0.8 – 0.9 per cent over the period.