

8 Views of third parties

Contents

	<i>Page</i>
Introduction.....	330
Consumer bodies.....	330
Consumers' Association.....	330
General Consumer Council for Northern Ireland.....	332
National Consumer Council.....	333
Wholesale interests.....	333
A G Parfett & Sons Limited.....	333
Costco Wholesale UK Limited.....	334
Spar (UK) Ltd.....	334
The Big Food Group (Iceland).....	334
Vikas Buying Group.....	336
Farmers' cooperatives.....	336
Anglia Quality Meat Association Limited.....	336
Lilburn Estates Farming Partnership.....	337
WyeCycle Ltd.....	337
Yorkshire Farmers' Livestock Marketing Limited.....	337
Retailers.....	338
Boots Group PLC.....	338
Budgens Stores Ltd.....	338
Co-operative Group (CWS) Ltd.....	339
E H Booth & Co Ltd.....	342
Marks & Spencer plc.....	342
Netto Foodstores Limited.....	344
Nisa Gillen's Supermarkets.....	344
Proudfoot Group of Companies.....	345
Somerfield plc.....	345
Thresher Group.....	346
Predatory pricing.....	346
Market definition.....	346
Public interest issues.....	347
Waitrose Ltd.....	347
A general retailer.....	349
Suppliers.....	349
A G Thames Limited.....	349
Albert Bartlett & Sons (Airdrie) Ltd.....	350
C R Melton & Sons.....	350
Cumbrian Seafoods Limited.....	350
Ethnic Cuisine Limited.....	351
Evesham Vale Growers Ltd.....	351
Express Dairies PLC.....	351
Flagship Foods Limited.....	351
G's Growers Ltd.....	352
Geest plc.....	352
Gosberton Bank Nursery Limited.....	353
Lloyd Maunder Ltd.....	353
Loseley Dairy Ice Cream Ltd.....	353

Marshalls.....	354
Minor, Weir & Willis Ltd.....	354
Molyneux Farms Limited.....	354
Music Box Leisure Ltd.....	354
Peter Gilding & Co Ltd.....	354
Premier Housewares.....	355
R L Clapp & Sons (Cheesemakers) Ltd.....	355
S C Johnson Limited.....	355
Status International (UK) Ltd.....	355
The Thomas Food Partnership Limited.....	356
Thumbs Up (Bury) Ltd.....	356
Tulip Limited.....	356
Turton Quality Foods Ltd.....	357
Vitacress Salads Ltd.....	357
Wensleydale Dairy Products Limited.....	357
Windward Islands Banana Development & Exporting Company (UK) Limited.....	358
A supplier.....	358
Bargaining power.....	359
Restriction in consumer choice.....	359
Impediments to product innovation.....	359
A supplier.....	359
A supplier.....	360
A supplier.....	360
A supplier.....	360
A supplier.....	361
A supplier.....	361
A supplier.....	362
A supplier.....	362
A supplier.....	362
A supplier.....	363
A supplier.....	363
A supplier.....	363
A supplier.....	363
A supplier.....	364
A supplier.....	364
Government departments.....	364
Department for Environment Food and Rural Affairs.....	364
Scottish Executive.....	366
The Countryside Agency.....	367
Trade associations and other organizations.....	367
Association of Convenience Stores Limited.....	367
Association of Town Centre Management.....	368
British Independent Fruit Growers' Association.....	368
British Printing Industries Federation.....	369
The Countryside Alliance.....	369
Crisis.....	369
Fairtrade Foundation.....	369
The Federation of Wholesale Distributors.....	370
Food and Drink Federation.....	370
Friends of the Earth.....	370
The Future in Our Hands.....	373
GMB National Trade Union.....	373
The Graphical, Paper & Media Union.....	373
The Green Party.....	373
Institute of Asian Businesses.....	373
Marine Stewardship Council.....	374
National Association of Clubs for Young People.....	374
The National Farmers' Union.....	374
The National Pig Association.....	375
Scottish Grocers' Federation.....	375
Transport and General Workers' Union.....	376
The UK Association of Frozen Food Producers.....	376

The Ulster Farmers' Union	377
Union of Shop, Distributive and Allied Workers.....	377
Wheathampstead Liberal Democrats	378
A suppliers' organization	378
Consumers	379
Other parties.....	380
Corporate Culture plc.....	380
Sir Donald Curry KB CBE	380
Information Resources	380
Mr Peter Law AM.....	381
Mr Barry Sheerman MP	381
York Research.....	381
A specialist investment bank and strategy consulting firm	381
A member of the public working in the food industry	381

Introduction

8.1. We invited views from a wide range of interested parties including retailers, wholesale interests, suppliers, trade associations, government departments, consumer bodies and others. This chapter summarizes the evidence we received. We held oral hearings with a number of these parties.

Consumer bodies

Consumers' Association

8.2. CA said that what happened in this merger would decide the shape of the sector for a decade. High entry barriers and restrictive regulations made the merger decision a particularly important one, and the inquiry needed to take heed of the risk of competition being impaired by any of the mergers. The key questions for consumers were choice, in the number of stores that could be visited, and the effectiveness of competition by which choice was produced. In this context, whilst three fascias could work effectively, it was more likely that four would be better, both in terms of choice and competition effectiveness.

8.3. CA considered the sector unlikely to see new entrants. Acquiring sufficient scale speedily enough presented real difficulties, compounded by issues of land acquisition and planning permission.

8.4. CA saw the main impact of any merger in the local markets within which supermarkets competed, although this was offset by supermarket pricing strategies ranging from aggressive, through reactive, to those less constrained by competitors' prices. Local level prices were a highly significant issue, turning on pricing policies and the reduction in competition that each bid might engender. Local pricing flexibility became relevant only if those in that market used their power to increase prices, so indicating likely future pricing trajectory if they gained significant market power. Morrisons and Asda were national-level proactive pricers whose absence from an area was deleterious to local price competition. Sainsbury's and Tesco, both flexible pricers with market power, acted against the public interest in following their policies.

8.5. CA said that store divestments would have to become a part of the remedies process and the number of markets significantly affected by each merger would be quite different. The Morrisons bid potentially affected less than 14 per cent of all local markets adversely. The other bids affected 30 to 45 per cent of all local markets.

8.6. CA recognized that non-price competition in diversity of store fascia was important for consumers, but this did not necessarily affect bid rankings. Individual marketing and differentiation on the basis of perceived quality was practised, but CA was unconvinced that that equated to significant differentiation within store offerings. Supermarkets were likely to continue responding to demands such as those for high-quality products.

8.7. Account should be taken of the fact that the Sainsbury's and Tesco bids would exacerbate local price-flexing problems. This was not so with the Morrisons and Asda bids, but their national pricing policies were against the public interest. Unlike the other bidders, Sainsbury's was less likely to make Safeway a more proactive and aggressive price competitor. The Morrisons/Asda bids were least likely to lead to price policy problems. The Tesco bid was likely to increase pricing aggressiveness, and also price flexing in markets where Tesco was the major player. The Sainsbury's bid was likely to keep Safeway both as a reactive price-setter and local price-flexer, depending on how each bid was likely to affect competition overall.

8.8. The view of CA was that, whilst Sainsbury's was strengthening its position, Tesco and Asda were considerably stronger still. A takeover of Safeway by either Tesco or Asda would put Sainsbury's under significant strain in view of the overlap between Sainsbury's and Safeway stores. The difficulty for Safeway had been in conveying the message as to what it offered, and Sainsbury's had benefited from that weakening position.

8.9. CA identified two countervailing factors in assessing the national market. First, Asda and Morrisons operated national level pricing, important in assessing the accrual of market power either bid

would afford them. Secondly, the degree of rivalry between supermarkets had resulted in their prices being on a downward trend for some time. Consumer satisfaction with supermarkets was generally very high, with supermarkets favoured over other shopping opportunities.

8.10. CA noted that Safeway had a diverse range of store sizes. Any divestments would have to be of the larger stores. Distribution costs could be very important for a divestment strategy in that scale economies might not accrue for a supermarket acquiring stores in an area from its existing operations, in turn raising serious questions about the viability of a divestment strategy.

8.11. CA saw little impact from any of the merger bids on the convenience sector. Nor was any accrual of petrol retailing likely to be significant, although non-grocery items were beginning to play an increasing role overall. The main business of the supermarket groups, however, remained grocery shopping, and that should continue to be the market of concern.

8.12. In terms of bids, CA saw a clear division between Morrisons and the other three supermarket bidders. Morrisons would create a fourth significant sector competitor, and would move to being proactive and national in its pricing policy. The store overlap level was very low for this bid; in only three cases would this merger produce less than four effective competitors. The potential positives, in terms of pricing and simply energizing Safeway, outweighed the negatives.

8.13. In contrast, the Asda, Sainsbury's and Tesco bids raised potential competition concerns. CA felt one of the top three would be significantly strengthened, with a noticeable gap to the fourth, fifth and sixth competitors. For Asda, Sainsbury's and Tesco, CA reserved judgement as to whether divestments would meet all competition concerns, but was anxious lest any bid led to an ineffective triopoly.

8.14. Of the smaller stores, CA believed Waitrose and M&S might find difficulties against a stronger Sainsbury's. Many of the smaller players had developed niche strategies, however, and served those niches well, whilst others again were suffering from demographic shifts and behavioural changes in consumers.

8.15. At a national level, CA saw the supermarket sector, and the food sector generally, as being particularly good at serving niche markets. Against a background of four national supermarkets, one regional supermarket and a number of smaller niche operations, achieving five fascia situations would be difficult, other than where they were already found.

8.16. CA did not view supermarkets as inherently hostile to other, local competition. In the 1960s, the planning regime had forced them out of towns; they were now being brought back, but this had not made them more, or less, threatening. The problem facing small shops stemmed from having competed on price rather than quality. CA also thought below-cost pricing was socially beneficial in that the price of certain goods effectively subsidized some staple commodities.

8.17. CA identified few changes in entry barriers since the Supermarkets inquiry of 2000. Work to identify either price or value of land for supermarket developments was needed.

8.18. On merger benefits, CA said that there would be immediate short-term benefits in lower prices. In the longer term, CA was less certain that those reductions would be maintained, but recognized that efficiency gains would be passed on to the extent that constraints in the overall market forced them through to the consumer. Beyond that, CA saw a more general benefit in a new fascia attracting shoppers to the stores. The base market for analysis should remain the one-stop shop. There remained a separate market for convenience shopping, although the entry of the supermarket groups was beginning to blur this.

8.19. The Internet had the ability to change the way market definitions were carried out, but the extent needed examining on a market-by-market basis, in particular whether a small share of the consumer base generated significant profits, and how likely that segment was to migrate their purchases to the Internet. Little evidence of this was seen in the grocery sector. CA did not see chains of substitution as greatly affecting a market definition. Their effect was a long way from a disciplining behaviour, and more akin to rivalry than true competition.

8.20. In considering local competition between stores, CA thought that any assessment should be based on two measures: first, the degree to which local market fascia-based competition replicated

national fascia-based competition; secondly, the effectiveness of local competition on a numbers-equivalent HHI basis. Combining these two parameters provided a clear indication of store disposals. Local competition was driven by the frequency of local market competitor contact. CA looked for indicators that pointed to markets where significant local competition was lost, judged both by effectiveness of competition and number of fascia within the given distance.

8.21. At present, Safeway provided some degree of competitive restraint on its rivals. Allowing for present and any future bids, CA thought the strategy should be a risk-averse one, ensuring that any reasonable desire to keep Safeway as a stand-alone competitor did not create a worse situation than would occur with a successful Morrisons bid.

8.22. On buyer and supplier issues, CA thought any accrual of market power for Morrisons would be marginal, having regard to the vertical integration in the company. Asda's significant buyer power forced consumer prices downward; provided that downstream market was competitive, a fair share of efficiency benefits should pass to the consumer, which to date did not appear to have transpired.

8.23. CA considered the Remedies Statement a broadly sensible analysis, supported a number of proposed approaches, but also had some points to make. Its view remained that, on balance, the Morrisons bid alone offered a net positive balance for consumers and competition.

8.24. CA recognized the problem of stores below 1,400 sq metres, agreed with the approach to identify possible competition problems, but was not convinced that defining a separate market would necessarily assist the inquiry, indeed such a focus could divert us from judging the merits and demerits of each bid. Work on procurement should be carried out as part of each bid, to assess the likely impact on suppliers.

8.25. On pricing, CA noted that the bidding parties divided into two camps on the issue of local/national pricing. Accrual of market power could affect the approach in each case, depending on relative market share, and cultural attitudes to the market. On barriers to entry, the present bidding process would have identified any potential new entrant. It would be a matter for concern if we sought to freeze the market in the hope of a future bid, designed to re-energize Safeway.

8.26. CA noted the threat to competition in a reduction from five to four major players but saw this as preferable to a reduction from four to three. The question of capacity to merge successfully following an acquisition was not for us, other than to take cognizance, but a concern for shareholders. Whether any potential merger impacted on price and innovation turned on the vigour and frequency of competition. Only creating a fourth significant player gave a probability of immediate and long-lived price cuts. CA shared the view that Safeway could not be considered a failing firm; however, the issue for the CC was rather to assess the potential impact on competition of different merger bids.

8.27. On buyer power, the CA view remained that below-cost selling was not against the public interest. Nor did it believe that global brands would be significantly harmed by any of the proposed mergers. Whilst recognizing the problem that undue buyer power could bring, the key concern was that a fair share of buyer power was passed on to consumers, thus guaranteeing that the sector was functioning effectively. If suppliers tried to recoup margin from smaller players, a competitive market would mean their being replaced by new entrants. Such a possibility should not unduly affect this inquiry.

8.28. Morrisons store divestments should be mandatory, approved by the OFT, and sold only to firms wishing to use them as grocery outlets. Divestments should not be used to better the status quo; the primary yardstick for sales to other supermarket chains was the state of local competition, then national competition, with the primary measure stores. CA believed that the divestment process was only feasible in the Morrisons case and that it was sufficient to base a decision on local market positions, balanced by a national market picture, with no qualitative criteria being used. For Tesco, Asda and Sainsbury's, the scale of divestments was so large as to make the process extremely difficult, if not impossible. In the case of Morrisons, it was legitimate to limit store sales to smaller players. Additional suggested remedies were impractical and should be ignored.

General Consumer Council for Northern Ireland

8.29. The General Consumer Council for Northern Ireland (GCCNI) believed that the specific impact of changes on the Northern Ireland market as a result of any of the proposed mergers should be considered. Northern Ireland was a distinct market and should be viewed as such.

8.30. The GCCNI noted that 1999 data showed the three largest grocery retailers in Northern Ireland as Tesco, Sainsbury's and Safeway with a grocery market share of 26, 10 and 10 per cent respectively. The GCCNI was concerned that, should Tesco acquire Safeway, the former's market share would increase to 36 per cent. In the event of either Tesco or Sainsbury's merging with Safeway, the two largest retailers would then control almost half of Northern Ireland's grocery market.

8.31. The GCCNI said that Asda or Morrisons would be new entrants to the Northern Ireland market. Provided the new owner did not sell Safeway's Northern Ireland stores, Safeway's existing position would effectively be replaced, and the competitive position left unchanged.

8.32. The GCCNI was also concerned about the regional concentration of grocery retailers in Northern Ireland. Any closure of stores following a merger had the potential to reduce local choice and competition, and could possibly create further monopolies.

National Consumer Council

8.33. The National Consumer Council (NCC) was concerned by the consequences for consumers of further consolidation in the supermarket sector and felt the proposed acquisitions raised significant risks of reductions in competition at both national and local level. In a market of essential importance to consumers, there was a clear risk of detriment if choice was reduced at local level. Evidence was needed that consumer choice would not be hindered by the creation of either local monopolies or a national oligopoly.

8.34. The NCC said that a merger between Safeway and any of the four bidders would produce a high level of concentration in one-stop grocery retailing at the national level where the effect of the planning regime as a major barrier to entry could result in a reduction in competition. Were Safeway to merge with any of the three largest supermarkets, a substantial gap would open between those three and the remaining players, who might be prevented from acting as effective competition restraints. The NCC had seen no evidence of countervailing consumer benefits to outweigh such a lessening of competition.

8.35. The NCC believed that local markets should be individually examined to test whether a merger might lessen competition. Market definitions should be reconsidered: 62 per cent of households in the lowest income quartile did not have a car, and lack of transport, public or private, was a difficulty for some disabled and elderly consumers. Other factors such as rural deprivation suggested a smaller market definition.

8.36. The NCC had reservations about the implications of any major divestment programme, where success would depend upon the capacity of smaller-scale competitors to purchase Safeway stores. Were this to happen, the NCC wanted open consultation on hypothetical remedies. Any solution leading to a highly concentrated market, dominated by three large players, raised significant national competition concerns.

Wholesale interests

A G Parfett & Sons Limited

8.37. A G Parfett & Sons Limited (Parfett's) said that it was an independent family business, based in the North-West, and operating as one of the top ten UK cash-and-carry companies. It relied heavily on serving the needs of independent retailers, mainly convenience stores.

8.38. Since 1992, 25,000 local neighbourhood stores had closed. Although some had failed to react to new market conditions, the huge and unwarranted buying power of the multiple retailers was now seriously damaging those small family businesses which would otherwise be viable, and which provided a vital service to the local community, including employment, convenience, and facilities for those unable to travel to large supermarkets.

8.39. A Safeway acquisition by Tesco, Sainsbury's or Asda would further limit supermarket competition, exacerbating abuse of buyer power, leaving suppliers attempting to recoup some of their losses by

charging higher prices to the small remaining independent sector. A Morrisons acquisition, whilst not ideal, was by far the best of the current proposals.

8.40. It was vital that the CC recognized there was just one grocery market, comprising one-stop and convenience shopping, and that the abuse of buying power was seriously damaging sectors of this market. Proper account should be taken of the effect of increased market dominance by multiple retailers.

Costco Wholesale UK Limited

8.41. Costco Wholesale UK Limited said that it was a wholesale supplier to tens of thousands of independent retailers in the UK. As such, it recognized the vital importance of preserving the independent sector, by giving them the chance to sell top-quality items at keen prices.

8.42. It urged us to recognize that suppliers were the same for all food wholesalers and retailers, big or small. As such, it was wrong artificially to delineate the food market into one-stop and convenience.

Spar (UK) Ltd

8.43. Spar (UK) Ltd (Spar) said that it was a voluntary buying group comprising 1,800 independent members operating nearly 2,700 convenience stores under the SPAR fascia. Spar was the central office providing trading, marketing and support services to the six Spar wholesalers serving those stores.

8.44. For Spar, the consequences of Safeway being acquired by any of the four bidders would be one less major buying point, and additional pressure on suppliers who would both reduce their own overheads, with consequential job losses, and attempt to recover margin by cost price increases. In turn, the reduced opportunity for convenience retailers to expand against increased competition would lessen choice for consumers.

8.45. Spar believed there was evidence, which suppliers feared to put in writing, that the largest retailers abused power. This justified the Code of Practice, although Spar had no view as to its effectiveness.

8.46. Spar also believed that demand on suppliers would intensify if Safeway was acquired. The major supermarkets already secured better terms than the independent trade, and this gap could only widen. Safeway would give Asda or Morrisons an entry to the successful petrol forecourt convenience market. Sainsbury's and Tesco had already achieved this and in consequence two independent forecourt operators were closing every day.

8.47. Spar said that regulation was required to protect the consumer from a reduction in choice. Multiple-owned businesses could delist suppliers when negotiating improved terms, whereas similar action by buying groups could result in prosecution. A review of the law was much needed in this area.

8.48. Below-cost selling disadvantaged independent retailers and impacted unfairly in the UK because of the dominant position of major supermarkets. Amending the Code of Practice to prohibit below-cost selling would prevent major retailers deliberately harming smaller players.

8.49. In conclusion, Spar felt all Safeway bids should be rejected until a detailed food market study was carried out with the strategic objective of reducing the monopoly reference from 25 to 15 per cent, and outlawing below-cost selling.

The Big Food Group (Iceland)

8.50. Iceland had provided written views and had also attended a hearing. It told us that it was the only integrated food provider in the UK, participating in the retailing sector through the Iceland fascia, and the wholesale sector through the Booker cash-and-carry chain. It employed almost 30,000 people and supplied 240,000 outlets.

8.51. Iceland was developing an integrated system of provision for retailers, as an alternative to competing with the major supermarkets for the same suppliers and the same distribution chains. This had

become necessary, because the three leading supermarket supply chains had effectively eliminated the ability of others to have access to the products they were sourcing.

8.52. Iceland wished to emphasize that the grocery market was a single entity. It should not be dissected by major players to provide expansion. Iceland was pleased that the CC was looking at the relationship between large and small stores. They were not separate business sectors that could be treated as distinct markets.

8.53. Iceland saw a Safeway takeover by any of the potential bidders as having profound implications for the supermarket sector. Competitiveness between supermarkets and the rest of the sector would intensify further. Polarization would drive smaller players into niche or convenience operations, and increased pressure on their relationships with suppliers could lead to a reduction in their numbers.

8.54. Iceland said that supermarkets already represented serious competition for convenience stores. This would be exacerbated by a Safeway takeover. The economies of scale enjoyed by the large players could mean some small stores being priced out of the market. All the bidders were claiming that prices would fall; the short-term impact of this would be suppliers passing on higher prices to smaller food retailers. If three major players were left, the long-term consequences might also be price increases.

8.55. Site availability problems, planning constraints and government policy had all resulted in some major retailers moving back to town centres. Iceland saw this as adding to competitive pressures in the high street, where the convenience store sector was already being targeted.

8.56. A small number of large, sophisticated competitors dominated the food market. The ability to invest sufficiently, compete on price, gain sufficient selling space and create a supporting infrastructure combined to make entry for a new player most unlikely. That prospect would recede further following a takeover and subsequent aggressiveness in pricing policy, reducing consumer choice yet again.

8.57. In ranking the bidders, Iceland said that Tesco would impact the food retailing marketplace to the greatest extent, followed (on a reducing scale) by Sainsbury's, Asda and Morrisons. The first three would deter new entrants, Morrisons less so, whilst an independent acquirer would have minimal impact. At local level, publicly available research from TNS showed that, following a takeover, Tesco would have over 25 per cent share in eight out of ten regions, Sainsbury's six, Asda five and Morrisons two, with resultant impact on supplier terms, local pricing, staff costs and retail rents.

8.58. Iceland said that the history of the previous 30 years had been one of consolidation. Well-known names had gone, and three players controlled much of the food chain. The industry was on the cusp of an irreversible change which Iceland suggested should concern Government.

8.59. On divestments, Iceland felt that both local and national competition needed to be considered, together with a further range of factors affecting the community. If unsuccessful bidders targeted smaller retailers, the effects on the competitive environment could outweigh the impact of divestment. Store locations should be considered, with local market share guidelines being applied in each case and the potential acquisitions of each bidder reviewed on a store-by-store basis.

8.60. The growth in market share achieved by Tesco, Asda and Morrisons between June 2000 and June 2001 suggested to Iceland the possibility of improving buying terms through sales growth. Simultaneously growth strengthened the retailer in negotiating more favourable terms with suppliers, and those savings could result in higher prices to smaller food retailers.

8.61. Iceland recognized that the one-stop shop had met a need in society, but local provision for smaller purchases for impulse, social or convenience reasons met an equally valid need. Consumer expectation now was that the local corner shop was a smaller version of a one-stop shop, able when required to provide family needs for a week.

8.62. Viewed overall, the Iceland preference would be for an independent Safeway, purchased by a non-trade buyer with restrictions on disposal of any assets. The preferred trade buyer was Morrisons, with a view to sustaining four strong players in the market. If successful, Morrisons should be made to divest stores in Yorkshire and the North-East, as the addition of Safeway stores to its portfolio in that region would give it a market share advantage beyond local market share guidelines.

8.63. Iceland said that the Code of Practice made sound business sense and it had adopted it voluntarily. It felt that a similar code should exist for suppliers in view of some questionable practices. But it also considered that retailers such as M&S and Tesco had worked for sustainable supply chains. Iceland supported the Code because its practices were already consistent with its contents.

8.64. On the Remedies Statement, Iceland had a number of points to make. It was disappointed that no decision to date had been taken to revisit the division of the grocery market into one-stop and convenience shopping. This did not reflect the reality of people's shopping behaviour, nor was it in their interests, or the interests of industry suppliers or small grocery independents. There were four reasons for this:

- (a) The formula did not allow the true competitive effects of a merger on a small business to be identified and assessed. Since 1992, 25,000 neighbourhood stores had closed in the UK, with a further 10,000 predicted to close by 2007. Iceland data showed unarguable evidence as to the material impact superstores had on convenience stores.
- (b) The formula prevented accurate social impact analysis—the dramatic effect of smaller store closures on communities they served, particularly the elderly, the less well off, and those who lacked transport. Our use of an isochrone exercise was welcomed, but this should be extended to all Safeway stores, and the current exercise done as a full impact analysis, including smaller stores, so that the real impact of a merger on other operators might be assessed.
- (c) The formula led to flawed decisions on subsequent competition issues. Iceland referred to the Tesco and T&S merger, which it believed was based on a fundamental misunderstanding. Tesco now had 1,000 or so convenience stores competing directly with existing convenience players, but already had a dominant share of the grocery market. Tesco's economies of scale could not be matched by an independent operator, and were likely to lead to the closure of many more independent outlets.
- (d) The divided market formula produced a domino effect not always recognized, from major retailers through suppliers to smaller stores. Major multiples wielded enormous power over suppliers, which increased with market growth, and this power would increase again by virtue of any acquisition. Such pressures would result in suppliers charging higher prices for smaller retailers.
- (e) Finally, on possible remedies, Iceland did not believe that divestment rules would be adequate to deal with the competition issues arising from trade bids from any of the bidding parties other than Morrisons.

Vikas Buying Group

8.65. Vikas Buying Group said that independent retailers, which it represented, had an important role within the community, but had fought a losing battle against the large multiples for three decades and were now in terminal decline. Market share had dwindled from 53 per cent in the 1970s to barely 9 per cent in the 1990s. The multiples had used their financial muscle to decimate virtually all trade across the board, and small grocers, butchers, tobacconists etc were on the point of extinction.

8.66. Vikas Buying Group said that out-of-town stores had sucked trade away from the high street, and their entry into the small convenience store sector threatened to eliminate what was left of the independent sector. This latter development should be blocked, to protect communities by ensuring that high street and village stores remained viable.

Farmers' cooperatives

Anglia Quality Meat Association Limited

8.67. Anglia Quality Meat Association Limited (Anglia) said that it was a farmer-owned marketing cooperative from Royston in Hertfordshire. It did not think its members' best interests would be served by any of the major supermarkets acquiring Safeway.

8.68. Anglia had witnessed an ever-decreasing proportion of the final sale proceeds being returned to the primary producer. In the pig sector, this was at an all-time low. Anglia was currently engaged in developing food chain linkages, of great benefit to producers, UK processors, and consumers. These initiatives, essential to sustain UK livestock production long term, would be greatly damaged by further concentration of buying power by the multiple retailers.

Lilburn Estates Farming Partnership

8.69. Lilburn Estates Farming Partnership wrote to express its concern at the prospective takeover of Safeway. If another large multiple were to acquire this retailer, the result would be to make the marketplace smaller, marginalizing producers, lowering farm-gate prices and farmers' returns

WyeCycle Ltd

8.70. WyeCycle Ltd (WyeCycle) described itself as a farmers' cooperative, including farmers' markets in its activities.

8.71. WyeCycle said that the root cause of the many concerns expressed about supermarkets was their power in the marketplace, quantified as a percentage share of the market. It was only logical, therefore, that what constituted a supermarket should be defined by reference to a company's market share. WyeCycle defined a supermarket as any company responsible for more than 1 per cent of UK food retailing.

8.72. Using this definition, WyeCycle said that it was possible to get over the mental block affecting decision-makers that 'the public liked shopping at supermarkets'. The public did want to do all their weekly shopping under one roof, with a wide range of produce and an adjacent car park. They did not demand that such a shop was owned by a company responsible for more than 1 per cent of UK food retailing.

8.73. Once it was accepted that supermarkets could be disinvented without the general public being inconvenienced, there were two possible causes of action for Government. Most simply, legislation could be passed stating that no single business could be responsible for more than 1 per cent of UK food retailing. Alternatively, a range of measures could be introduced with the openly stated aim of achieving the 1 per cent figure. WyeCycle believed such measures should include:

- (a) a tax on supermarket car-parking spaces, set at such a level as to be revenue neutral with a 95 per cent rate rebate for independent food retailers;
- (b) no approvals for new supermarkets, extra floor space, longer opening etc;
- (c) accurate meat and dairy product labelling, especially as to origin and methods of production; and
- (d) a range of legislation on issues which would favour the local over the global: deposits on bottles, charging levels to discriminate in favour of small abattoirs, increases in vehicle excise duty to add to the cost of transporting food, etc.

8.74. In addition to setting out its own views, WyeCycle provided a number of papers by researchers, academics and analysts addressing the same or similar issues.

Yorkshire Farmers' Livestock Marketing Limited

8.75. Yorkshire Farmers' Livestock Marketing Limited (Yorkshire Farmers) said that it was a farmer-owned marketing cooperative, based in Malton since 1932.

8.76. The pig sector, unsupported by public subsidy, had seen significant trauma in the past six years. The retail value had reduced considerably since 1997, and retail price deflation had similarly reduced the total value of meat. Over a third of the pig industry was going out of production with the remainder on the verge of bankruptcy, or simply packing up. Much of the bacon market had been surrendered, and a great deal of the industry was being exported to countries with lower production standards.

8.77. Various health problems (noticeably foot and mouth) and the strength of the pound had contributed to the situation, but in an industry where the UK led Europe in production standards, the buyer power of major retailers was a major contributory factor. The buying policies of all the major multiples were damaging a livestock industry already on the critical list. A further concentration of retail power would result in fewer larger suppliers, fewer slaughterhouses, more miles travelled for livestock and increased environmental costs.

8.78. Yorkshire Farmers believed greater regionalization would increase sustainability and be better for the environment. Instead of further concentration reinforcing the downward trend in the UK pig industry, what was wanted was four evenly-matched retailers.

8.79. Excellent, mutually beneficial relationships had been developed with the smaller retailers. Yorkshire Farmers was currently developing further food chain linkages, of benefit to livestock farmers, UK processors and consumers. Any more concentration in the buying power of the multiples would adversely affect these and similar initiatives.

Retailers

Boots Group PLC

8.80. Boots Group PLC (Boots) told us that it had over 1,400 stores in the UK with some 95 per cent of them in town and city centre locations. It had a presence in virtually every town and city in the UK.

8.81. Boots drew attention to a planning system which allowed supermarkets to create local monopolies at the expense of other local retailers. Permission for many out-of-town locations was secured before the introduction of stricter rules. These now prevented further growth in out-of-town developments; in consequence, supermarkets traded in isolation, in increasingly large units, with a competition advantage.

8.82. Many supermarkets had expanded the range of goods sold into non-food items, traditionally the preserve of the town centre. They had become the new primary retail centre, with a growing monopoly in that shopping area, often relegating town centres to a secondary status and continual decline.

8.83. Boots made two recommendations:

- (a) In the light of the competitive advantage described above, the inquiry should investigate the potential effects of a smaller number of larger supermarket chains being created.
- (b) Local authorities should be encouraged to draw up local action plans to address the problem of the creation of new, single-store primary shopping areas, to include allowing other retailers to locate in those areas.

Budgens Stores Ltd

8.84. Budgens' overall view was that the Morrisons bid for Safeway represented the least bad outcome, but that all the bids were damaging for the sector as a whole. Large-player behaviour militated against fair competition and any reduction in numbers leant further towards oligopoly.

8.85. Supermarkets depended increasingly upon secondary shopping to drive turnover, and also used their leverage with suppliers to drive down cost prices in the convenience market. The vastly superior trading terms enjoyed by the major multiples created a non-competitive market, whereas true competition required a level playing field. Convenience competitors, including Budgens, faced tightening supplier margins and smaller retailer margins. Reducing choice and rising prices would impact on consumers.

8.86. Budgens said that petrol retailing would be affected by any cross-subsidy between petrol and grocery sales. Safeway had been at the forefront of this development.

8.87. Site availability remained a problem. Supermarkets continued developing through acquisitions. New entrants faced planning constraints, establishing supply chains and start-up costs, especially staffing, which made them vulnerable to suppliers looking to recoup lost profit margins.

8.88. Budgens said that divestment could significantly impact the economic health of an area if store closures followed. Questions to be addressed included how to stop acquisitions disrupting competition, and identifying bidder plans for divestments. To avoid competition problems, the sale of small block or single stores to smaller retailers should be the approach taken, with appropriate restrictions because of potential local domination by large retailers.

8.89. A Safeway merger with any bidder would create a strong new competitor. Budgens questioned the risk involved, which might manifest itself in suppliers relieving pressure at the expense of smaller retailers. Sainsbury's was seen as a less aggressive buyer than Tesco or Asda. The number of suppliers favouring Morrisons was instructive.

8.90. Budgens welcomed the review of the Code of Practice. It should be completed before recommendations concerning Safeway were made. More precise terminology was needed, below-cost selling should be addressed, together with stronger provisions protecting suppliers, full disclosure of terms, and a facility for confidential complaint to the OFT whose officials should be empowered to carry out spot checks on agreements between supermarkets and suppliers.

8.91. Budgens had three further points to make on the Remedies Statement. First, it remained concerned about the adverse effects on smaller grocery or convenience stores following any increase in buying power of a merged entity, because suppliers to that entity might seek to recoup lost margins against those smaller retailers. This was an area of vital importance to the convenience store sector; there was evidence of distortion occurring in the short term, and every chance of it also having a long-term damaging effect. This issue required further attention.

8.92. Secondly, in noting that work was in hand to determine whether lower buying costs following any of the mergers would be due to economies of scale, on either or both of the supply and buying side, Budgens felt that such an analysis ignored one other possible factor: namely, that lower buying costs were brought about not by purely economic factors, but through apprehension on the part of suppliers that preferential terms had to be offered to large retailers, irrespective of whether the economic case for them could be made. This should also be considered, and any findings passed to the OFT, to consider in its review of the Code of Practice.

8.93. Thirdly, Budgens supported the suggestion as to a level playing field to improve the position of suppliers, but felt that the logic should be taken a step further. Full transparency (ie publication of relevant invoices) was needed in all transactions between suppliers and retailers, so that market and competition authorities might be certain that purported cost differences were genuine and not based on unfair practices. Insisting that price differences mirrored cost differences did not alone guarantee a level playing field.

Co-operative Group (CWS) Ltd

8.94. The Co-op described itself as a large retail business with 1,700 stores throughout the UK, and the aim of being the market leaders in the convenience/top-up shopping market. Its portfolio ran from stores over 3,700 sq metres to those under 50 sq metres. The Co-op believed that sub-1,400 sq metre stores could consistently meet one-stop main trip demand where the purpose of that trip was limited to 'groceries' as defined for the purposes of the CC's Supermarkets inquiry in 1999/2000. These stores were, however, likely to exceed 900 to 1,000 sq metres. Stores as small as 280 sq metres were capable of meeting many of the shopping needs associated with the 'main trip' in rural and semi-rural locations, where shoppers could be 20 minutes or more drive-time from a 1,400 sq metre store, which, in consequence, they chose to visit infrequently, at up to monthly intervals.

8.95. The Co-op told us that it was now following a broad strategy of disposing of large stores whilst focusing increasingly on medium and smaller units, many in market towns. Volume growth in smaller stores and convenience stores allowed periodic divestment of larger units. This helped address issues of location, brand strength and critical mass.

8.96. The Co-op saw much greater growth in top-up and convenience shopping. The involvement of all the major players in these segments was increasing, it being perfectly possible for a top-up and convenience offer to exist in a main trip environment of a 1,400+ sq metre store. Whilst the non-grocery segment was increasing, core grocery items remained the driver of the regular weekly visit.

8.97. The Co-op said that each of the four potential mergers would reduce consumer choice and increase market concentration, especially locally. If Tesco succeeded, its market share in six of the twelve regions considered by the CC in 2000 would exceed 45 per cent. The emergence of four big players would also perpetuate below-cost selling practices, increasingly subsidized from non-food lines. The margin mix benefits, which some major multiples had derived through developing non-food within their customer offer, had significantly assisted their ability to fund below-cost selling of known-value food items. A means was needed to end this practice.

8.98. The Co-op suspected that a successful Tesco or Sainsbury's bid would take buyer power beyond 30 per cent of the wholesale market in certain products, in Tesco's case producing disproportionate market power, and putting more pressure on UK suppliers. It would also provide more home market access to overseas suppliers, with no guarantee that customers would benefit.

8.99. Global retailers bought products more cheaply, increasingly sourcing outside the UK. Many suppliers now offered fixed basic prices, with variations depending on the closeness and fit of the relationship, for example the way in which payments were organized. Smaller operators probably could not achieve this to the same extent as the large operators. The Co-op was also concerned that only one or two UK sources now existed for certain items. Whereas large players could access overseas sources, the consequence for small retailers was an increasing squeeze on pricing and availability. The Co-op had itself suffered as a consequence of what it believed was deliberate non-availability.

8.100. It was the belief of the Co-op that any of the proposed mergers would reduce choice at local level. Resultant enhanced buyer power would impact adversely on convenience stores in the sub-280 sq metre grocery bracket, and on the 48,000-strong community of specialist retailers, for example off-licences, grocers, butchers, etc. Increased concentration of buyer power would reduce diversity and lessen choices for customers in the high street. A merger among the big five would further tilt the supply relationship in favour of the successful buyer, and to the detriment especially of dependent smaller retailers.

8.101. Each of the proposed mergers would enhance barriers to entry for the 'cold start', organic-growth-driven, domestic competitor. The Co-op had considered possible scenarios in the event of each of the bidding parties succeeding, and concluded that none of those possible outcomes necessarily closed the door on further consolidation, whether involving domestic or Continental competitors. What did militate against market entry, other than by substantial acquisition, was the availability of sites, the planning regime, and the size of the four remaining players.

8.102. Growth would be a slow business for Morrisons if Safeway was not acquired. Without substantial growth, it would face problems of scale in a competitive market. Entry now from scratch was very difficult, if not impossible.

8.103. On its analysis, the Co-op did not see Safeway as a business in decline, let alone terminal decline. A takeover might strengthen the Safeway stores, but damage to the market infrastructure also had to be considered, for example an intensified competitive environment reducing the Co-op's ability to supply stores in outlying areas such as the Scottish Highlands and Islands. At present the Co-op, as a cooperative, serviced its members where they were found, with standard terms and prices, supporting relatively uneconomic stores in 'food deserts', with disproportionately high distribution costs, as long as its financial success among other stores enabled it to do so. The increased prevalence of below-cost selling, or other trading pressures arising from a consolidation, could damage that fragile environment, with adverse consequences for the 'food desert' store.

8.104. Using 1998/99 data, the Co-op had concluded that a successful Tesco or Sainsbury's bid raised risks of the creation of local duopolies. These would be more numerous than Sainsbury's/Asda or Tesco/Asda duopolies. Any divestment process would require transparency and structuring to avoid divested stores automatically going to unsuccessful bidders, and competition levels being reduced. The method adopted should not create local, regional or national competition issues but, those issues apart, there should be no restriction in buyer identity. Consideration should be given to requiring bidders to divest elements of store infrastructure such as distribution, with a view to removing barriers to entry.

8.105. Four fascias were better than three for competition, and three better than two, where each fascia was sufficiently strong to constrain the competitive behaviour of the other two. The three-fascia principle was seen as an imperfect rule. Its effectiveness, in competition terms, was governed by at least:

- (a) whose fascia it was;
- (b) local demographics;
- (c) the size of store to which it attached;
- (d) the breadth and depth of offer within that store;
- (e) transport links;
- (f) proximity, number and 'strength' of neighbouring fascias; and
- (g) individual retailer loyalty of customers in the catchment.

8.106. The Co-op said that it complied voluntarily with the Code of Practice and would continue to do so. The Code should be reconsidered following any merger, to determine whether it was still the most effective means of regulating the supplier/buyer relationship. A poor claims history suggested that it had not achieved what it set out to do. Suppliers were disinclined to complain about buying practices, for fear of being blackballed. This might be addressed by a regular reporting regime on trading relationship fluctuations (which might also inform any controls to be introduced in respect of below-cost selling) and extending the Code to include indirect suppliers.

8.107. Having considered the Remedies Statement, the Co-op wished to comment on new issues, and reiterate other points. It confirmed its view that secondary/top-up and convenience shopping took place in stores above 1,400 sq metres, and that the 600 sq metre threshold had no relevance in defining any segment of the grocery market. It also expected the definition of a separate procurement market, including groceries, to be a natural outcome of our inquiry given the potential level of procurement involved. That market should be defined by considering the sources from which food retailers obtained their goods for resale.

8.108. The Co-op broadly accepted that competitive dynamics in one-stop shopping operated primarily at local and national levels, but had reservations as to the direct applicability of that analysis to the non-central belt regions of Scotland. Experience suggested that more remote areas presented unique distribution and store economics challenges. Scotland should therefore be treated in the same manner as Northern Ireland.

8.109. The limited evidence of the 'waterbed' effect was surprising: economic common sense suggested that suppliers subjected to price reductions by customers over whom they had no effective bargaining power would look to recoup from other customers. Concern also remained that margin benefits, secured through enhanced purchasing strength, might not be passed on commensurately to the benefit of the consumer.

8.110. The Co-op had consistently maintained that eligibility to acquire Safeway stores should be tested against competition law criteria only, whatever form the acquisition took. In those circumstances there should be no outright prohibition of any of the mergers precluding the prohibited party from acquiring Safeway stores in any circumstances. Any restraints should be those imposed by competition considerations. Occasions where divestment to a non-food operator would only very marginally prejudice the competitive dynamic should be tolerated, but not otherwise. Acquirers should be at liberty to divest their own rather than the acquired Safeway store, subject to adequate competition being preserved. In dealing with bids for divested stores, constraints might be necessary, to ensure that both national and local competition remained real, rather than apparent. The divestment process should be managed in a way that ensured that competition in the relevant market was not reduced by the impact of a successful bid, which required an OFT supervised process. We should be satisfied that a divestment regime had a high probability of proving achievable, within time frames which the market, as a whole, would find acceptable; on the other hand, it would not be appropriate for us to be involved in product ranging within stores, and this should be a matter for the retailer/customer market to resolve.

8.111. Finally, the Co-op supported strengthening the Code of Practice in the event that the OFT review determined it had not achieved its stated objectives. The Code should establish an acceptable balance of power between suppliers and major retailers, with that relationship left to itself in terms of price negotiation.

E H Booth & Co Ltd

8.112. Booths said that the sale of Safeway would significantly disadvantage small, independent grocers/multiples and that any stores divested in consequence would go to another peer group member, further increasing major multiple buying power. If a merger took place, then divested stores should be made available in small blocks, or indeed individually, in order that small independent operators might be given an opportunity to bid. There should be a restriction on who was able to buy divested stores, designed with regard to a potential purchaser's market share, either as a whole or regionally.

8.113. If a major operator acquired Safeway, Booths believed that suppliers would be pressed to reduce prices, forcing them in turn to cut R&D budgets. Customers would be left with less rather than more choice, and no guarantee of subsequent price reductions. Increased buyer power did not always mean lower costs for customers, but reductions could in turn force smaller operators to reduce trading margins, denuding them of vital profitability.

8.114. Booths said that a merger could result in supermarket forecourt petrol becoming cheaper. Although a benefit, there could be a downside in countryside fuel retailers closing following volume losses.

8.115. Booths believed the planning regime had kept supermarket site availability tight, with a consequent intensification in competition for locations. This, together with the matching of suppliers' distribution networks to those of supermarkets, made it almost impossible for a new player to enter and establish a sustainable business.

8.116. Booths had not signed the Code of Practice, believing it written to suit large multiple operators. It should be made clear at whom the Code was directed from a supplier perspective. As a small operator, Booths would welcome the Code giving some protection from large-scale manufacturers and distributors.

Marks & Spencer plc

8.117. M&S provided views to the OFT and also attended a hearing with the CC. M&S told us that it had 320 stores (now 340) in the UK, all providing a grocery offering, with most also offering general merchandise, primarily clothing. A key focus of M&S's current store expansion strategy was to grow its food-only formats (Simply Food) using its high-quality, 100 per cent own-label food range, to reach a broader base of customers.

8.118. M&S distinguished itself from a one-stop supermarket. It provided real choice and a true point of difference, in a market where customers visited a range of shops. Whilst M&S did not see itself as a one-stop shop, recognizing that customers spent more on food elsewhere, it was visited by consumers for a range of unique products on a regular basis. Its ethos was to be innovative, differentiated, and to be used by consumers as a 'repertoire store'. As such, M&S provided a source of effective competition for one-stop stores rather than a complement to one-stop shopping, increasing consumer choice in the local market. In particular, M&S stated that where there was already sufficient competition between one-stop stores in a local catchment area, the presence of M&S provided greater consumer choice and a source of effective competition to the one-stop-shop competitors in that local market.

8.119. M&S said that a reduction from four to three major players would damage consumer welfare. Barriers to entry, already substantial, would be increased as a result of further concentration, leaving smaller and medium-sized grocery retailers vulnerable to the adverse consequences of a restrictive planning regime, and lack of suitable sites. These conditions could lead to anti-competitive estate acquisition and management practices by major retailers, further limiting or foreclosing competition. To maintain effective local competition, M&S believed that the proposed local monopoly test should be extended to areas where consumer choice was limited to three major retailers, rather than two.

8.120. M&S noted that the more concentrated national picture arising from the proposed mergers of Safeway with Asda, Tesco or Sainsbury's (but not Morrisons) could result in further pressure for margin reduction on the agricultural and manufacturing base, resulting inevitably in fewer suppliers, less product choice, and lower-quality products. M&S required a healthy and sustainable food 'supply base' in order to develop its overall strategy. Damaging the competitiveness of small suppliers would substantially lessen competition, and could have adverse consequences for consumers. The nature of the relationship between own-label suppliers and the large grocery multiples was particularly susceptible to the adverse consequences of buyer market power and price squeezing.

8.121. M&S also believed that the practice of price flexing distorted competition to the detriment of competitors, and ultimately consumers, whether through price increases or reductions. 'Selective premium pricing' (where it was not justified by real cost differences like those arising from premium cost locations such as transport hubs and central London) distorted competition, to the detriment of both consumers and retailers, like M&S, who pursued consistent pricing policies. Increased consolidation of the market in the hands of the bigger multiple retailers could lead to increased use of 'selective premium pricing', particularly in areas where consumers had little or no choice as to where they shopped, and where in consequence those retailers would not be subject to competitive constraints.

8.122. The disposal of Safeway presented an opportunity to stimulate competition in the food grocery market which would not be met by any of the major players. Having said that, M&S would have significantly less concern in the event of a successful bid for Safeway by Morrisons, seen as a regional rather than a national player. Provided the appropriate divestment strategy was followed, M&S believed that a Safeway/Morrisons merger would not lead to a substantial lessening of competition in the UK grocery market. A Morrisons acquisition would best and most easily balance market and national shares. Morrisons as a national business would be a better-placed competitor.

8.123. M&S said that the reduction in consumer choice in a local market occasioned by the loss of a Safeway store could be redressed by divestment to competitors other than the main parties alone. Possible alternative competitors should include other national, regional and local operators. Divestment to one of the main players would not invigorate competition at the local level, but would reinforce the existing collective position enjoyed by the main players in the relevant locality.

8.124. M&S had very real concerns as to the adverse effects on competition which resulted from the increasing number of local markets dominated by major retailers, because of the high proportion of stores therein under the control of a single player. The existence of three fascia in a local catchment area would generally be adequate, provided one was a price-led retailer, but catchment areas where the fourth store was actually one of the major supermarkets would again raise real concerns and M&S believed that, in such instances, the fourth store should be in the hands of another competitor. Any monopoly on outlets in a particular area constrained consumer choice of retailer and fascia, and raised the prospect of retailers creating a form of 'portfolio power' in sites and outlets controlled.

8.125. The sheer diversity of the Safeway property portfolio would need addressing. M&S had experience of one-stop stores of 550 or so sq metres proving viable, dependent upon the configuration of other stores in the area. At the lower end of the market, the model was a sensitive one, allowing small stores to fill in the gap in the footprint of nearby larger branches. It was also the case that the growth in non-food products was increasingly important in affecting catchments by drawing customers from greater distances. Some grocers had now become strikingly powerful in particular non-food markets.

8.126. There was evidence to suggest that the main grocers offered a credible main shop catalogue in a store space of 1,000 sq metres. In particular:

- (a) stores of 1,000 sq metres stocked all the food and non-food categories needed for a main shop, both in terms of range, product choice and type;
- (b) stores of 1,000 sq metres tended to have car parking, or access to nearby parking;
- (c) most stores of 1,000 sq metres provided shopping trolleys as well as baskets; and
- (d) changing patterns of consumer behaviour meant that smaller formats could be used for one-stop shopping.

8.127. M&S believed that petrol sales were influential in affecting the distances customers would travel. It did not, however, see the rate of growth in Internet shopping as of any great significance to the inquiry.

8.128. In considering the Remedies Statement, M&S reiterated a number of points and made further comments. It was concerned lest subsequent acquisitions circumvented objections to the prohibited bids. Viable options were to prohibit subsequent store acquisitions or limit numbers of stores prohibited bidders could acquire, requiring national, local and regional tests for each acquisition. Such limitations should take account of the need to maintain choice in rural areas.

8.129. There should be restrictions on who might buy the divested stores. This could be enforced by a prohibited, rather than permitted, bidder list, with the former likely to comprise the failed Safeway bidders. Smaller national and regional grocery retailers, such as M&S, should be considered potential bidders, subject where appropriate to the process outlined above. Acquisition of sites by other than prohibited bidders should be facilitated to the maximum extent, with certainty that competition concerns had been addressed, and remedies capable of implementation.

8.130. M&S urged caution in defining what constituted a non-grocery outlet. Many mixed-offer stores (including M&S) acted as powerful competitors in the grocery market. It also believed that the successful bidder should be required to sell the Safeway store, rather than its own, in order to solve a local market issue. A cap on the national market share of any successful bidder would be very desirable, not least as a means of resolving competition concerns which local divestments would not necessarily solve.

8.131. M&S judged there to be sufficient buyers and competition for large, divested Safeway stores, and a prohibited bidders' list would ensure maximum competition. Time limits on site sales should be imposed, and qualitative as well as quantitative elements of any local offer taken into account in setting local divestment rules.

8.132. When considering the form of divestments, M&S believed that it did not matter too much in principle whether stores were divested singly or in large blocks, but considered that, for efficiency reasons, all the bidders would seek to divest in larger blocks. However, M&S sounded three notes of caution in this regard:

- (a) that sales in sizeable bundles might be preferable, including distribution assets, to deal with regional issues, for example in Scotland and Northern Ireland, thus allowing early critical mass to be achieved;
- (b) if bundles were too large, the package could be beyond the scope of smaller players; and
- (c) on the other hand, store bundles too small could be used by the seller to shape local competition markets to its own advantage.

8.133. It was also arguable that land-bank assets should be included in local competition assessments as identifying a major bidder's potential to open additional stores.

Netto Foodstores Limited

8.134. Netto believed it would be better to divest stores in small blocks following any acquisition. There should be no restrictions as to who could buy such divested stores.

8.135. Netto did not feel that the CC should consider requiring bidders to divest distribution assets.

Nisa Gillen's Supermarkets

8.136. Nisa Gillen's Supermarkets said that it did not want to see any further consolidation on the part of the top three supermarkets. In reality, the major multiples worked on greater margins in their dealings with suppliers, and in effect operated a protected market. Smaller independent retailers were unable to compete fairly and suffered in consequence; in fact, suppliers were turning to them for their profits, because they could not cope with the massive buyer power of the leading supermarkets.

Proudfoot Group of Companies

8.137. The Proudfoot Group of Companies (Proudfoot) provided written views and also attended a hearing. It told us that it was established in 1946, and is an independently-owned retail food supermarket company with five food supermarkets and one non-food store, operating in North Yorkshire, the East Riding of Yorkshire, and North Lincolnshire. Its ethos was to be very modern, to expand, and to work to multiple national standards. Its customers were a mix of convenience and one-stop-shop visitors. Proudfoot's success came from its location, and the quality of its people services.

8.138. Proudfoot took the view that a successful Morrisons bid for Safeway would incur less public scepticism. A mixture of Asda and Morrisons also appeared acceptable, but if Tesco or Sainsbury's acquired Safeway the top two would acquire half the market, which raised immediate concerns. The merger situation needed to be viewed from all angles, including turnover, outlets and size.

8.139. If Safeway was acquired by another major retailer, the industry would be controlled by even fewer large players, reducing competitiveness and increasing retail prices nationally. The position of other retailers, including the better independent ones, should then be considered. If smaller players were prevented from expanding through acquisition, a reverse process might then force some of them out of the market. A good number of medium and smaller players would be interested in acquiring diverted stores, thus keeping another fascia in many areas.

8.140. Proudfoot's information, via its membership of a buying group, indicated that major supermarket buying power was up to 11 per cent greater than that available to others. The situation lacked transparency and the gap lacked fairness in competitive terms. Any strengthening of the multiples would only make things worse. Suppliers would come under great pressure, with major supermarkets threatening to use alternative sources, sometimes abroad, in order to drive down prices.

8.141. Proudfoot had noted pressures as a consequence of big retailer buyer power, ameliorated to an extent by its comparatively isolated situation. The dangers of this process intensifying were long term rather than immediate, but the CC needed to consider potentially serious consequences a decade hence. The greatest changes had occurred in the fruit and vegetable market, with direct contracts between leading supermarkets and farmers making it very difficult for other players to source and purchase the best produce. Wholesale suppliers in particular were going out of business.

8.142. Proudfoot said that some locations could support three or four fascias, but factors such as remoteness of location also came into play. Shoppers travelled considerable distances to grocery stores co-located or close to other facilities. It also believed that Safeway could continue as a viable entity, although considerable restructuring would be necessary, to improve productivity.

8.143. Proudfoot had found that its position as a local player had not helped its own expansion plans. The present merger situation apart, it was now very difficult for any contender to reach national player status. The planning regime, building process, and sales growth to a viable level all acted as inhibiting factors.

8.144. Proudfoot said that it would be interested in acquiring some stores under 1,400 sq metres. A Head Office and distribution structure already existed; it was the branches that were now wanted, although Proudfoot recognized that there would be competition for these. Apart from maintaining a static web site, it was presently unconvinced, for an organization of Proudfoot's size, of the viability of Internet shopping.

Somerfield plc

8.145. Somerfield said that a Morrisons bid, whilst reducing choice to the consumer in some areas of the country, would retain four national players. Were Asda, Sainsbury's or Tesco to succeed in bidding for Safeway, reducing the number of national multiples to three, that would be extremely damaging for the food retail sector, and the interests both of customers and the supply chain. Even if a successful bid by a national multiple were to be followed by forced divestments, that would not affect the reduction in major national players from four to three. Any pre-selling divestment agreement should be vetted by the OFT in the same way as the bid itself. Restrictions on the purchase of any divested stores would have to depend upon the local competition analysis.

8.146. Barriers to entry in the one-stop-shop market remained high. Fewer major players, in a market effectively closed to new entrants, was likely to have an insidious effect. Barriers to entry in the convenience market were also higher than was generally believed—whilst it might be relatively easy to acquire a small/medium portfolio of convenience stores, there would be considerable difficulties for a new player in gaining access to an authoritative range in the key fresh food area, and in creating the necessary logistical ability. The inquiry needed to cover the effect on the market as a whole: the previous categorizations were no longer relevant. A clear trend towards multi-trip main shopping in stores considerably below 1,400 sq metres was discernible. Somerfield believed that the planning consultation process was slower than in 2000 and competition for both out-of-town sites and town-centre locations greater.

8.147. There would also be a potentially anti-competitive effect on the supply chain if over 90 per cent of one-stop-shopping buyer power were to be concentrated in three major multiples, with powerful buyers continuing to drive down cost prices. Heavy cost increases in the supply chain would fall disproportionately on small suppliers (farmers), and there would be more below-cost selling. Short-term price reductions would be offset by longer-term negative effects on competition and consumers.

8.148. Somerfield noted that 1,000 forecourt sites a year were closing. If Tesco, Asda or Sainsbury's increased their dominance in the food market, this trend in the petrol sector would intensify.

8.149. Somerfield said that the bidding parties overlapped in their grocery operations, both one-stop shopping and secondary shopping. Safeway possessed a diverse estate, but customers saw the range of store sizes as a continuum of shopping experience, using different store sizes for different purposes. The market around each Safeway store comprised all retailers selling products sold by the grocer within the catchment area. Research indicated that any merger might, in principle, lead to some loss of customer choice and competition, by significantly reducing the number of conflicting fascias.

Thresher Group

8.150. Thresher Group described itself as the UK's leading specialist off-licence retailer. The Group traded from 2,000 stores under a wide variety of brand names, and employed around 12,000 people, all but 390 directly in the stores.

8.151. Thresher Group believed that none of the proposed mergers with Safeway should be approved. Such an acquisition would jeopardize the continued existence of independent retailers, reducing consumer choice, and both levels and quality of service to the consumer. If any merger went ahead, the anti-competitive policies currently displayed by the large supermarkets would increase further. Thresher Group had three particular points to make.

Predatory pricing

8.152. The grocery multiples used predatory pricing techniques to put specialists out of business. Following success with butchers and bakers, the specialist off-licence sector and the drinks category were now firmly in their sights, with cross-subsidy used until a particular specialist sector was unable to continue, after which the major player moved on. Predatory pricing and the abuse of market dominance would inevitably result in the end of the specialist drinks retailer. Already over 3,000 off-licences had closed since 1997 under these marketing practices.

Market definition

8.153. Clarity was needed over market definition. Thresher Group said that neither consumers, suppliers, nor the grocery retailers themselves saw neighbourhood and superstore markets as being separate or distinct, and grocery market definitions should not treat them as such. Moves planned by the grocery multiples into neighbourhood retailing constituted an integral part of their overall grocery dominance strategy. Supermarket growth meant that few high streets were far from a superstore. In consequence, consumers no longer viewed the superstore and neighbourhood markets as meeting distinct and separate shopping needs or occasions. As suppliers were often forced to run promotions across multiple formats, they too did not perceive these markets as distinct. Suppliers were often forced to reduce prices to cost

level and below, in which event they sought to recover losses from specialist multiples and local independent retailers, who thus subsidized the major players. The steady trend towards different formats with common marketing and promotion mixes, buying teams, supply chains and pricing indicated that the grocery retailers also saw these markets as a single continuum.

Public interest issues

8.154. Research demonstrated that, whilst consumers appreciated the existence of superstores for wide choice and low overall basket pricing, they remained wedded to the continuing existence of specialist retailers, particularly specialist off-licences, citing specialist advice, range, and convenience in terms of proximity. If the last few specialist off-licence firms were forced out of business, the loss in consumer benefit, employment and overall economic impact would be significant.

Waitrose Ltd

8.155. Waitrose attended hearings and also provided written views. As the food shops of the John Lewis Partnership, Waitrose (as at end-June 2003) had 143 branches in the South of England, Anglia, the Midlands and Wales, with 3.5 per cent of the retail food market (7 per cent in the South of England where it had its main presence). It told us that its customers were drawn from all socio-economic groups [

Details omitted. See note on page iv.

]. It told us that it operated a model with a single list price across the estate. A service-based ethic supported service-based stores of varying size, and its offering was geared to customer type rather than against any competitor. Every store looked to source locally, to relate to the community, and to address the local market.

8.156. Waitrose said that the Safeway situation probably represented the last major restructure in the market for one-stop grocery retailers for the foreseeable future. Competition should be maintained between retailers, smaller retailers, and suppliers, for the benefit of consumers. A Safeway takeover by another major food retailer would result in an increase in concentration in an already highly concentrated market. This in turn would lead to:

- (a) a significant lessening of competition in the one-stop grocery market;
- (b) a reduction in consumer choice;
- (c) a threat to the viability of smaller operators who provided diversity; and
- (d) a significant increase in the power exercised by a small number of dominant players over farmers and other suppliers.

8.157. Waitrose believed that both the local and national market situations should be examined. For the former, the methodology for examining local competition should be looked at again, focusing on:

- (a) potential monopoly, duopoly and triopoly situations;
- (b) isochrone analysis for each potentially affected store, or, where it might produce a more informed assessment of competition, significant population centre;
- (c) careful analysis to determine appropriate drive-times per isochrone;
- (d) overlaps between isochrones only in instances where these overlaps affected the vast majority of consumers;
- (e) situations where Safeway was part of a concentrated local market in which a potential bidder was not present, but where the bidder had stores outside the isochrone and choice would be limited even for those customers prepared to exit the isochrone; and
- (f) isochrone patterns post any transaction.

8.158. For national market situations, Waitrose suggested that careful consideration should be given to any enhancement of buyer power. Any merger strengthening the presence of a major could also impact on the convenience store sector, where some major players were already involved. On the other hand, petrol retailing was unlikely to be much affected.

8.159. Waitrose said that planning consent for large stores was increasingly hard to obtain. Approval for extensions was also becoming more difficult to secure. Although online grocery retailing was growing, the rate of expansion did not suggest that it would provide a solution to barriers to entry arising from planning controls. Moreover, the existing players were basing their e-commerce offerings on the existing store network.

8.160. Waitrose said that divestment following a merger would be necessary, and could offset entry barriers by assisting new entrants and small/medium-sized operators to acquire sites. However, if the divested stores were merely 'swapped' among the major supermarkets, this could merely reinforce their current market power, hence the need to ensure that such divestments were subject to appropriate rules.

8.161. Waitrose believed that buyer power practices continued to operate against the public interest, and distorted competition to the detriment of small and medium-sized retailers. Any increase in buyer power could only worsen the situation.

8.162. Waitrose followed its own code of practice with suppliers. The Code produced following the 2000 report was heavily weighted in favour of the buyer, and lacked enforcement mechanisms. There were fundamental flaws. A model giving complete security to a supplier with a complaint was needed, and a combination of a strengthened Code and rules for divestments could deal with local competition concerns and buyer power issues.

8.163. Waitrose saw local competition issues as central to the impact of the bids on the one-stop-shopping market. Competition was focused at a local level. Waitrose believed that the list of relevant competitors in the 2000 report remained basically appropriate, and that the original definition of 15,000 sq feet still held good. Waitrose offered criteria for the application of isochrone-based analysis which it had then applied in an exercise using [§] stores. This rules-based approach indicated which local markets might be potential divestment candidates for each proposed bid.

8.164. In considering fascia reduction, Waitrose believed four to three to be a clear limitation of choice. Four plus was the minimum amount of competition which customers should be offered. Where four unique fascia existed, steps should be taken to prevent further reductions.

8.165. Non-traditional non-food groceries were becoming more of a force in the marketplace. This was relevant to the extent of competition needed in a local market, and Waitrose had noted examples in stores of supermarket food provision being reduced to make room for non-traditional non-food items.

8.166. Safeway's difficulties had been compounded by a very disparate estate. The process of acquisitions had resulted in heavy store concentrations in some regions and little presence in others. [*Details omitted. See note on page iv.*] Restriction to entry in terms of land was the dominant feature of today's structure.

8.167. Waitrose recognized that a merger could result in lower prices being passed on to customers of ex-Safeway stores. It also believed that a successful bidder might drive down supplier prices, but with higher prices a consequence for those without the same market power.

8.168. Waitrose said that a merger, or acquisitions by various players of divested Safeway stores, could bring scale economies in the IT, marketing, distribution and administration areas. If Safeway were split up, the process of divestment would be a complex one, possibly using qualified buyers, and a rules-based approach.

8.169. Waitrose also had a number of views to advance on the Remedies Statement. Subject to national or local threshold criteria not being exceeded, there should be no absolute ban on any prohibited party acquiring Safeway stores. Divestment, whilst an appropriate remedy, should not produce additional

unwelcome market concentrations through unsuccessful bidding parties acquiring divestments from the successful bidder. The OFT should both enforce restrictions and approve divestments, voluntary or otherwise, aiming at a process which balanced the loss of the Safeway fascia by increasing the penetration of smaller grocery retailers. Firms not intending to continue operating stores within existing markets should not be approved.

8.170. Successful bidders should not be allowed to divest their own stores instead of Safeway stores as this could frustrate the aim of maintaining effective competition in the local market. Acquisition of divested stores should be subject to the same threshold criteria applied to the original reference transactions, and based on purchases. If that proved difficult, Waitrose suggested that a national market share of total grocery sales would be an acceptable alternative.

8.171. Waitrose was clear that there would be sufficient buyers for the large Safeway stores to be divested, but if the only buyers were unsuccessful bidders, then no reason was seen to stop them going ahead. It was clearly impractical to require that parties should not complete the acquisition of Safeway before entering into binding divestment agreements. Expense apart, there would not be time enough to set up the number of potentially binding contracts required. Whilst recognizing that, immediately after acquisition, many consumers would be deprived of Safeway stores, there was no need to take account of this in setting divestment rules, as remaining retailers would look to meet the requirements of local markets. A trustee, authorized to conclude a sale, would resolve price difficulties concerning divestments. Divestments should not be offered only in large blocks, and the OFT should actively monitor the process to ensure that smaller players were not unfairly frustrated in their efforts to bid for stores.

8.172. Waitrose said that it was premature to conclude that some distribution assets should form part of the divestment process, as much would depend upon the successful bidder's infrastructure. Were this to become a factor, the OFT should have regard to the successful bidder's approach, to ensure that smaller players were not unfairly frustrated in their efforts to bid for stores. Land-bank divestment was not an alternative to store divestment as it would not, in given local markets, address reduced competition and choice issues. Such divestment should, however, be considered for very concentrated local markets, with a view to enhancing competition.

A general retailer

8.173. A large high-street general retailer had experienced growing competition from multiple supermarket chains broadening into extensive non-food ranges, and was particularly concerned about the audio and audiovisual hardware and software entertainment sector.

8.174. Its stores catered for a broad range of music (including back-catalogue recordings etc through its specialist entertainment chain stores), whereas the large supermarkets focused on their overall market share within the grocery sector, using limited ranges of chart-only material, heavily discounted and loss lines. Entertainment was not a core market for them, simply a means of boosting footfall.

8.175. The retailer said that it was passionate about its entertainment product, sponsoring both musical events and music-based charities and seeking to provide a wide range for most tastes of popular music and video. A further unregulated and unfettered concentration of chart entertainment retailing would make both music specialists and generalists unviable (since the margin impact of seeking to compete on chart lines would impact on the ability to stock slower catalogue and specialist lines), and force a reduction in choice and value for customers.

Suppliers

A G Thames Limited

8.176. A G Thames Limited (Thames) said that it was comprised of three companies, two of which were involved in procuring and marketing fruit, and that it supplied fresh produce to three of the major supermarket chains in the UK. The perspective offered was that of a lead supplier, rather than a peripheral one.

8.177. Thames had suffered no detrimental effect from the issue of concentrated buying power. Although the business environment had at times been difficult, supermarkets had proceeded by negotiation rather than demand, and it had been fairly treated. Its formula for success was total focus on what the customer wanted, and ensuring that the business was set up to deliver that in the most cost-efficient manner.

8.178. Thames pointed out that, whilst the ultimate goal for the customer was value for money, other factors such as quality, convenience and image played a part. Wider choice and variety also produced higher levels of customer satisfaction. From the supplier perspective, choice of outlets was needed to ensure a balance of power, failing which prices could be driven down to an unsustainable level. The producer base also needed to remain innovative to meet evolving needs of customers.

8.179. At present, the food retail industry did provide sufficient choice for both the consumer and producer, and sufficient competition to avoid either party being disadvantaged. Further concentration could realize further economies of scale, dependent upon who acquired Safeway.

8.180. In surveying the bidding parties, Thames took the view that if either Asda or Morrisons were successful, the resultant price war would be unsustainable. This could be initiated by either multiple if successful, or by Tesco, and the long-term effect on consumer choice would be an adverse one. Such an outcome could also put Sainsbury's under considerable pressure, with a risk of losing market share.

Albert Bartlett & Sons (Airdrie) Ltd

8.181. Albert Bartlett & Sons (Airdrie) Ltd (Bartlett) said that it supplied a range of vegetables to Safeway and Somerfield, the majority of the business being with the former. The company had grown over 50 years to become one of the leading growers and packers in Europe, with 850 staff on two sites.

8.182. Bartlett was concerned that the supply business should be given the same level of consideration as consumer interests, and the implications of the possible mergers for the thousands of staff in the food business supplying Safeway, as well as farmers growing crops for suppliers, not lost sight of. Disposing of Safeway as a single concern offered the best option for minimizing business failures, job losses and farming crisis. Companies supplying branded products would see little effect following a Safeway disposal, as any new owner would also require those products. However, those supplying supermarket own-brand products could suffer negative effects on their business, with consequences for employees.

8.183. Were Safeway to be broken up into smaller concerns, there would be serious implications for numerous suppliers throughout the country. These would include potentially significant job losses in areas where unemployment was already high.

C R Melton & Sons

8.184. C R Melton & Sons said that it was one of the largest strawberry growers in the UK, and for 25 years of its 59-year existence it had worked with Morrisons. The trading relationship was excellent, payment was always timely and without penalty, and discounts to below the market price were never sought. In C R Melton & Sons' opinion, this excellent practice contrasted significantly with other retailers.

Cumbrian Seafoods Limited

8.185. Cumbrian Seafoods Limited felt that the consumer would benefit from four evenly-matched retailers, competing with each other. This would be achieved by a successful Morrisons acquisition, whereas any other outcome could eventually lead to the domination of the retail sector by two large players.

8.186. Global sourcing had exploited developing communities, who were ill-equipped to deal with large-scale buying power. In the fish industry, this had accentuated the demise of fish stocks and repeat-

edly compromised the best interests of the British consumer. Morrisons had consistently adhered to the principles of quality, value and service, and had delivered a better offer to the consumer, despite lacking the purchasing power of larger competitors.

Ethnic Cuisine Limited

8.187. Ethnic Cuisine Limited said that it was a supplier of chilled Chinese ready meals. Its product was completely dedicated to Sainsbury's.

8.188. Ethnic Cuisine Limited had not noticed any change in buyer power, which continued to be strong, nor in relationships since the introduction of the Code of Practice. In the event of a successful acquisition by Sainsbury's, existing Safeway suppliers were likely to be very aggressive on price, in order to retain business.

Evesham Vale Growers Ltd

8.189. Evesham Vale Growers Ltd said that Sainsbury's, to whom they had supplied fresh produce for over 20 years, had always been supportive of the British grower and producer, assisting UK agriculture through some difficult times, whilst other retailers had sold inferior cheap imported produce. Sainsbury's worked closely with suppliers to meet customer demands for innovation and commitment to quality.

8.190. Both Sainsbury's and Safeway offered customers good food at affordable prices. There was a real synergy between the two companies. Their combination would offer the greatest value to shareholders, suppliers and customers, with a greater-quality food offering reaching a wider audience.

Express Dairies PLC

8.191. Express Dairies PLC (Express Dairies) said that it had had no experience of the adverse use of buyer power in connection with any of the bidding parties. It had solid trading relationships with each major supermarket. Express Dairies had, however, experienced further examples of buyer power exercised by Safeway since the 2000 report, and instanced both demands for non-cost-related payments, and changes to contractual arrangements without adequate notice.

8.192. The Code of Practice was not working effectively. Express Dairies believed it to be enforced too slowly and, as interpreted, it provided no benefit to suppliers additional to their normal contractual rights.

Flagship Foods Limited

8.193. Flagship Foods Limited said that it was a privately-owned, medium-sized company, with a significant share of the fresh pork, bacon and cooked meats markets. It operated from eight factories in England, employed over 3,000 people, and had a sales turnover of £400 million, half of which was sales to the four bidding supermarkets. It was probably the largest pig farmer in the UK.

8.194. Flagship Foods Limited's principal concern was further concentration in the marketplace. 70 per cent of the retail grocery market was controlled by the four leading supermarkets. An increased concentration in buyer power would exacerbate existing problems for suppliers. Supermarket competition had manifested itself in ever-increasing demands on suppliers, who in turn sought to pass the pressure back to farmers and growers as primary suppliers. It was totally unreasonable in commodity markets, where supply and demand caused price fluctuations, to suppress prices artificially via buyer power.

8.195. A variety of problems had resulted in a 40 per cent reduction in the national pig herd, reduced exports and increased import penetration. Supermarkets with global ambitions paid scant regard to the health of their supply chain in any particular country. A smaller, British-based acquirer would be a better solution for the UK pig sector.

G's Growers Ltd

8.196. G's Growers Ltd (G's) said that it was a grower (salad and vegetables) marketing business representing 20 growers in the UK and Spain. Annual sales were £170 million and 2,000 to 4,000 people were employed, depending on seasonality. G's supplied markets in Europe, but 70 per cent of total sales were to a range of UK supermarkets.

8.197. In its experience, G's found Sainsbury's a highly ethical business, genuinely interested and proactive in food safety, tough but fair to deal with, and loyal to growers who invested in quality, food safety and the environment. They worked well with suppliers to cut the costs of the supply chain, and did not ask for money upfront. Other retailers had provided contrary experiences, whereas an expanded Sainsbury's would be good for growers and consumers alike.

Geest plc

8.198. Sir John Banham wrote to us in his capacity as the Chairman of Geest PLC (Geest), as well as a former Chair of the Government's Retail and Consumer Affairs Foresight Panel and of Kingfisher, one of the largest UK-based non-food retailers. Geest was a FTSE 350 company, with a turnover of approximately £800 million, 90 per cent of which was with the major UK grocery retailers. The majority was fresh prepared foods, virtually all retailer branded, the remainder being unbranded wholehead produce (for example, lettuce, tomatoes). Wherever possible, produce and ingredients were sourced in the UK. Retailers had gone to great lengths in recent years to earn trust in their brands with consumers. In consequence, the UK market had a higher share of retailer-branded products (close to 50 per cent) than comparable European markets.

8.199. The fresh prepared food market, now some 20 years old, was predominantly retailer branded. Existing food brands had looked to enter this market, but failed both because trust in retailer brands was sufficient, and because retailer-branded products were 10 per cent cheaper to produce. This market was now concentrated in the hands of large multiple retailers (including M&S).

8.200. The Wal-Mart acquisition of Asda had produced a fundamental change in the British multiple retailing sector. Wal-Mart had massive scale advantages over most UK retailers, particularly in non-foods, and had evolved very effective partnership arrangements, squeezing waste out of the supply chain, to the ultimate benefit of customers, shareholders and suppliers. Asda now had an emphasis on retail pricing to secure market share, a strategy pursued by virtue of its store size and greater non-food offer. Other UK retailers could not match this, lacking scale and an ability to pursue an EDLP strategy, and were suffering competitive and financial pressures in consequence as demonstrated by share price reductions. The more marginal UK retailers, who had not been able to contrive an effective partnership sourcing approach, had responded by putting increased pressure on their suppliers. Tactics included:

- (a) demanding upfront payments to keep existing business;
- (b) creating phantom bids at e-auctions;
- (c) demanding lower prices after agreeing prices and gaining suppliers' commitment to investment, a few days before launch;
- (d) demanding recompense for 'lost profit' if the supplier failed to meet the entirety of the order on a daily basis (orders are daily for same-day delivery);
- (e) demanding, without consultation, a disproportionate supplier's 'contribution' to the retailer's promotional costs; and
- (f) requiring that a supplier from whom the retailer might receive overriding discounts or payments should be used for items such as packaging and transport.

8.201. The practices listed above, taken to extremes, could undermine the financial health of suppliers, and compromise their ability to innovate. This would lead, inevitably, to job losses, more imports,

lower wages, and lower incomes for local growers. Such predatory pricing practices were the inevitable response of failing competitors in any market. The only way to compete effectively was by a low-cost supply base, and a supply chain with minimal waste and inefficiency. Few UK retailers could make the transition, but those at the margin could do serious damage to their UK supply base whilst struggling to survive.

8.202. Experience elsewhere suggested that retailer concentration was not the main issue. Provided two credible local alternatives to Asda existed, there was no evidence that customers would be disadvantaged in terms of price, quality and choice; indeed, consolidation could serve to reduce waste and efficiency. The key issue was existing buying practices by marginal retailers, affecting suppliers who presently had no market, economic or regulatory protection.

8.203. Further consolidation of the UK grocery retail sector should continue, and would produce significant benefits for consumers and retailers' suppliers. But as a condition of allowing further consolidation, steps should be taken to outlaw predatory pricing practices, by a voluntary Code of Practice covering all parts of the supply chain. As a minimum, such practices should be made transparent to investors.

Gosberton Bank Nursery Limited

8.204. Gosberton Bank Nursery Limited (Gosberton) was the only remaining large freesia cut grower in the UK. It believed that the continuation of an independent Safeway would be in the best interests of consumers.

8.205. Gosberton's experience of the major multiples was either that they were not interested in taking on a small supplier or did not wish to deal with an additional supplier. In one case Gosberton was delisted without being informed. It was subsequently obliged to include a comparison between the retail price of the old product and its lower-quality replacement, and to reduce the supply price: the arrangement was no longer economic and it was forced to withdraw.

Lloyd Maunder Ltd

8.206. Lloyd Maunder Ltd (Lloyd Maunder) said that it was a family business and had supplied the supermarket trade with meat and poultry products for over 100 years. It had direct contracts with 130 poultry farmers, and traded regularly with over 1,300 lamb producers annually.

8.207. Lloyd Maunder was increasingly concerned at the global sourcing policy of some main supermarkets. If any Safeway acquisition increased this practice, it would be disastrous for Lloyd Maunder and for the UK farming community.

8.208. Were Sainsbury's to win, or gain more stores from the outcome, this would greatly benefit suppliers and West Country producers. Sainsbury's would create a larger premium end-group, which would offer substantial support to British farming rather than global sourcing. Lloyd Maunder's relationship with Sainsbury's was good, based on honesty and communication.

8.209. Lloyd Maunder thought little had changed regarding buyer power. Major multiples remained very powerful, and little could be done to change this. Since the Code of Practice had been introduced, a change had been observed in the notice period for line deletions, important for suppliers in managing raw material and packaging more efficiently.

Loseley Dairy Ice Cream Ltd

8.210. Loseley Dairy Ice Cream Ltd said that it would be in the best interests of the grocery trade, the public at large and suppliers to have four strong multiple retailers, all with similar market share. Conversely, near-monopolistic situations produced corresponding poor service and pricing.

Marshalls

8.211. Marshalls said that it was a third-generation family company supplying fresh market vegetables sourced across the UK, and during the winter months from Spain. It employed 250 people in the UK, rising to 450 during peak periods, and 350 people in Spain. Sales turnover was approaching £55 million in the UK, and £16 million in Spain.

8.212. Marshalls said that it supplied vegetables to several UK multiples and to eight large European multiples; 54 per cent of sales were programmed to Sainsbury's. Marshalls had found Sainsbury's an operator of integrity. A 35-year partnership had achieved the highest standards of product quality, with numerous joint initiatives, and a partnership approach which had improved field production techniques. From these perspectives Sainsbury's was frequently more proactive than similar-sized companies, and its success in the acquisition process would guarantee a sustainable future for many people and a high standard of vegetables to discerning consumers, unsurpassed by other more dominant retailers.

Minor, Weir & Willis Ltd

8.213. Minor, Weir & Willis Ltd said that it was a supplier of fresh produce. Its customers included Continental European multiple retailers, and in the UK wholesale markets, caterers and multiple retailers including both Safeway and a number of the bidding parties.

8.214. Products in the fresh produce sector were sold under supermarket own-labels, with a fragmented supply system giving ample scope for short-term price pressures. This made compliance with the Code of Practice, both as to the letter of the Code and retailer attitudes, a key issue for suppliers.

Molyneux Farms Limited

8.215. Molyneux Farms Limited (Molyneux) said that there appeared to be less of a conflict on store mixes with the Safeway/Morrisons pairing than with any other grouping. As a Lancashire producer, Molyneux had indirectly supplied all the supermarkets involved in the inquiry, and had suffered at times with large multiples moving supply away to larger areas. This inconsistency made it difficult to plan ahead. Morrisons had sourced locally, and showed fairness in the way it sourced over a wider range of produce.

8.216. From the consumer perspective, Molyneux thought there was little doubt that Morrisons gave good value, supplying good product at competitive prices. As it owned its own abattoir, local sourcing also meant less travelling for livestock.

Music Box Leisure Ltd

8.217. Music Box Leisure Ltd said that Morrisons actively sourced and maximized new routes to market, outside the supply chains of the other bidders. This was the only means for many suppliers such as itself to develop future supply routes. Any alternative to Morrisons succeeding with its bid was likely to be an increasingly monopolistic situation, resulting in less consumer choice and less competition.

8.218. Music Box Leisure Ltd saw the merger situation as a unique opportunity to stabilize the market. The location of the Safeway estate would enable Morrisons to deliver value offers in all UK areas, as well as providing a career within the new company for many Safeway employees, an unlikely scenario with any other bidder.

Peter Gilding & Co Ltd

8.219. Peter Gilding & Co Ltd (Gilding) said that it had, for 17 years, been a supplier of fresh horticultural produce to Morrisons. Morrisons had been professional and equitable in every respect, with the relationship one of partnership. The buying team worked in partnership with Gilding for the benefit of the customer, in a manner both transparent and open.

8.220. From the consumer perspective, Gilding believed interests were best served by healthy competition among the retailing giants. Its preference was for four main players rather than three, with as many domestic heavyweights as possible to counteract the threats from powerful overseas aspirants.

Premier Housewares

8.221. Premier Housewares, an importer and distributor of kitchenware and general houseware, said that several large retailers were dictating to their suppliers which carrier must be used for delivering goods to the retailers' warehouses. Carriers nominated in this way took advantage of the position by charging excessive carriage/freight rates in the knowledge that the supplier had no option other than to use their services for delivery to the customer, normally one of the large multiple retailers. This went against all competition rules, as Premier Housewares was restricted from using its own carriers, with whom competitive rates had been negotiated, and wanted this pursued both with carriers and the multiple retailers involved.

8.222. A similar situation obtained with artwork for colour boxes or other packaging material. Premium Housewares said that a number of large retailers were specifying which design agency must be used, and in consequence the fees charged were up to ten times those which suppliers could get elsewhere. This too went against competition rules, in that in-house designers, or preferred design agencies, could undertake the same work at a fraction of the cost.

R L Clapp & Sons (Cheesemakers) Ltd

8.223. R L Clapp & Sons (Cheesemakers) Ltd said that it supplied West Country Farmhouse Cheddar, through Dairy Crest, to Safeway. As such, it was concerned that there should be an element of competition between the supermarkets.

8.224. If Asda succeeded in its bid, and became the dominant food retailer, this would produce a great imbalance. Wholesale prices, which were barely sustainable now, would be driven down further with destructive consequences for the supply chain. The most sensible bid, and the one likely to have the healthiest effect on the market, had come from Morrisons.

S C Johnson Limited

8.225. S C Johnson Limited (SCJ) said that it was a family-owned company that had operated in the UK since 1915. It manufactured and supplied domestic cleaning and other household products and insecticides to the consumer market, mainly through grocery multiples.

8.226. SCJ did not think a successful bid by any of the four potential acquirers would operate against the public interest, and had little concern about a post-merger lessening of competition, despite an increase in concentration. Effective competition would remain whether a merger resulted in three or four large players, because all the potential acquirers had a long-term commitment to the retail sector. Most already possessed significant buyer power, and any unnecessary squeeze on the supply side would be constrained over time by a negative effect on that retailer's own downstream market in terms of quality and service. Retailers would, as at present, continue to compete strongly, and price wars on products would continue between major retail outlets.

8.227. SCJ said that there were many advantages in having strong, equal players in the market. The Competition Act 1998 was capable of effectively dealing with any post-merger anti-competitive behaviour in the retail sector.

Status International (UK) Ltd

8.228. Status International (UK) Ltd (Status) described itself as a small to medium-sized company, supplying all parties involved in the present merger considerations, and virtually all supermarkets and retailers in the UK.

8.229. Status believed that it made geographical common sense for the Morrisons bid to succeed: most consumers would wish to benefit from a Morrisons presence in the South of England, and take advantage of its success in ranging and pricing. More jobs would also be retained in consequence.

8.230. Commercially speaking, Status said that four players with shared influence would ensure competitive prices for the consumer, and more flexibility for smaller suppliers. If a major supermarket acquired Safeway, that would be detrimental to consumer interests, whilst small and medium-sized suppliers would lack the influence to secure a fair deal.

The Thomas Food Partnership Limited

8.231. The Thomas Food Partnership Limited (Thomas Food) described itself as a food manufacturing company based in South Yorkshire. During the past ten years it had supplied all the companies involved in this inquiry.

8.232. Thomas Food supported the Morrisons bid on two specific issues. It believed that the creation of a fourth strong retail group would provide better short- and long-term opportunities for a larger number of small and medium-sized enterprises (SMEs). A strong SME manufacturing base was essential for the health of the UK food industry, and for maintaining the undoubted lead the UK had in providing a wide range of high-quality, interesting and safe, convenient food to the UK customer. Secondly, a fourth group would also add significantly to customer choice.

8.233. The consolidation of retailers was now reaching a critical stage, where the fundamental interests of consumers and manufacturers were at some risk. To allow any of the three larger bidding groups to enhance their respective market share by acquiring Safeway would merely provide more of the same. Genuine competition would be limited or removed, especially in the South of England. The enforced disposal of a number of stores would not redress the balance. Unless purchased by one of the three leading bidding parties, they would not have the purchasing power effectively to maintain competition and improve consumer choice.

8.234. Thomas Food said that a Morrisons/Safeway merger held many attractions for the consumer and supplier base. It provided a real point of difference and a competitive alternative for the other major retailers that they would have to recognize. The successful track record of the Morrisons offering had been recognized by its stock-market rating, and the steady growth in profits and sales over a prolonged period.

Thumbs Up (Bury) Ltd

8.235. Thumbs Up (Bury) Ltd explained to us that it was a manufacturer and distributor of plastic house and gardenware. During 11 years of trading with Morrisons, it had noted that company's support and loyalty to its British manufacturers and suppliers, at a time when many major retailers were sourcing non-food goods exclusively from abroad. The CC was asked to keep in mind the future of the British manufacturing industry during its proceedings.

8.236. Thumbs Up (Bury) Ltd considered that a successful Morrisons bid would increase consumer choice in areas such as Northern Ireland and Scotland, where that company currently had no outlets. In current business conditions it was difficult to see where major retailers could increase profits from the non-food aspect of their offer without consequences for the supplier base.

Tulip Limited

8.237. Tulip Limited (Tulip) said that it was a supplier of meat products to all the grocery retailers in the UK and wished to express a supplier perspective on the possible outcome of the various bids for Safeway.

8.238. If one of the three leading supermarkets acquired Safeway, they would between them, even allowing for some divestments, control around three-quarters of the market. In Tulip's view, such an outcome would not be good for suppliers or customers.

8.239. If Morrisons were successful, its size would then balance that of Asda and Sainsbury's. Equally, a fresh entry into the grocery market would also prevent the leading three multiples getting bigger.

Turton Quality Foods Ltd

8.240. Turton Quality Foods Ltd (Turton) said that it supplied its own brand of sausages to many supermarket multiples regionally, including some of the present bidders. A key philosophy was 100 per cent usage of British meat which used the equivalent of 2 per cent of all the pigs produced in the UK, and cost Turton £300,000 more a year than purchasing on the spot market in France.

8.241. Sainsbury's had not put Turton under any distinct price pressure, thus allowing them to continue buying British-only ingredients. Sainsbury's had invested time and effort in Turton's development, including entry to its Supplier Development Programme, and was working with it on a pilot programme designed to:

- (a) put meat of all species from the region into their stores;
- (b) support the local farming community; and
- (c) cut down food miles, and provide local employment.

8.242. Turton was concerned about pressures which would result from an Asda or Morrisons acquisition of Safeway and a subsequent price war. Such pressures could only be met by lay-offs and re-evaluation of raw material sources to reduce overheads. This could mean looking to Europe to reduce costs, or going out of business. Sainsbury's lived by its value offer, and the most positive outcome would be for it to prevail, with appropriate store divestment, thus neutralizing the market situation.

Vitacress Salads Ltd

8.243. As a supplier of salads to Sainsbury's, Vitacress Salads Ltd (Vitacress) noted that a reduction in the number of major supermarkets from four to three could lead to a reduction in consumer choice, and an increase in unreasonable pressure on suppliers. Specialist suppliers such as Vitacress had a more limited portfolio, and took a particular view, in this case that an acquisition of Safeway by Sainsbury's would have considerable benefits, both for suppliers and the British consumer. For Vitacress, such an acquisition would help protect over 600 agricultural jobs, and would also result in reduced prices, benefits of scale which suppliers would pass on to consumers, and greater choice.

8.244. Sainsbury's had consistently taken the lead in supporting British agriculture. The real risk of increased importation from abroad, which might follow acquisition by one of the other bidding parties, particularly those who focused on a price rather than a quality proposition, would further undermine the agricultural infrastructure in this country.

Wensleydale Dairy Products Limited

8.245. Wensleydale Dairy Products Limited (Wensleydale) said that it was a company with a turnover exceeding £13 million. It supplied Wensleydale and other specialist cheeses to all the major multiple retailers. Wensleydale enjoyed good relationships with all the bidding parties including Morrisons, who had a sound reputation for supporting local Yorkshire suppliers, and also with Safeway.

8.246. Wensleydale said that it would prefer Morrisons to acquire Safeway. It was genuinely fair and ethical in its business methods, and its structure gave it an appreciation of manufacturing issues. Four major players would achieve a greater balance in the market. The Morrisons ethic did not hold good for all the other bidders, some of whom were not supplier friendly and who, if successful, might well seek to break up Safeway.

Windward Islands Banana Development & Exporting Company (UK) Limited

8.247. Windward Islands Banana Development & Exporting Company (UK) Limited, trading as Windwards Bananas, told us that it was a UK-based 100 per cent subsidiary of the Windward Islands Banana Development & Exporting Company Limited. The latter was based in St Lucia and owned jointly by the four governments and the banana producers of the Windward Islands.

8.248. Windwards Bananas said that the Windward Islands banana industry was established by the UK Government post-war, to avert social unrest following the decline in the sugar industry. Following deregulation and other changes, marketplace support now came mainly from companies with ethical trading policies. Sainsbury's had been at the forefront in the promotion of Windward Islands bananas as a 'Fairtrade' product.

8.249. A decision by Asda in 2002 to award its entire business to a single banana supplier was followed by a banana price war which still continued, creating hardship across the spectrum for banana producers. Windwards Bananas believed the prevailing price trend was set to destroy the lives of more vulnerable producers in the Caribbean, after seriously damaging the banana trade. Windwards Bananas recognized that its own industry was high cost, because:

- (a) it operated in a democratic environment where labour rights were respected and a minimum wage observed;
- (b) it was structured on small-scale family farming, without economies of scale and requiring higher average margin;
- (c) levels of agrochemical usage in the industry were relatively low, meaning a lower yield per hectare; and
- (d) the production system was socially and environmentally friendly.

8.250. The UK was highly a competitive market, with bananas the biggest-selling line in all the supermarket chains. Until 1992, Windward Island bananas were sold in all four bidders' supermarkets, as well as Safeway. Today Sainsbury's, Tesco and Safeway sold them, with the support of the first-named being significant. Sainsbury's sold a much larger percentage of Windward Island bananas than any other supermarket, and this multiple suffered a price disadvantage in consequence, thus demonstrating a clear corporate social responsibility. Sainsbury's trading with the Windward Islands was founded on ethical as well as commercial principles. If Asda or Morrisons succeeded to Safeway, the Windward Islands were likely to be the loser again and their banana industry could not survive without being able to sell its product in the multiple supermarket sector. In particular, Windwards Bananas was concerned that Asda would inflict more damage on vulnerable suppliers through its pricing policies.

8.251. Sainsbury's demonstrated genuine fairness in its trading with Windward Bananas. In the event of a merger, Windwards Bananas believed that Sainsbury's was the retailer most likely to strike an equitable balance between the interests of consumers and those of suppliers.

8.252. The views of Windwards Bananas were supported by Dr The Honourable Ralph J Gonsalves, Prime Minister of St Vincent and the Grenadines. He broadly repeated the points made above, but added that what was at stake was not the sale of a few thousand boxes of bananas, but the future of the banana industry and the livelihood of thousands of small producers and the economies of the Windward Islands.

A supplier

8.253. A large manufacturer and supplier of grocery products, particularly canned goods, had concerns over the acquisition of Safeway, which it felt would lead to an undesirable increase in retailer concentration in the event of any of the major supermarket chains gaining control. Such concentration was undesirable for the consumer, the manufacturer and large sections of the retail trade. Beyond this principal issue were three further major areas of concern.

Bargaining power

8.254. The supplier saw nothing wrong in the supply chain being used to reduce customer prices provided the Code of Practice was adhered to, but customer choice would be lost if consolidation undermined the capacity of some retailers to compete. Branded goods prices were more easily recognized by the consumer, and smaller retailers lacking the scale to leverage competitive pricing positions might reconsider stocking them, further intensifying retailer concentration for suppliers.

8.255. Supply chain initiatives such as factory-gate pricing or primary consolidation, many available only to large retailers, gave them control of chain elements, securing cost improvements but leaving long-term cost issues on the residual network with the manufacturer. As the network shrank, unitary distribution costs went up, resulting in cost increases for other customers.

Restriction in consumer choice

8.256. Further retailer consolidation could be to the detriment of consumer choice. Scale allowed the large multiples to develop their own brand of products, and the range of particular goods offered could reduce in consequence. Consumers could then lose the opportunity to make direct price comparisons between retailer chains on identical proprietary-branded goods.

8.257. The growth of supermarket non-food goods had led to space and range reductions in traditional grocery areas, diminishing customer choice. Targets limiting that choice to own-label plus the brand leader's product item would reduce competition by driving smaller companies out of business.

Impediments to product innovation

8.258. Increased retailer concentration could act as an inhibitor to product innovation. The supplier saw the cost of market entry rising as few operators controlled access, with increased costs ultimately being charged to the customer. Smaller, less secure manufacturers could be eliminated from the innovation stream.

8.259. Scale allowed retailers rapidly to imitate branded new products under their own label. This would erode returns on investment, reducing those innovators able to bear investment costs, and again risking price increases for consumers.

A supplier

8.260. A supplier of branded products to all the bidding parties and to Safeway gave oral evidence. It had been operating for some 13 years and described its business as growing robustly in an expanding market, primarily with ethnic food branded products, but also with some own-label products. Some 45 products in total were supplied in what was something of a niche market.

8.261. Relationships with the major multiples were generally good. The supplier felt the relationship gained from its being small, quite interesting, and not a large corporate entity. Frustrations arose where good communications could not be maintained, and this had resulted in undertrading with Tesco.

8.262. The supplier saw the biggest market change in recent years as due to the arrival of Wal-Mart. In consequence, Asda was willing to work on less margin than other retailers. Its business model was about low cost and volume increase. This had led to lower selling and retail prices and had created much competitive pressure, with other retailers seeking matching price reductions. Tesco pursued this strategy, but also sought to keep the same margins by pressing suppliers to improve their selling prices, whereas Sainsbury's tended to seek profit increase by retail price rises.

8.263. The supplier believed it was still possible, using innovation, to build a sustainable business with supermarkets. However, new supplier competitors were adding to marketplace pressures and affecting profitability, which until recently had improved. Asda was also the only major retailer showing real aggression in seeking to launch new products. Some competitors watched and followed this process.

8.264. The supplier saw Asda as single-mindedly price driven and in that context it led the market. Price reduction produced shoppers who believed that Asda prices would not be more expensive than elsewhere. That focus, to the exclusion of developing and growing the business in harmony with suppliers, carried risks. There had been no pressure to reduce prices or product quality; on the other hand, the supplier had contributed to Asda's low-cost philosophy by changing packaging style.

8.265. Tesco also aimed to be price driven, but in tandem to appeal to a much broader range of customers. Safeway was seen as in decline, and the supplier would be delighted to see something happen. The retailer lacked clarity in brand positioning, and the competition had become too strong, too quickly. Turning Safeway round would be an enormous task, with weaknesses in its store portfolio. The supplier's preference for acquisition of Safeway was Morrisons, on the ground that more rather than fewer strong players would be preferable.

8.266. The present state of the market made it virtually impossible for suppliers to raise prices. Where possible, additional costs were recouped by improving distribution or the ranging of a product. The supplier did not see smaller retailers being forced to pay higher prices, but recognized that with major multiples seeking to reduce supplier costs the price charged gap between the two was widening. Large retailers also sold products at volumes which meant quite different servicing costs. Whether small stores got a fair deal in the market depended to an extent on their relationship with their distributors, but they achieved more power through membership of buying groups.

8.267. There were dangers for branded suppliers in present supermarket price strategies. Price should be a brand strategy, but supermarket power in delivering the customer was staggering and there was no alternative route to the market. Whilst the Internet was a potential alternative, most people did their shopping at the supermarket.

A supplier

8.268. A farmer and supplier to many supermarkets told us that it was very concerned about the growing dominance of the big three multiples. Whereas profits and growth had soared for them, their suppliers and farmers were being driven out of business.

8.269. Morrisons alone spoke to and dealt with progressive farm businesses. The supplier said that Morrisons allowed farmers to make a margin without obliging them to use middlemen, who took large margins for doing very little. Morrisons was clearly the best supermarket for farmers.

A supplier

8.270. A grower-owned organization that was a year-round supplier to a number of UK retailers, including Safeway and Sainsbury's, told us that it comprised differing levels of growers with a variety of products, including British-grown ones.

8.271. The supplier believed that Sainsbury's represented an alternative and strong offer to the other bidding parties. Sainsbury's also enabled suppliers to provide quality-driven and innovative volume products which afforded consumers wider choice in the high street. In turn, suppliers utilized full growing abilities and maximized their effectiveness. Sainsbury's was committed to working with its supply base and, through business planning, developing long-term partnerships at both business and grower level.

A supplier

8.272. An international food manufacturer and supplier told us that the major supermarket chains, together with another large multiple, now accounted for one-half of its sales. In the supplier's view, the several bids for Safeway marked a new, defining point in the development of multiple retailing in the UK. The exercise of buyer power remained a major factor in the commercial relationship between retailers and suppliers.

8.273. The supplier believed that short-term as much as long-term consumer interests should be the primary concern in considering the proposed mergers. Each multiple retailer had a role in offering con-

sumers choice, in product selection, together with price and location of store. But retailers also acted as 'gatekeepers' between manufacturers, who developed the market and supplied new and existing products, and consumers, and so controlled what products became available to consumers, and on what terms. A successful bidder for Safeway would be in a strong position to demand of suppliers that they made significant additional concessions in their terms of supply, as a condition of continuing to do business. Such concessions could not be justified economically, and attempting to do so would prejudice suppliers' ability to invest in developing and marketing new products. Consumers' interests were best served by a vibrant and innovative food-manufacturing industry, with a variety of suppliers of varying sizes who competed vigorously to attract and retain consumer commitment to their products. The supplier found it difficult to see that the Code of Practice had had any effect in the area and exercise of buyer power.

A supplier

8.274. A supplier told us that it was a manufacturer of own-label products which it supplied to supermarkets. It had no comments to offer on the relative merits of any of the bidders. It was, however, concerned at the overall effect on the markets should one or more of the proposed acquisitions be given clearance.

8.275. Should one of the bidding parties acquire Safeway, the result would be to reduce the number of buyers in the market and thus increase the relative strength of those left. This in turn raised issues of the potential exercise of undue buyer power, the potential for abuses of that power, and the need for undertakings to cover the acquirer's dealings with suppliers. In the area of intellectual property rights, the supplier was already facing buyer power abuse.

8.276. The supplier devoted considerable resources to developing new products and formulations; this was one of the principal ways in which it competed with other suppliers, both of retailer own-label products and of branded products. Certain major supermarkets had attempted to claim ownership of intellectual property and confidential information relating to products which had clearly been developed by the supplier and then, without permission from the supplier, to make that intellectual property and confidential information available to other suppliers, who were competing in the same market. This practice was damaging to competition and to the potential for innovation by suppliers.

8.277. The supplier's conclusion was not that acquisition of Safeway should be blocked, but that any clearance should be conditional on the acquirer providing firm undertakings in relation to its dealings with suppliers. This was of fundamental importance, because undertakings given under the present Code of Practice had had no effect on reducing the undue exercise of buyer power by the supermarkets in their dealings with suppliers.

8.278. The supplier instanced the following additional problems in dealing with supermarkets:

- (a) supermarkets insisting that money be paid in advance, indicating that failure to do so would result in the loss of future contracts; and
- (b) supermarkets dictating which suppliers be used for artwork and printed supplies.

8.279. The supplier believed that the likely outcome of reporting abuses of the Code, or seeking to use the dispute resolution procedure, would be the loss of future contracts. Regular monitoring and enforcement of the Code was necessary. The Code relied too heavily on the concept of 'reasonableness', and a different regime, involving an ombudsman empowered to make regular investigations, was needed if malpractices were to be detected.

A supplier

8.280. A fresh produce supplier, who dealt with all the present-day major supermarkets, believed that the acquisition of Safeway by any one of the three market leaders could result in a significant loss of competitiveness in the market, to the detriment both of suppliers and consumers. There had been a significant concentration in retail outlets in recent years. Market data showed, for the UK fresh produce market, that the market share for major multiple retailers had gone from 34 per cent in 1988 to 83 per cent for 2003, with Sainsbury's, Asda and Tesco accounting for 57 per cent of that 83 per cent.

8.281. Concentration of the retail sector had been driven by changing consumer demands on quality, choice, convenience and price. Scope for the major multiples to further increase market share was now limited by the absorption of almost all the independent sector, and planning constraints inhibiting increased sales footage. In consequence, they had focused on reducing supply chain inefficiencies. Whilst justified and successful, these too had now largely run their course with suppliers under immense pressure to reduce prices further, but with little opportunity similarly to make further reductions in their own costs.

8.282. The supplier was concerned that a sale of Safeway to Asda or Tesco could result in the eventual demise of Sainsbury's, reducing the major players from four to two. Were Asda to acquire Safeway, it would have a dominant position in the UK market. Were Tesco to acquire Safeway, it would have more than 35 per cent of the UK market, leaving the customer, in many regions including Scotland, with little or no choice.

8.283. A Sainsbury's acquisition of Safeway appeared more favourable for the following reasons:

- (a) Sainsbury's was strong in the South of the country whilst Safeway had a considerable presence in the North and Scotland. Although divestments might be necessary in the South, the combined business would produce a strong, national operator and real competitor to the other major multiples.
- (b) Sainsbury's had a proven track record of tangible support for UK agriculture.
- (c) Sainsbury's had shown a real desire to work with suppliers to reduce supply chain costs to the benefit of growers and farmers, as well as consumers, an example being support for the banana producers of the Windward Islands.
- (d) Sainsbury's had a genuine commitment to concepts such as the Ethical Trading Initiative, both in the UK and internationally.

A supplier

8.284. A major UK manufacturer, supplying branded dairy products to the UK retail trade, said that it saw a serious threat to UK manufacturers if any of the major supermarket groups were to be allowed to purchase Safeway. Large retailers already exercised enormous power, not always fairly or equitably.

8.285. If consolidation reduced the current four major players to three, then almost inevitably further consolidation would occur. Such a situation would be catastrophic for manufacturer margins.

8.286. The supplier favoured an acquisition of Safeway by Morrisons, on grounds both of current size and its practice of fairness. It offered keen prices to customers, but also honoured supply agreements.

A supplier

8.287. A producer and supplier of fresh food products said that it thrived in a competitive market, providing good products, service and innovation.

8.288. The supplier shared the concerns of others that the sale of Safeway could distort the market, competition and restrict innovation. With four major retailers the number of buying points was already more centralized than in the EC. If that number reduced to three, close relations with a very limited number of major food producers would develop. If three major groups supplied major retailers, sales potential for the remainder would be unlikely to make investment in R&D attractive, which would in turn reduce capacity, efficiencies and competitive advantage, leaving them unable to serve these major retailers. Competition would be restricted, to the disadvantage of the industry and consumers.

8.289. Retailers already dictated distribution and supply-side activities. A reduction to three would allow leverage to dictate product sources, production programmes and logistics, all to enhance retailer operating margins. In short, four retailers were manageable, but three were not.

8.290. The supplier noted that any reduction in the number of major retailers would further reduce the number of chilled-food distribution companies available to serve the remainder of the market. As major retailers increasingly brought their distribution in-house, so distribution capability for other market sectors was being reduced. This meant that parts of the market could not be served, with increased cost having to be passed on to smaller retailers.

8.291. The supplier did not think the Code of Practice had made any significant impact. Many of the practices it had been designed to address continued.

A supplier

8.292. A leading supplier of canned goods and other commodities had seen no noticeable changes in buying power issues since the 2000 report. Nor did it envisage any significant change in its relationship with any of the bidders, were any of them to be successful in acquiring Safeway.

A supplier

8.293. A specialist food manufacturer and supplier said that, when considering the various bids for Safeway, the interests of consumers should take precedence. Any revised arrangements should also have due regard to the supply chain.

8.294. It was the belief of the supplier that the interests of UK consumers would best be served if there were to be a minimum of four national retail chains.

A supplier

8.295. A food supplier wrote to express concern at the concentration of power that would follow an acquisition of Safeway by any major multiple. In the interests of both consumers and suppliers, there should be more, not less, high street competition.

8.296. The supplier said that the Code of Practice was not working, because of anxieties about retribution by those complained against if issues were raised. The supplier had experienced numerous abuses of power when dealing with certain retailers. These included sudden demands for substantial monetary payments, retrospective payment demands, and requests for payment to be made to protect business. On one occasion goods had been produced on request for promotional activities which did not go ahead, leaving the supplier with stock worth several hundred thousand pounds. On other occasions build-up of promotional stocks, not taken on time, involved the supplier in carrying substantial storage and financial costs.

A supplier

8.297. A chilled foods manufacturer and supplier with around 30 per cent of its business with Safeway told us the stark commercial reality was that only a handful of large retailers could give a manufacturer substantial volumes. If a Safeway sale made the largest three supermarkets even bigger, then current problems would be magnified. Suppliers would have to gear up accordingly, and would be obliged to accede to all demands, as the volumes involved could not be replaced. Volumes available through the remaining UK retailers would be small by comparison.

8.298. The future of many UK world-class food manufacturers, and ultimately consumer choice, depended upon the three largest bidders not becoming yet more dominant. The supplier's own preference was for Morrisons to acquire Safeway, creating enough critical mass and sufficient volumes to give suppliers more options.

8.299. The Code of Practice had not helped manufacturers. The supplier had been subjected to disgraceful bullying in recent months. Not even legislation would prevent retailers using their power to extract better prices and terms from manufacturers, and to squeeze suppliers.

A supplier

8.300. A food supplier said that any further consolidation of retailer buying power was a cause for concern in respect of its ongoing impact on the consumer. Whilst the supplier felt it could operate with any of the bidding parties, the key impact would be on the way the successful bidder chose to leverage its increased buying power.

A supplier

8.301. A major own-label food manufacturer supplying all the multiples said that it believed the acquisition of Safeway by Tesco, Sainsbury's or Asda would have a significant and adverse effect for it in that the additional leverage would be used to secure reductions in purchasing prices from food manufacturers. The supplier had an active new product development programme, geared to deliver more choice and variety, but continuous demand for price reductions was already resulting in an inability properly to develop and support the brand, and further price pressure would worsen that situation both in respect of brand development, and investment in production facilities.

8.302. The Morrisons proposal was more attractive to UK food manufacturers. A successful merger with Safeway would mean four major players within the UK food retail sector, as opposed to three. This would be good for competition within the food-retailing sector, and less damaging for food manufacturers.

8.303. In the view of the supplier, the Code of Practice had had little or no effect on the relationship with food manufacturers. Major multiples were still using a variety of methods to extract money from food manufacturers.

Government departments

Department for Environment Food and Rural Affairs

8.304. The Department for Environment Food and Rural Affairs (Defra) said it was concerned that restructuring of the multiple retail sector should not jeopardize the Government's Sustainable Food and Farming Strategy. It was particularly concerned about the prospect of a merger that resulted in a reduction in the number of major players from four to three which it considered could lead to a significant lessening of competition or the intensification of the oligopsonic buying power of the sector with detrimental effects on the rest of the food chain.

8.305. One of Defra's main concerns was the potential impact of a merger on the competitiveness and sustainability of smaller suppliers and farmers. It noted that there was already a major disparity in size between the larger supermarkets and the small businesses that supplied them, either directly or, in the case of most farmers, through intermediaries. It felt that further concentration would exacerbate the problems acknowledged in the 2000 report (namely that the burden of cost increases in the supply chain had fallen disproportionately heavily on small suppliers such as farmers, and that large supermarket buyer power adversely supplier competitiveness) and that this would contribute to the squeeze on the margins of small suppliers. It did not believe that this situation was sustainable and felt that if it were to persist it would have a negative effect on the viability of many farming enterprises and small food businesses, which in turn could have serious consequences for the rural economy and the rural environment. Defra felt there was value in the CC putting in hand an econometric analysis of the relationship between farm-gate and retail prices with a view to determining the impact of buyer power, and had itself let a contract for research on the topic.

8.306. Initiatives were being pursued under Sustainable Farming and Food Strategy which aimed to improve the competitiveness of the agriculture and food sectors, but these would take time to bear fruit. In the meantime, Defra was keen to avoid actions that might further damage an already fragile industry.

8.307. Defra was also concerned about a number of other aspects. These included the possible reduction in consumer choice between supermarkets, particularly in rural areas; the impact of any merger on the resilience of the food chain (pointed up by the threat that the 2000 fuel crisis posed to fresh food supplies); and the potential impact on sustainability in terms of possible consequences for the development of regional and local foods, food miles and animal welfare.

8.308. Defra supported its position with detailed comments on the grocery market, the food supply chain, the impact on consumers, barriers to entry, the Government Strategy of Sustainable Development and emergency issues. The main points made were:

(a) The grocery market

Defra agreed with the CC's assessment of two distinct grocery markets in our report on Supermarkets, namely: (i) one-stop shopping and (ii) top-up or secondary shopping. In terms of consumer impacts, Defra's main concern was the one-stop segment of the market. It also agreed with the CC's view that the relevant geographic market was primarily local and defined by drive-times—10 minutes in urban areas and 15 minutes in rural areas. Market shares at a national level should also be looked at, particularly in relation to the impact on suppliers.

(b) The food supply chain

The elimination of Safeway as an independent grocery multiple would enhance the bargaining position of the remaining supermarket groups relative to suppliers. This was likely to lead to a squeeze on manufacturers' margins and the transmission of the lower prices upstream to the farm gate. Concentration within grocery retailing would lead to further concentration and dominance of major suppliers. Restructuring among the numerous small food manufacturers and UK farms supplying the food chain would be much slower. As a result, structural imbalances within the food supply chain were likely to be exacerbated.

(c) Impacts on consumers

If any of the bids were to be successful, there would be a reduction in consumer choice, though acquisition of Safeway by Morrisons would, arguably, retain four major national level players. The increased concentration of retailing could be expected to push up retail food prices, but set against this any efficiency savings might be passed on to the consumer. The main consumer impact of greater concentration of grocery retailing would be at the local level, particularly in rural areas and small market towns where the number of competing one-stop-shopping outlets were likely to be limited. A thorough examination was required, area by area, of store divestments and the implications for local competition for both rural and urban consumers. Any divestment should be subject to competition authority agreement.

(d) Barriers to entry

Defra accepted the findings of our 2000 inquiry that the shortage of suitable development land was a barrier to entry. It also felt that the economies of scale enjoyed by the largest retailers and the cost to any newcomer of establishing a consumer presence made it difficult for anyone to establish themselves as an effective competitor other than by acquisition of an existing portfolio of retail outlets.

(e) Government Strategy on Sustainable Development

The nature of the impact of any merger on the Strategy was uncertain, but implications of further concentration might include:

- (i) a focus on price competition to the detriment of quality, choice and value for money, considerations which might inhibit the development of local and regional foods;
- (ii) a change in the distance that food was transported; and
- (iii) a possible adverse effect on animal welfare if further concentration resulted in closure of local abattoirs.

Defra would wish for these wider public interest issues to be fully taken into account.

(f) Emergency issues

Greater concentration of grocery retailing is likely to result in rationalization of distribution networks which might, as a result, be more vulnerable to actions which could prove disruptive to food supply.

(g) Remedies

- (i) Defra supported the idea floated by the CC in its Remedies Statement of the definition of a separate procurement market, but sought clarity as to what was intended by identifying supplies of groceries to non-retail outlets. It suggested that the share of total grocery purchases accounted for by the parties, their proportion of the total UK agricultural output, and their share of food produced by SMEs, should all be examined.
- (ii) Defra noted that we had work in hand on the relationship between increased scale and lower buying costs, but remained concerned that farmers at the top of the chain rather than immediate suppliers might bear the cost of lower purchase prices resulting from increased buyer power. Merger impacts, particularly instability, resulting for suppliers from any increase in the proportion of goods sold under own-label brands should also be considered. Concerns about increased buyer power leading to a reduction in suppliers, quality and diversity of products, and increased product prices had also been identified, and these too should be pursued. A reduction in product lines, many produced by small rural businesses, would not be in the interests of consumers. Although not aware of a causal link with increased buyer power, Defra noted the modest but steady decline in UK food processor numbers, and the number of full-time farmers. It drew attention to research that it was funding into the determinants of retail/farm-gate price spreads.
- (iii) Defra believed that the Code of Practice should be examined to determine whether it had curbed the problems it was designed to address: anecdotal evidence suggested that it had not, in part due to supplier fears of losing business as a consequence of using the dispute resolution procedure. A key issue was whether any of the mergers would significantly alter that picture.
- (iv) The impact of any merger on the size, efficiency or diversity of the supply chain was a key issue for Defra. Account should be taken of the health and viability of the chain as a whole, and the viability of businesses with it, particularly at the upstream end where the brunt of any cost savings might be borne. Defra was concerned as to what work was in hand in this area.
- (v) Defra agreed that prohibition and divestment were the main remedy options. For the latter, there should be restrictions as to who should be allowed to buy divested stores, and all divestments should be subject to OFT approval. Defra also wished to see divested stores sold individually or in small packages, so that smaller retailers might participate, but recognized that this might be difficult to manage.

Scottish Executive

8.309. The Scottish Executive said that the market in Scotland differed from the UK in terms of main player shares. Safeway had almost 25 per cent of the Scottish one-stop segment, as against just over 11 per cent in the UK, and almost 24 per cent of the Scottish convenience segment as against around 8 per cent for Tesco, the next largest player. In the rest of the UK none of the largest five supermarkets had more than 9 per cent of the convenience segment. These variations meant that a potential acquisition would impact very differently in Scotland to the UK.

8.310. The Scottish Executive believed the following facts were relevant to the merger situation:

- (a) As the largest private sector employer in Scotland, with over 18,000 staff, the impact of Safeway store rationalization on jobs needed careful consideration.
- (b) It should not be overlooked that Safeway spent over £650 million a year with Scottish suppliers.
- (c) Safeway had the largest share of the 'food-only' market in Scotland, and a larger overall share of the Scottish market than it had elsewhere in Great Britain. Any sale would have high public profile, and the impact of any change of ownership on consumer choice could be more pronounced than elsewhere.

8.311. The Scottish Executive also confirmed that it was content for any decision on whether or not to refer bids to the CC to be based on the normal criteria and processes used by the OFT. Decisions on referral to the CC were matters reserved to the UK Government under the Scotland Act (1998).

The Countryside Agency

8.312. The Countryside Agency said that it was the statutory body working to make the quality of life better for people in the countryside and the quality of countryside better for everyone.

8.313. The Agency was concerned that greater concentration of supply towards larger individual businesses tended to exacerbate the negative effects of downward pressure on unit prices and large-scale production and transport. Large retailers had the power to influence the entire chain of food production. Some exercised power responsibly, engaging with local and smaller producers or requiring high environmental standards for the whole life of some products, but more often they tended to follow policies aimed at highly standardized products at low unit cost. This resulted in intensive, industrial-scale low unit cost (but potentially high environmental impact) production and processing techniques, often harmful to landscape and wildlife.

8.314. The Agency encouraged us to note the track records of the bidding parties in relation to their support for sustainable supply, and with regard to their farming methods, transport, packaging and recycling. Companies that demonstrated a more positive approach to these issues should be considered acting more in the public interest than those focused simply on price competitiveness.

Trade associations and other organizations

Association of Convenience Stores Limited

8.315. The ACS provided views and attended a hearing. It told us that it represented 30,000 of the 54,000 convenience shops operating in neighbourhoods, town centres, villages and on petrol forecourts throughout the UK. The convenience sector had turnover worth about 20 per cent of the total grocery market. Members ranged from independents owning their own stores through to symbol groups. Convenience stores worked on very tight margins, typically 1 to 2 per cent, compared with over 5 per cent in a supermarket. Convenience stores allowed people to shop early and late, without using a car, and offered local, flexible employment. Data showed demand for convenience stores increasing, some of it driven by items such as mobile phone top-ups and utility payments.

8.316. The ACS had concerns about the acquisition of Safeway, by any bidder. Each of the proposed mergers could work against fair competition, if appropriate safeguards were not put in place. Further superstore consolidation would increase pressure on convenience and neighbourhood stores. That consolidation would lead to four major operators, in place of five, further entrenching the major supermarket groups. Even the unsuccessful bidders could find their hands strengthened, through the divestment process.

8.317. Increased buyer power would increase factory-gate pricing, adding to the pressure on margins for more suppliers, who would also face higher prices by manufacturers seeking to replace lost profit. The independent retail sector was serviced by wholesalers who broke bulk purchases into smaller units for distribution, and in many cases superstores sold products at prices cheaper than those at which those wholesalers could buy them. The disparity in prices, and consequent additional costs for smaller operators, could force closures and the loss of retail services in rural areas and deprived neighbourhoods. Independent retail outlets were declining by over 1,000 a year.

8.318. The ACS was concerned that a successful purchaser might use the Safeway acquisition to pursue activity in the convenience store sector where Tesco already had a strong presence. Major multiples already generated significant sales from purchases totalling under £10, and whilst competition should be encouraged, major player buying power would mean lower superstore prices, to the detriment of the rest of the retail industry and its customers.

8.319. Fuel sale growth had been at the expense of independent forecourts, driven in part by cross-subsidization of profits from stores, a practice independent operators lacked the scale to match.

Consolidation would increase cross-subsidization, leading to a decline in local competition and reduced customer choice.

8.320. The ACS thought the present planning regime represented a fair balance between conflicting interests. Multiple operators were now finding their way back to the high street. Stores of ACS members tended to operate from secondary areas: smaller high streets, estates on the edge of town, the suburbs and rural areas.

8.321. The ACS had welcomed the Code of Practice, and the review aimed at its strengthening. Members were not directly affected by the Code, which operated between major multiples and suppliers, but a more effective regime would have a positive impact for small shopkeepers. Concerns remained at how the Code was structured and enforced. In particular, the question of a ban on persistent below-cost selling should be examined.

8.322. Below-cost selling was of the greatest concern to members of the ACS. Almost alone in Europe, the UK lacked some level of protection for smaller retailers competing against the major retailers. There was advantage in looking to see what happened in other countries, both to encourage competition and to do so by prohibiting practices which favoured big operators. A ban could be enforced by providing for grocery competitors to complain, under an amended Code, through an independent mechanism. Linked with this there should be provision for transparent buying prices to ensure fair competition. Safeguards were needed to protect smaller operators and their customers. Suppliers should be required to publish the invoice cost of supplies according to volume supplied.

8.323. Subsequent to the hearing with us, the ACS provided further evidence on the issues of a ban on below-cost selling and transparency of buying prices. The material covered definitions of below-cost selling in Europe, strengths and weaknesses of enforcement methods used elsewhere, and outline options for implementing a ban on below-cost selling in the UK. The ACS recommended a ban on below-cost selling, with exceptions in special circumstances, as a necessary safeguard against the predatory effects of monopoly.

8.324. The ACS also examined how regulations to ensure transparent pricing worked in other countries, and reasons for concerns over the lack of transparency of buying prices in the UK retail market. It concluded that a requirement should be placed on suppliers to publish terms, and to make them available to all retail buyers. Prices would be related to volume, and transparency should extend to all payments included in deals between suppliers and retailers. The paper submitted by the ACS indicated that the Supermarket Code was the most suitable vehicle for these provisions, offering a statutory framework alongside a self-regulatory element.

Association of Town Centre Management

8.325. The Association of Town Centre Management wrote to say that town centre management was a mechanism to strengthen a town's attractiveness as a place to live, work, visit and invest in. Sainsbury's had been an active Association member since 1995 and its commitment to its corporate responsibilities, expressed through putting something back into the communities in which it traded, was encouraging. A successful acquisition by Sainsbury's would be viewed by the Association as a positive outcome for the future of town centres in the UK.

British Independent Fruit Growers' Association

8.326. The British Independent Fruit Growers' Association (BIFGA) believed that both consumers and suppliers would be much better served by a marketplace comprised of a relatively large number of small and medium-sized supermarket chains, rather than a small number of very large chains. In addition, there was a very good case for downsizing some of the existing larger chains.

8.327. Increased consumption of local food was far more likely to be achieved with smaller, rather than larger, supermarket chains. Removing a multiple retailer from the field would act against the public interest, by reducing choice. If sold, Safeway should go to a new market entrant rather than an existing supermarket chain.

8.328. BIFGA continued to call for the appointment of a permanent regulator to oversee all major multiple retailers. Such a regulator would help ensure a fair deal for both consumers and suppliers, as well as advising the CC on future proposed takeovers in the retail sector. BIFGA believed that the need for a permanent regulator was well demonstrated by the way in which the Code of Practice, on its own, had failed totally to address problems experienced by suppliers to supermarkets, problems which would increase should the number of supermarket chains decrease.

British Printing Industries Federation

8.329. The British Printing Industries Federation (BPIF) wrote to express its concern at the possible further consolidation of supermarket power. It preferred to see the concentration of supermarket power reduced, not increased. Any consolidation would have a negative effect on the supply chain, increasing the possibility of abusive practices against suppliers, and a further reduction in choice for the consumer.

8.330. The BPIF said that the Code of Practice had not proved an effective tool in dealing with abuse of power. An example was the extended credit taken by the major supermarkets, which in the UK was estimated to have gained them an extra £623 million in 2001.

8.331. BPIF members had expressed a preference for Safeway to be acquired by a major supermarket that had a reputation for integrity in dealings with suppliers.

The Countryside Alliance

8.332. The Countryside Alliance said that it had (together with the North Cumbria Health Authority) organized and run a project based on the concept of creating food-buying cooperatives in deprived urban communities that could source food from participating local farmers. Forty such cooperatives now in existence, providing food for 6,000 people weekly, testified to its success. It was run by the Rural Regeneration Unit, a not-for-profit company established by the Alliance, and the Cumbrian cooperatives were undoubtedly competing with the supermarkets.

8.333. Whilst some of the evidence was anecdotal, The Countryside Alliance understood that members of the cooperatives mentioned above were better off both in terms of price and quality than if they had used their local supermarket, and produced price comparisons to that effect. It was also recognized that the question of quality was subject to interpretation.

Crisis

8.334. Crisis, the national charity working for homeless people, said that Sainsbury's had played an important part in the formative years of Crisis Fareshare, the scheme which redistributes surplus food, not just financially but with the provision of food and logistical support. This support continued as Crisis Fareshare increased its operation from one London project to six national franchise operations. Sainsbury's remained an important supporter and continued to provide food donations.

Fairtrade Foundation

8.335. The Fairtrade Foundation (Fairtrade) said that it was set up by leading international development agencies in 1992 to operate the FAIRTRADE Mark, an independent consumer guarantee of a better deal for producers in the developing world. The Mark was licensed for use on products that met internationally-agreed standards, and in 2002 consumers spent £63 million on those products.

8.336. Fairtrade had developed effective partnerships with all the national supermarkets. Some took a lead on fair trade, some had responded as the market grew, and some had been resistant to the idea. The top five supermarkets had 75 per cent of the UK food market. They competed fiercely on prices charged to consumers but the competitive costs were largely passed back along the supply chain. Primary producers—often poor or disadvantaged farmers—had no option but to sell at prices below the cost of production.

8.337. Continuous intense downward pressure on prices undermined grower ability, especially that of small-scale growers, to develop more socially and environmentally sustainable production practices, exacerbated by the ability of large retailers to source globally from the lowest-cost producers. Fairtrade believed that there should be no further consolidation of supermarket retailing, and also that effective measures should be implemented to ensure that the major multiples adopted more responsible purchasing policies.

The Federation of Wholesale Distributors

8.338. The Federation of Wholesale Distributors (FWD) told us that it represented the major cash-and-carry and delivered wholesalers in the UK food and drinks, and related products, marketplace. Members supplied the majority of independent retailers, convenience stores, neighbourhood shops and newsagents countrywide. The FWD was concerned at the unrestricted predatory expansion by the big four superstore corporations, and instanced a large area of Eastbourne now dominated by the multiples following acquisition of smaller stores. Communities living in the area were subjected to monopolistic price imposition, and remaining independent retailers were at risk.

8.339. The FWD questioned whether the CC wished to see further extensions of multiple dominated territory, where independents were clinging on by their fingertips.

8.340. In considering the Remedies Statement, the FWD had one principal concern. The concept of the market as divided into one-stop and convenience required urgent revisiting. The UK grocery market should be seen as a single entity. Superstore concentration had produced a situation where top-up or convenience shopping took place in every kind of outlet, of every size.

8.341. Splitting the market made it impossible to curtail the expansion of giant superstore corporations into the local store sector, increasing the market domination already enjoyed by the four largest groups. Present definitions meant that communities were defenceless against major multiples taking control of local neighbourhood stores. The consequence could be both a further reduction in consumer choice, and increased abuse of market power by the leading supermarkets.

Food and Drink Federation

8.342. The Food and Drink Federation (FDF) said that it was the principal body representing the food and drink manufacturing industry in the UK.

8.343. The FDF was concerned at the prospect of the top four multiple retailers consolidating into three. This would result in:

- (a) a substantial lessening of competition;
- (b) a further increase in retailer buyer power together with increased dependency by suppliers on fewer outlets; and
- (c) a reduction in the width and depth of the range of food and drink products on offer to the consumer.

8.344. The Code of Practice had not resulted in any change of behaviour on the part of the four leading retailers. Since the Code was first considered, the market had changed, becoming more concentrated—a process which would be continued were Safeway to be acquired by a bidder. The FDF said that greater market concentration would further restrict supplier market access; as a consequence, the buying power behaviour of the leading multiple retailers would intensify.

Friends of the Earth

8.345. Friends of the Earth provided written views on both the Issues and the Remedies Statements and also attended a hearing. It considered that the acquisition of Safeway by any of the bidding parties

would operate against the public interest. The negative impacts of the proposed mergers could not be addressed by means of store divestments, or other such undertakings.

8.346. It said that a concentration of the market resulting from a Safeway takeover would give the main parties increased buyer power, which would further tilt the imbalance between the supermarkets and their suppliers. The OFT Code of Practice was not considered a strong enough tool to prevent abuses of power between supermarkets and their suppliers. It was ineffective in the case of farmers who supplied the major multiples, and who were not covered by the Code if they supplied their produce to an intermediary. Friends of the Earth surveys revealed both that many farmers were unaware that the Code existed and that many others were afraid to speak publicly about their dealings with supermarkets. This made it difficult to present evidence of unfair practices. Yet Friends of the Earth had been told of particular instances of unreasonably late payment of invoices (over 30 days and sometimes over 90 days), which would in the organization's view amount to breaches of the Code, but which the farmers concerned were reluctant to pursue because of the possible detrimental commercial repercussions. A merger would give the successful bidder a significant increase in buyer power, which could only exacerbate the problem. Friends of the Earth sought a stronger Code, which should be imposed, and the appointment of an independent regulator; without these measures no consolidation in the grocery market should be allowed to go ahead.

8.347. Friends of the Earth said that a more diverse range of shopping opportunities was central to the public interest. They said that an earlier CC survey suggesting that just 1 per cent of shoppers relied on local shops under-represented the situation in particular localities and among particular sectors of the population.¹ One recent unpublished report by another organization found that, in one inner-city area of high unemployment, 25 per cent of the residents used local shops for their main weekly shopping. This contradicted suggestions that most people undertook a weekly shop in a supermarket irrespective of the level of their weekly grocery expenditure. Low-income consumers were more likely to shop around to keep within a tight budget. Evidence suggested that such consumers could not afford to buy all their groceries from one major supermarket. Supermarket growth was part of the problem of food poverty, and the anti-competitive behaviour of the major multiples contributed to the problems facing low-income consumers.

8.348. Any assessment of local impacts should therefore include that on independent and smaller shops, which were more likely to benefit the local economy, even with lower takings. The result of increased market concentration could have a damaging effect on local shopping areas. Independent grocery shops were already finding it difficult to compete with the major supermarkets and a further concentration of power could make the situation worse for them by drawing away even a few high-volume shoppers. The loss of local shops would have a disproportionate impact on lower-income households and households without access to a car. The trend for major supermarkets to return to the high street in a convenience store format was another aspect of market concentration which merited examination. If mergers meant that more local shops could not compete, divestments were no solution, especially if the divested store was closed and was situated in a high street, and the one retained was out of town or peripheral.

8.349. Independent stores also offered different products, often sourced locally, rather than similar product ranges produced by a few large manufacturers for major supermarkets. Further consolidation would make it even harder for those seeking to enter the market and offer a new experience, for example those selling local or farm produce. Friends of the Earth had carried out two surveys on apple sourcing and variety in supermarkets. The 2002 survey demonstrated that, although there was overall a greater number of varieties of apple on sale in supermarkets, this was because of the greater number of imported varieties. The recent survey by Mintel, *Attitudes towards buying local produce* (2003), found 'a considerable degree of frustration among shoppers who appear to be willing to buy British but are unable to do so because the produce is not stocked by their retailers. Almost one third (30 per cent) complain that British produce is not always available; specifically (21 per cent) point the finger at supermarkets for not stocking enough British-grown fruit and vegetables, and 11 per cent claim that these same retailers do not carry enough British meat'. Mintel commented 'there is no indication of any direct support (among most supermarkets) for locally sourced produce'.

8.350. The CC's remit for this inquiry should include goods that went beyond the grocery offer. Supermarkets were able to cut prices significantly on non-food items, forcing independent shops to do

¹2000 report, paragraph 2.19.

the same. The situation would intensify after any Safeway merger. Cheap prices did not represent a consumer benefit if independent stores closed and choice was reduced. The supermarkets were expanding into the non-food area, and rapidly gaining market share in consequence. Asda had been able to cut prices aggressively by virtue of Wal-Mart global buying power, and was steadily expanding its non-food sales. The CC should consider the increased market share that would accrue to the bidding companies from an acquisition of Safeway, plus existing expansion plans, and assess the impact this would have on clothing chains, independent clothes shops and other non-food shops, together with the extent to which customer choice would be reduced. Asda was exploiting a planning law loophole in order to expand floor-space, planning the installation of mezzanine floors in about 40 Asda stores, to increase non-food sales floor space. This needed considering in the context of competition with local non-food retailers.

8.351. The impact of market concentration on the newspaper and magazine sector should also be examined. Three hundred independent newsagents closed during 2002, and supermarkets were likely to carry a narrower range of choice than independent stores.

8.352. Friends of the Earth welcomed the recognition in the CC's Issues Statement that shops below 1,400 sq metres might be used for one-stop shopping in rural areas. Significant numbers of the population relied on small local shops for all their shopping requirements. Merger effects on convenience stores needed to be considered.

8.353. Recognition that divestment at the local level would not necessarily solve national level competition problems was also welcomed. Real choice was provided by a diversity of shopping provision, and impacts of any proposed merger on the whole range of grocery and non-food outlets at local level required consideration. Major multiples varied prices locally according to local competition, and short-term cuts were extremely damaging to smaller stores. Once local competition was removed, prices rose again.

8.354. Tesco already held over 25 per cent of the grocery market. Any Tesco acquisition should be prohibited and a moratorium on further market expansion considered. Tesco had significant influence on the other main parties and often led price wars. Asda and Tesco were both global retailers, and the effects on UK suppliers should be considered in this context. Asda also initiated price wars.

8.355. A Morrisons/Safeway merger would increase overall concentration in the grocery market. Friends of the Earth was concerned that Morrisons could then put greater pressure on suppliers, noting an apparent relationship between market share, and the extent to which retailers were able to extract lower purchase prices from suppliers. It also echoed the concern reflected in the CC's Remedies Statement that increased concentration could lead both to higher prices and lower quality. Increased market concentration could reduce major retailers' sensitivity to consumer concerns such as pesticide residues in food and animal welfare, with more global sourcing and associated environmental impacts. In particular, Friends of the Earth noted that we did not consider Safeway a failing firm, concluding that the proposed merger was not to prevent closure, but to increase the bidding parties' market share.

8.356. The issue of loss leaders needed to be resolved. Aggressive pricing tactics were used by the biggest supermarkets to kill competition. Once competition was removed, or significantly reduced, prices could be raised again. Friends of the Earth welcomed the recognition in the CC's Issues Statement that below-cost selling might be encouraged or facilitated by a merger. Information on this subject should be updated, reasons why attempts at prohibition failed analysed, and alternative solutions put forward. It was not surprised that most suppliers found the Code of Practice had not made any difference. The Code needed strengthening, with a regulator to enforce legally binding provisions. This was needed whether or not an acquisition succeeded, but even a stronger Code might not work in the face of increased buyer power.

8.357. Divestment of stores was an inadequate remedy and did not address issues of increased market concentration. However, were any merger to proceed, Friends of the Earth said that Tesco, because of its already high market share, should not be allowed to buy divested stores. All purchases of divested stores should be subject to the approval of the OFT, and each assessment focused on local impacts. The form of divestment should not favour major multiples whose other expansion plans should be kept under review, and smaller chains or local cooperatives should have an opportunity to purchase.

8.358. In support of its views, Friends of the Earth cited academic and other studies.

The Future in Our Hands

8.359. The UK branch of an organization called The Future in Our Hands wrote to suggest that Safeway should not be acquired by any large supermarket chain. The Wal-Mart reputation in the USA for locating supermarkets in unsuitable locations, with a consequent reduction in the quality of life for those living locally, as well as destroying smaller local competition, gave cause for concern. A successful Asda acquisition of Safeway could result in further supermarket takeovers, followed by job losses and the loss of even more small businesses.

GMB National Trade Union

8.360. The GMB National Trade Union (GMB) did not wish to express a preference for any of the bidding parties to acquire Safeway. It did, however, wish to emphasize that people should be seen as a key element in the whole process. That being so, the GMB proposed that the bidding parties, as part of that process, should be requested to put in local plans, based on divestments, showing the potential impact for communities in terms of their economic and social stability, as well as employment opportunities and choice.

The Graphical, Paper & Media Union

8.361. The Graphical, Paper & Media Union (GPMU), which represents workers in the printing, paper, publishing and packaging sectors, and works closely with employer organizations and trade associations, told us that it was also an active participant in the Fair Deal Group.

8.362. The GPMU was concerned at the market dominance which would emerge from a merger of one of the largest three supermarkets with Safeway. The purchasing power and dominance of the successful bidder would increase to such an extent as to further distort marketplace activity. Competition would reduce rather than increase, and the result would not be in the interests of the consumer. Such a merger would only serve to strengthen the influence exerted on suppliers, and ultimately would accelerate the use of anti-competitive practices. It was, however, possible that a Morrisons/Safeway merger would produce a fourth major player, offering increased competition.

8.363. The GPMU said that the Code of Practice was ineffective and needed major strengthening. Through its participation in the Fair Deal Group, the GPMU was aware that the Code was not robust. It was regularly circumvented by the supermarkets, and much anecdotal evidence suggested that suppliers feared using its provisions because of the risk of repercussions. Concerns remained that the OFT was not interested in protecting the suppliers of the large supermarkets.

The Green Party

8.364. The Green Party recognized that consumers welcomed lower prices, but said that the hidden costs of mergers must also be taken into account. Concentration of supermarkets had given rise to exponential growth in traffic from both shoppers and distribution lorries. Transportation required more packaging and caused rapid decline in the vitamin content of many foods.

8.365. Environmental issues should increasingly be at the heart of long-term public interest issues. Neither increased traffic, pollution, nor global warming were in the public interest, and no merger should go ahead if it resulted in increased traffic. The Green Party believed that consideration should also be given to shoppers without cars.

Institute of Asian Businesses

8.366. The Institute of Asian Businesses (IAB) told us that a merger between any of the major grocery retailers and Safeway would represent an unacceptable additional concentration of market share nationally. The present market share of the major multiples gave them a position of immense power.

8.367. The IAB said that any post-merger increase in buying power would result in an increase in below-cost selling and exacerbate the problems of damage to smaller grocery outlets and to consumers, particularly the elderly, less mobile, and those from ethnic communities experiencing language difficulties. Such problems should be addressed before any acquisition proceeded. Industry figures suggested that almost eight independent stores were closing every day.

8.368. Were two main supermarkets to merge, the IAB believed that local competition would be reduced, allowing major multiples to raise prices in more locations. Divestments did not necessarily resolve the problem, as the continued use of the divested store as a grocery outlet could not be guaranteed. Further concentration of the grocery market threatened the closure of more small independent shops with negative consequences for low-income families and unemployment in disadvantaged areas of England.

8.369. The IAB suggested that a review of the Code of Practice should be carried out before any further large supermarket mergers were permitted. There was plenty of anecdotal evidence to suggest that undertakings had not worked, and in consequence many small Asian retailers were struggling to stay in business.

8.370. Any assessments of impacts should be made at both regional and local levels. Particular issues of concern were the potential for loss of jobs and local shopping access caused by store divestment. Regional concentration of market share would make it harder for new entrants to gain a foothold and smaller chains or existing independents to survive. Local independents were more likely to source products from local suppliers, whereas the big multiples had global sourcing systems. Loss of local independent shops was a real concern for small producers and in turn consumer choice was reduced. Local sourcing was beneficial for the local community and also reduced damaging transport and other pollution.

Marine Stewardship Council

8.371. The Marine Stewardship Council (MSC) said that it was an international charity, working to combat the devastating effects of overfishing by running an eco-labelling programme which identified independently certified sustainable seafood through a product label. The MSC was fully independent, had established a global coalition of support, and the main user and promoter of the MSC label was the retail sector, most particularly supermarkets.

8.372. Many large multiple retailers supported the MSC in varying degrees. Consideration as to the bidding parties for Safeway should include commitment to ethical and community values. Some of those bidders offered little hope in that area, but others demonstrated an all-round commitment to sustainable development, taking overfishing seriously and working with the MSC and other organizations to provide the best environmental choice. The MSC urged the CC to take its concerns into consideration in reaching conclusions.

National Association of Clubs for Young People

8.373. The National Association of Clubs for Young People said that it had worked in partnership with Sainsbury's and Homebase who had generously donated gifts in kind over the years. Donations went to the network of 3,000 clubs around the country, and the goodwill created ensured strong bonds between the national office in London and the 400,000 young people participating in clubs located in some of the most deprived inner city boroughs, as well as isolated rural areas, in the UK.

The National Farmers' Union

8.374. The National Farmers' Union (NFU) believed the interest of both consumers and its members were best served by a broadly-based, competitive food retail industry. Any contraction in the food retail base would be a matter of great concern.

8.375. Consolidation over the past decade had already reduced the base. Real buying power rested in the hands of a few companies, and had produced intense price competition. The effect on NFU members if this continued would be catastrophic, reducing British agriculture to a niche industry, but without enhancing consumer choice.

8.376. The preferred NFU option was for Safeway to remain as a major food retailer, offering real consumer choice, but without ferocious price competition. If consolidation was to be the outcome, a more level playing field should be the aim. The NFU would favour a position by which Tesco would maintain its leading position, achieved by organic growth, with Sainsbury's, Asda and Morrisons all having broadly similar market shares. An outcome which resulted in a duopoly accounting for over 50 per cent of food sales would cause the NFU grave concern, and serve the interests neither of its members nor the consumer.

8.377. On the Remedies Statement, the NFU reiterated certain points and made further comments. It strongly supported the need for a restriction on who should be allowed to buy divested stores, and that such disposals be subject to approval by the OFT. The NFU agreed that the OFT should decline to approve any divestment where the intention was to operate the store other than as a grocery outlet. There should be no limitation on an acquirer divesting its own store rather than a Safeway store, provided that necessary competitive balance was maintained. The issue of market share should be a main consideration for the OFT, and the factors to be considered should be those in the Remedies Statement. There should be constraints, related to market share, on acquisition of divested stores, including those divested voluntarily.

8.378. The NFU believed, given the level of interest in the acquisition of Safeway, that there would be sufficient interest on the part of another food retailer in acquiring large, divested Safeway stores. It was satisfied, from the Remedies Statement, that we had taken adequate cognizance of competition issues. It believed that market forces would be the decisive factor, with location, geographic fit, sales potential etc determining the price achieved.

8.379. The NFU believed that divestments should be in small blocks or individually. It assumed that a tender system, open to all food retail companies, would be overseen by the OFT. Other suggested forms of divestment were felt impractical.

8.380. The NFU said that the Code of Practice should define 'reasonableness' sectorally, and require complete transparency and bilateral agreement in all dealings between suppliers and retailers. Independent auditors should check the process regularly, and any successful bidder should automatically be subject to the Code of Practice if its current market share did not warrant this.

The National Pig Association

8.381. The National Pig Association (NPA) wrote to express its concern at any acquisition of Safeway that would result in two companies accounting for more than 50 per cent of the UK retail food market. Such a duopoly would be damaging to farming profitability. Four major national groups, rather than three, would provide a wider market and maintain a competitive balance in favour of customers and suppliers, whether they be manufacturers, farmers or growers.

8.382. The NPA supported an acquisition of Safeway by Morrisons, providing a strong fourth national option. The need for store disposals would be minimized, Morrisons had supported British agriculture over the years, and their fresh food vertical integration allowed them to pay farmers and growers a fairer price than some other major retailers. Such an acquisition would be beneficial to both the food retail market, and the farmers and growers of the UK.

Scottish Grocers' Federation

8.383. The Scottish Grocers' Federation told us that it was established in 1918 and represented over 3,500 retail units throughout Scotland, through independent chains, cooperatives, symbol groups and private individuals. It wished to emphasize that the Scottish marketplace differed from the rest of the UK.

8.384. Safeway had 115 supermarkets in Scotland, a proportionately greater representation than in any other region of the UK. A takeover or merger by one of the big two supermarket multiples, which together enjoyed in excess of 40 per cent of the Scottish market, might reduce competitiveness rather than enhance it.

8.385. Any merger might produce duplication in Scottish locations; subsequent divestments could result in redundancies and employee uncertainty. Safeway's estate and market share in Scotland was likely to consolidate the complex monopoly by the four largest supermarket companies identified in the 2000 report. The implications of a merger for the whole grocery food market should therefore be considered, as should the implications for the Scottish region where the effect would, in relative terms, be greater.

8.386. The Federation preferred to see a merger with one of the two retailers who had historically less market share north of the border. Scotland currently enjoyed four major supermarket groups, and, as an alternative, it would benefit the Scottish consumer to maintain this position.

8.387. The practice of below-cost selling had increased since the 2000 report. This undermined competition, substituting consumer spending from one retailer to another, and excluding both trade sectors and individual regions from product supply to the consumer. The elimination of below-cost selling, and the publication of transparent buying prices from suppliers, were both encouraged. The Federation wished to see conditions put in place to ensure equitable cost prices throughout the grocery industry, reflected in retail prices which were above cost.

Transport and General Workers' Union

8.388. The Transport and General Workers' Union (T&G) said that it was the largest food union in the UK, with members engaged in farming, processing and food distribution right through to food retailing and catering. Whilst noting that the Morrisons offer made for a good geographical fit, the T&G felt the final outcome likely to be determined at a higher price range. Members within the farming industry were particularly anxious about greater consolidation, but in the event that a Safeway disposal proceeded, the aim of the T&G was to ensure that the best outcome was achieved for the farming community, those in the food industry, and consumers.

8.389. The T&G preferred to see Sainsbury's cleared for a part or total acquisition of Safeway, allowing it to equal, but not exceed, the largest existing company in the retail food supermarket sector. This was because:

- (a) Sainsbury's placed great emphasis on buying British food products;
- (b) it recognized the need for a healthy farming industry;
- (c) it had developed impressive partnerships, particularly in the dairy industry;
- (d) of its focus on quality, rather than price (as with their competitors);
- (e) it had well-developed long-term relationships with suppliers;
- (f) it did a good deal of local sourcing, protecting smaller food producers; and
- (g) it made a valuable contribution in supporting the red tractor logo.

8.390. The T&G also noted that Wal-Mart had a strongly anti-trade-union reputation. It had been ruthless in its dealings with suppliers and communities in the USA.

The UK Association of Frozen Food Producers

8.391. The UK Association of Frozen Food Producers said that it represented frozen food manufacturers. Its members produced some 65 per cent of the frozen foods consumed in the UK, with frozen food comprising some 10 per cent of the total food industry output. Membership included small, medium and large producers.

8.392. The Association believed there was a significant risk that any further strengthening of the market position of the three leading players would severely damage the viability of food manufacturing in the UK, with negative consequences for employment, the balance of trade, the hard-pressed agricultural sector, and consumer choice. It had also found that the Code of Practice was clearly not working. The strength of the major retailers meant that the Code effectively had no teeth, nor any practical, worthwhile remedy, however large the supplier with cause for complaint.

8.393. Whilst five major players would be an ideal solution, the Association viewed further consolidation as inevitable. In that context, the Morrisons bid at least offered the prospect of maintaining four major players. Morrisons had an excellent record of commitment to British agriculture and British manufacture, whilst offering significant choice and very keen prices to the consumer.

8.394. The Association made clear that the opinions expressed above represented the views of the trade association following discussion at its Executive Council, but were not to be taken as the views of each and every individual member.

The Ulster Farmers' Union

8.395. The Ulster Farmers' Union (UFU) had no specific comments to make on any of the proposed mergers. However, it remained concerned that unreasonable demands were still being made of suppliers by major supermarkets. Suppliers approached were not prepared to make an issue of their treatment for fear of recrimination.

8.396. The UFU supported the view of the NFU that the Code of Practice lacked teeth. Provision was needed for an audit process, to be managed by the OFT.

Union of Shop, Distributive and Allied Workers

8.397. The Union of Shop, Distributive and Allied Workers (USDAW) told us that it was the premier retail trade union, uniquely qualified to speak with authority on developments in food retail, and with a membership of 225,000 throughout the food retail sector. Twenty-three thousand members worked for Safeway, and their concerns should be taken into consideration. USDAW was committed to a competitive supermarket sector. If the sector's long-term viability was compromised, then supermarket employees, customers, suppliers, farmers and manufacturers would all lose out.

8.398. USDAW said that a merger between Safeway and Morrisons would produce a fourth retailer able to inject a serious competitive edge into a market dominated by the big three supermarket chains. This would mean more competition, by giving customers, suppliers and employees a real fourth choice. An acquisition by Morrisons would also mean relatively fewer store disposals to satisfy local competition needs, an area the CC would need to consider. Were another of the bidding parties to acquire Safeway, some hundreds of store disposals would be likely to follow, with major upheaval for Safeway business and staff. Morrisons had also given assurances as to employment terms and conditions.

8.399. USDAW had particular concerns about an Asda acquisition. Further expansion of Wal-Mart would present competition problems which should be assessed on a global scale as well as in a UK context. There was widespread concern among employee and consumer groups that this large, wealthy and powerful corporate entity used that wealth and power to push through unhealthy employment and consumer practices.

8.400. Should Tesco or Sainsbury's come under consideration as a possible acquirer of Safeway, then USDAW had no evidence to suggest that either, despite their relative size, would ever abuse their position in pursuit of healthy competition. Both had international operations, but not on the same scale as Wal-Mart. The USDAW relationship with Tesco had been a long and healthy one.

Wheathampstead Liberal Democrats

8.401. A District Councillor representing a large village near St Albans told us that he was concerned at the entire merger concept. Some of the major multiples had acted unreasonably in closing down profitable operations in small towns and large villages, with a major impact on the elderly and less well off in the communities. Those without transport then faced sometimes lengthy and costly bus journeys, whilst those who could drive did so to the detriment of the environment.

8.402. Food was an essential constituent for the survival of an individual, and a food retailer a constituent part of the survival of a community. Pricing structures in smaller units might need to differ from the larger supermarkets, but unless protective mechanisms were put in place to preserve smaller units, any further consolidation within the food supermarket industry, including takeovers of small companies and suppliers, should be opposed.

A suppliers' organization

8.403. An organization of suppliers dealing in consumer goods provided views and attended a hearing. It told us that its membership varied in size, from manufacturers with one or two products in a particular category, to larger companies with a wide range of products across several categories. Access to the consumer at the point of sale was entirely in the hands of retailers in their role as gatekeepers to consumers. Consumer goods manufacturers were totally dependent on the supermarkets to reach their consumers, particularly in the context of the weekly shop, providing major retailers with a powerful bargaining tool.

8.404. The organization believed that an acquisition of Safeway by an existing UK grocery retailer would increase the chasm between large retailers and others, reducing consumer choice of fascia. This was particularly the case where the acquirer was an existing national chain, whose store network overlapped with that of Safeway.

8.405. Acquisition by a major multiple would reduce competition between retailers and point to an increasingly two-tier industry. The costs of investment were already disproportionately borne by smaller retailers. Competition between three large players was bound to be less dynamic, further marginalizing smaller grocery retailers. Consumers and suppliers had a strong interest in vigorous competition, whereas a Safeway acquisition might trigger further consolidation. The supplier's organization did not think acquisition would produce further savings; rather an expanded retailer might expect as much account resource as was previously generated by the two entities when separate. Increased buyer power would be deployed to extract yet better (for them) terms from their suppliers, in consequence exacerbating the price disadvantage already suffered by smaller retailers.

8.406. The acquisition of Safeway would further pressurize a highly concentrated UK grocery market. Buyer power would increase, with retailers able to extract non-cost-related discounts from suppliers. Suppliers would increasingly depend on a few major retailers, and the scope for pressurizing suppliers to accept onerous terms would expand. That pressure would widen the gap in purchasing power between the big retailers and smaller grocery chains and independent retailers. Increased buyer power would impact both on manufacturer-supplier/retailer relationships, and customer choice through a lessening of competition at the product level. Vertically-integrated supply chains tended to intensify this process, with the retailer takeover of wholesaling impacting adversely on the smaller retailers, but with no guarantee that buyer power cost savings would be passed on to the consumer. This situation might be met by separating the wholesale function exercised by large retailers from the retail function itself. For existing Safeway suppliers, the consequences of acquisition could be cancellation of agreements, or demands for improved terms.

8.407. Potential new suppliers would face fewer points of entry to the market. Site acquisition and planning difficulties, compounded by the need to build a retail brand, be competitive, and obtain supplies at a competitive price, constituted insurmountable barriers to entry.

8.408. The organization identified no improvement in the behaviour of retailers towards their suppliers since the introduction of the Code of Practice. There were problems with the dispute resolution procedure. The climate of apprehension between suppliers and retailers continued, with the former raising few breaches for fear of reprisals. In some instances there had been a deterioration in relationships, and if further retail concentration was not to exacerbate this situation, a more effective Code was

required. Were that not possible, either a statutory industry regulator might be required with monitoring and enforcement powers or the CC could undertake the function, but that apart, improvements might be achieved by:

- (a) realigning objectives to address the effects of practices identified in the 2000 report;
- (b) public reporting on this report's conclusions, with specific remedies where concerns arose and effective monitoring to ensure that remedies were effective;
- (c) guidance where vague language or loopholes in the current Code raised problems; and
- (d) six-monthly monitoring.

8.409. The organization also commented on the Remedies Statement. It too believed that the markets affected by any merger were primarily groceries. One-stop shopping was viewed as a distinct market, and whilst store sizes of 1,400 sq metres offered a reasonable defining guide, merger impacts in the context of stores of 2,500 sq metres and above also needed to be considered. Despite being different markets, there were overlaps between one-stop and convenience shopping, not least the presence of large supermarket operators using their buyer power advantage in the convenience sector, and which further reduced the competitive pressures which smaller stores could offer.

8.410. The organization urged consideration of the procurement market as a separate market, and provided information on EC case decisions together with a note on relevant EC and national cases. It endorsed the view that consideration of remedies would need to address both local and national dimensions of competition. It also believed that store catchment areas, and the extent to which they overlapped, represented an imperfect measure of both choice and competition, because of the variable distances shoppers were prepared to travel. It confirmed its view that a reduction from five to four fascias would present a competition problem.

8.411. The conditions outlined in our guidelines for merger references all existed in the market for one-stop grocery shopping. In particular, the organization noted that parallel behaviour by the leading retailers in their dealings with suppliers distorted and softened competition between them. Barriers to new market entry in the one-stop grocery shopping market were insurmountable, and the additional difficulty of establishing a competitive distribution network etc was pointed to.

8.412. Further concentration arising from any merger was likely to affect diversity and innovation. Extracting more money from suppliers meant a reduction in innovative investment and promotional activity. The potential for economies required careful assessment, and was considered limited in the areas of distribution, head office, IT and logistics. The organization agreed that the 'waterbed' effect was long term in effect, and unintentional, but indicated evidence to the effect that the gap in buying prices increased with scale, and supported the view that this would remain the case, were any of the bids to succeed.

8.413. Further consolidation arising from these mergers would have a considerable effect. In the whole of UK retailing there had never been a merger of this scale. The organization considered the proposals as to dealing with distribution assets imprecise. However they worked out, a more effective remedy would be to require the bidder to divest its own and Safeway's distribution facilities, so that a major new force in UK grocery distribution at wholesale level might be encouraged.

8.414. The Code of Practice should be strengthened by realigning its objectives to those originally specified in the 2000 report. The wording of many clauses should be tightened, and the Code given more cogency by a Statutory Instrument, putting it into a formal Order.

Consumers

8.415. We received some 251 representations from individuals, a number via their Members of Parliament. These covered the following issues:

- (a) the power of relatively few supermarket companies over food supply and farming;

- (b) the need for choice in particular areas;
- (c) the problems of local dominance;
- (d) the extent to which major supermarkets' prices tend to be similar;
- (e) the social impact of the declining number of small shops, with negative effects on communities, people on low incomes and those not owning cars; and
- (f) the adverse effects of any of the proposed mergers on consumer choice, smaller and independent retailers, farmers and other suppliers.

Other parties

Corporate Culture plc

8.416. Corporate Culture plc (Corporate Culture) had no connection with Asda, other than serving as a judge at annual internal award events to recognize individuals and stores for their work with local communities. As a company advising large organizations on corporate responsibility, Corporate Culture had been impressed by the enthusiasm and commitment of Asda employees, from top down. That commitment was genuinely and deeply felt, primarily driven by employees in-store, and in giving specific instances Corporate Culture felt the way employees actively sought to understand and respond to the social needs of local customers was a factor to be taken into account in the present inquiry.

Sir Donald Curry KB CBE

8.417. As Chairman of the Policy Commission on the Future of Farming and Food, and as Chairman of the Implementation Group established to oversee the Government's subsequent Strategy on Sustainable Farming and Food, Sir Donald Curry said that he had been struck, in preparing his report, by the imbalance in size between very many small retailers at one end of the food chain, and major retailers at the other. Whilst not a clear-cut relationship, major supermarkets manifestly had sufficient buyer power to dictate terms to suppliers, particularly the smaller ones, and the effects were felt most acutely by farmers at the bottom of the chain.

8.418. Sir Donald viewed the prospect of further consolidation with some trepidation. The number of buyers would reduce and the remainder gain increased buying power, whilst competitiveness in the agricultural industry, and the prospects for its recovery, would both be eroded.

8.419. Consolidation and concentration would make it difficult for farmers to reorganize their businesses. The development of regional and local sourcing could be negatively affected by a reduction in the number of outlets for small manufacturers, and this effect would be exacerbated if further concentration led to an increasing focus on price, at the expense of quality.

Information Resources

8.420. Information Resources said that it marketed sales data information to manufacturers of fast-moving consumer goods in the form of retail tracking. It believed it was important for us to consider the impact on the market for data sale when considering the public interest impact of any potential acquisition of Safeway.

8.421. Due consideration should also be given to the desirability of appropriate measures to ensure that retail tracking data remained available. Whilst that market might be relatively small, the impact it would have on the efficiency with which manufacturers could operate to meet consumer needs in terms of availability and price would be significant. In the UK, Asda had recently withdrawn its named chain data from the market. Such withdrawals diminished manufacturer insight into their product performance.

Mr Peter Law AM

8.422. Mr Law, National Assembly Member for Blaenau Gwent, National Assembly for Wales, wrote to us to support the Morrisons bid, which he felt would create a reasonably-sized company, far more acceptable than the monopoly which would result if other, larger companies acquired Safeway. Mr Law considered Morrisons a very effective, professional and profitable company, providing high-quality and value-for-money products, whose success in his constituency had been applauded.

Mr Barry Sheerman MP

8.423. Mr Barry Sheerman MP said that a number of Yorkshire colleagues joined him in expressing concern about the possibility of Asda acquiring Safeway. Such an outcome would have serious effects in reducing competition in UK supermarkets, and on UK suppliers to Asda. A suitable outcome, which would increase rather than reduce competition, would be a merger between Morrisons and Safeway.

York Research

8.424. We received a paper from York Research setting out its views relating to this inquiry and how a range of issues might be approached.

A specialist investment bank and strategy consulting firm

8.425. A leading specialist investment bank and strategy consulting firm said that it operated exclusively in the European food industry, its sole focus being the food-manufacturing sector.

8.426. Were Tesco, Asda or Sainsbury's to acquire Safeway, reducing the leading group of national food retailers to three, a number of food manufacturers would, over time, decrease their level of investment in the UK, or withdraw from parts of the market. The present concentration of power in the hands of four national chains meant, even for larger groups, that submitting to retailers' demands was unavoidable. Further concentration could only make an extremely difficult situation much worse.

8.427. Failure to gain sufficient distribution of a given product with key retailers at the right price meant that it would become uneconomic for food manufacturers to support that product, through investment in new development, in manufacturing, or in sales and market support. Where that occurred, the firm believed that the manufacturer would not pursue product investment, reducing choice for consumers. Due to concentration of the customer base, and consequent erosion of negotiating position, UK food manufacturers already had extreme difficulty in achieving a satisfactory margin, and further consolidation would again exacerbate this position.

8.428. It was apparent that the elimination of duplicated functions and purchasing savings anticipated by Tesco, Asda and Sainsbury's, in the event of a successful acquisition of Safeway, would come from greater leverage over suppliers. The concentration of buying power already made it very difficult to convince investors to invest in the UK food industry. However, whilst an acquisition by Morrisons would lead to some further buyer power concentration, the firm thought UK food manufacturers would be neutral on that proposition. Morrisons had a reputation for fair dealing with both customers and suppliers, honouring supply agreements once reached. Food manufacturers were also keen to see a more stable situation at Safeway.

A member of the public working in the food industry

8.429. A member of the public who worked in the food industry pointed out that the concentration of sales in so few supermarket companies had led to substantial consolidation in the supplier industry, which was likely to continue across the manufacture, distribution and retailing of food. Thousands of people working in the food industry were also members of the public, and a decision as to Safeway's future would affect them far more than other consumers.

8.430. Viewed overall, the member of the public thought it was for consideration that an acquisition by Morrisons would mean a strong fourth company, far better for manufacturers and consumers than three, or even two, major supermarket companies. Acquisition by any of the other bidders would be uncompetitive by any standard. Attention was also drawn to the imbalance of power between supermarkets and suppliers.

D J MORRIS (*Chairman*)

J BAILLIE

C GOODALL

P KLEMPERER

J B K RICKFORD

J D S STARK

R FOSTER (*Chief Executive and Secretary*)

18 August 2003