

GROCERIES MARKET INVESTIGATION

Statement of issues

1. On 9 May 2006, the Office of Fair Trading (OFT) referred the supply of groceries by retailers in the UK to the Competition Commission (CC) for investigation. The reference was made under section 131 of the Enterprise Act 2002 (the Act) and followed an initial OFT study into the sector and public consultation.
2. 'Groceries' is defined in our terms of reference as:
 - including food (other than that sold for consumption in the store), pet food, drinks (alcoholic and non-alcoholic), cleaning products, toiletries and household goods; and
 - excluding petrol, clothing, DIY products, financial services, pharmaceuticals, newspapers magazines, greetings cards, CDs, DVDs, videos and audio tapes, toys, plants, flowers, perfumes, cosmetics, electrical appliances, kitchen hardware, gardening equipment, books, tobacco and tobacco products.
3. We have already been asked to extend our investigation to markets for products and services other than groceries, as defined in our terms of reference. We are not inclined to do so. The market as referred to us appears to give us a sufficient basis to conduct a comprehensive investigation and we have powers under the Act to identify features which affect competition in any market in which grocery suppliers operate.
4. The CC is required to determine whether any feature, or combination of features, of the market prevents, restricts or distorts competition.¹ If this is so, there will be an 'adverse effect on competition', and we will seek to identify the detriment to consumers resulting from the adverse effect on competition (which might take the form of higher prices, less choice, lower quality of available products or lower innovation than if competition was working effectively). The competition issues set out in this statement are those which may be of relevance to our eventual decision. We have not yet reached conclusions on any issue set out in this statement.
5. We have already received evidence on a range of issues from a variety of sources. But we must distinguish competition issues from other issues of public concern associated with grocery retailing which we have no power to investigate or resolve. Unless they affect competition, issues such as the environmental impact of the grocery supply chain, the composition of the high street and its impact on communities, rural land usage or employment conditions in overseas suppliers are not things we can decide on. These issues and public concern about them may interact with competition issues and provide background and context for our investigation, but our focus must be on the competition issues.
6. This issues statement is based on our consideration of the OFT's decision document,² and on our initial thoughts about the issues we propose to investigate. We are issuing it before we have received much evidence in writing in order to assist those submitting evidence to focus their submissions on the issues which we

¹Section 134 of the Enterprise Act 2002.

²*The grocery market: The OFT's reasons for making a reference to the Competition Commission*, OFT845, May 2006 <http://www.offt.gov.uk/NR/rdonlyres/1A2D7FA2-FEA3-4459-9B25-4A737A20023D/0/oft845.pdf>.

envisage being central to this investigation. If parties consider that there are additional issues which we ought to investigate, they are invited to identify these, together with an explanation as to why they should be investigated.. We recognize that other issues will arise in the course of our investigation; we will consider these carefully and will pursue substantive issues which bear on competition.

7. We plan to hold hearings with interested parties during the period June—September 2006. Following these hearings, we expect to publish an ‘emerging thinking’ document for consultation. We may then hold further hearings before publishing our provisional findings. If we were provisionally to have found that there were adverse effects on competition, we would then consider possible remedies.

Presentation of the issues

8. The issues which appear to be most relevant to the decision as to whether any feature (or combination of features) of the market prevents, restricts or distorts competition fall into three broad categories:
 - (a) whether any aspect of the behaviour of grocery retailers towards their suppliers affects competition in any market;
 - (b) whether any aspect of the structure of any local market for groceries³, or any aspect of the conduct of grocery retailers or consumers in the market for groceries (or in any other market in which grocery retailers operate) affects competition in one or more local markets for groceries, or in any other product market; and
 - (c) whether the operation of the planning regime as it affects grocery retailing, or any conduct by grocery retailers, including any aspect of the acquisition, disposal, development or use of land, affects competition in any market.
9. We set out these issues in more detail below.⁴

Supply chain issues

10. The behaviour of multiple retailers towards their suppliers (including the exercise of buyer power) was considered in detail in the CC report on Supermarkets in 2000,⁵ one consequence of which was the establishment of the Supermarkets’ Code of Practice (SCOP). In this investigation we will consider:
 - (a) whether the behaviour of grocery retailers towards their suppliers affects competition among suppliers of groceries or other products sold by grocery retailers by, for example:
 - (i) causing suppliers to supply less than the amount of products that they would supply in an effectively functioning market;

³The reference to local markets for groceries is without prejudice to our consideration of the relevant product and geographic market—see paragraphs 13 to 16.

⁴In addressing the issues that appear to arise in this inquiry, the CC has had regard to the guidelines for market inquiries in its published document CC3, *Market Investigation References: Competition Commission Guidelines*, 2003. (A copy of this document is on the CC’s website. The relevant sections of CC3 for the purposes of this statement of issues are Parts 2 and 3.)

⁵*Supermarkets: a report on the supply of groceries from multiple stores in the United Kingdom*, The Stationery Office, Cm 4842, October 2000, (the CC Supermarkets report). The report is on our website at www.competition-commission.org.uk/rep_pub/reports/2000/446super.htm#full. Note that the terms of reference for this inquiry differed from ours in several respects; in particular they excluded smaller grocery retailers.

- (ii) reducing levels of investment and innovation because suppliers have less incentive and/or ability to invest and innovate than they would in an effectively functioning market; and
 - (iii) causing suppliers to limit the range, or nature, of products they offer, or otherwise to compete on non-price factors less vigorously or in ways which might not be expected in an effectively functioning market; and
- (b) whether the behaviour of grocery retailers towards their suppliers threatens the economic viability of suppliers or wholesalers (and thus the competitiveness and diversity of the supply chain) in a way which would not arise in an effectively functioning market;
- (c) whether the behaviour of grocery retailers towards their suppliers affects competition in grocery retailing:
- (i) by threatening the viability of parts of the supply chain (see paragraph 8(b); and/or
 - (ii) by causing prices charged by suppliers and/or wholesalers to grocery retailers without buyer power to be higher, or other terms offered less favourable, than those charged and offered to grocery retailers with buyer power, and whether this inhibits competition or threatens to do so in the foreseeable future;⁶ and
- (d) whether the behaviour of grocery retailers, which sell products other than groceries, towards their suppliers of non-grocery products distorts competition in the market for those products; and
- (e) what impact SCOP has on relations between grocery retailers and their suppliers.
11. We will consider, in particular, whether any detrimental effects on consumers have arisen, or might arise, from any of the above effects.

Retail competition

12. We consider the definition and analysis of the relevant markets to be linked, and regard them as component parts of the same collection of issues. We consider issues relevant to market definition and to the analysis of retail competition below.

Market definition

13. The CC identifies the relevant market, or markets, in order to provide the framework within which our assessment of competition and the effects of market features can be carried out.
14. We will need to define the relevant product market(s), and establish the geographic dimension of the relevant market(s), in order to assess competition within them. In assessing the definition of the product market, we note that in 2000, the CC defined the relevant product market according to the purpose of the shopping trip, in particular distinguishing between 'one-stop shopping' and 'secondary shopping'.⁷

⁶This is referred to in the OFT decision document as the 'waterbed effect'.

⁷CC supermarkets report (October 2000), paragraph 2.47.

15. We will have regard to, but will not be confined by, previous models or definitions, but in reaching our view on product market definition we will consider:
- (a) the pattern of consumer demand for groceries and how it has changed in recent years;
 - (b) consumers' shopping behaviour and how it has changed in recent years;
 - (c) the relationship, if any, between different patterns of shopping;
 - (d) how grocery retailing and the strategies of grocery retailers have developed in recent years in response to changes in consumer demand or shopping behaviour; and
 - (e) which fascias, formats or types of stores compete with, or impose competitive constraints on, one another (and how).
16. In assessing the geographic definition of the market, we note that in 2000 the CC concluded that 'taking the evidence as a whole, our view is that the ambit of consumers' search for groceries is essentially local'. We will consider:
- (a) whether and to what extent national grocery retailers vary their offering to the consumer by location;
 - (b) whether the nature, or extent, of competition varies across the UK (or differs in different parts of the UK);
 - (c) whether either of these has changed since 2000;
 - (d) what consumers consider to be the geographic scope of their search for groceries, and their ability to switch between outlets in different locations; and
 - (e) whether the increased incidence of online grocery shopping has affected the geographic definition of the market.

Market concentration

17. Total sales through UK grocery outlets were around £120 billion in 2005, a 4.2 per cent increase on 2004.⁸ Of this total, around £95 billion comprised grocery sales, with the remainder representing sales of non-grocery items. Groceries now account for nearly half of all retail sales, and around 13 per cent of all household spending (Institute of Grocery Distribution (August 2005), *Grocery Retailing*, page 11). It has been brought to our attention:
- (a) that national market concentration in the grocery sector is growing, and is relatively high in comparison with other countries;
 - (b) that while the convenience store sector has grown in recent years, both absolutely and as a share of all grocery retailing, the pattern of concentration in the convenience store sector has changed, specifically that:
 - (i) ownership of convenience stores by national multiple retailers has increased;

⁸IGD Grocery Retailing (August 2005), page 3.

- (ii) the number of stores affiliated to chains or symbol groups has increased;
 - (iii) the number of independent (and specialist) stores has declined; and
 - (iv) while the convenience store sector is characterized by low levels of concentration, if convenience sales through supermarkets are included, concentration in convenience retailing may have increased; and
- (c) that market concentration at a local level limits the choice available to consumers in some areas;⁹
- (d) that grocery retailers' sales of non-grocery items have increased markedly in recent years; and
- (e) that online grocery shopping has also increased markedly in recent years.
18. We will consider, in the light of these developments:
- (a) whether some local markets are highly concentrated or have become more concentrated in recent years;
 - (b) whether these changes are the result of normal market evolution or are the result of any feature of the market that adversely affects competition; and
 - (c) what impact the level of concentration (or the increase in concentration) and other changes have had, or are having:
 - (i) on price levels; and/or
 - (ii) on non-price dimensions of competition.
19. We will consider in particular whether any detrimental effects on consumers have arisen or might arise from any of the above effects.

Other aspects of competition in the market

20. We will also consider what drives consumers' preferences (for example their attitudes to price, range, quality, convenience and other aspects of service¹⁰), how these influence their shopping behaviour and how they have changed in recent years. We will consider what impact changes in consumers' shopping patterns and retailers' responses to them (for example changes in the pattern of types of grocery retail store available to shoppers) have had, or are having:
- (a) on price competition; and/or
 - (b) on non-price competition, including the range and diversity of fascias, types of shop, shopping experiences or any other features valued by consumers.
21. We will consider whether grocery retailers' activities in markets other than those for groceries (for example, in sales of non-grocery products) affect competition in the market for groceries, and whether the activities of grocery retailers affect competition in markets for non-grocery items such as those referred to in paragraph 2.

⁹OFT845, page 9.

¹⁰We include here the impact of issues such as concern for the ethical sourcing of food and the impact of loyalty programmes.

22. It has also been brought to our attention that certain pricing practices on the part of some retailers (including local price flexing and below-cost pricing¹¹) might affect competition.
23. In relation to price flexing, we will consider:
 - (a) whether some retailers flex prices locally;
 - (b) whether the incidence of this practice has changed since 2000;
 - (c) whether, in the light of trends identified in paragraph 16 and 17, the incidence of price flexing may be expected to change;
 - (d) whether the existence and extent of price flexing is, or appears to be, determined by the level of concentration in the market, or otherwise, by local conditions of competition; and
 - (e) whether there is any evidence of predatory intent or effect in local price flexing practices.
24. In relation to below cost pricing, we will consider:
 - (a) whether some grocery retailers price some items below cost, and if so, how prevalent is this practice;
 - (b) whether the incidence of this practice has changed since 2000;
 - (c) what impact this practice has on consumers' buying decisions (for example, what impact does it have on consumers' perceptions of relative prices charged by different retail outlets); and
 - (d) what impact this practice has on competition for products which are not priced below cost.
25. We will consider whether any such practices may be specific examples of any more general policy or policies of price discrimination. We will also consider whether, to the extent that they represent competition among some retailers, they might affect the viability of other retailers. We will consider whether some consumers may benefit from any such practices, and in particular whether any detrimental effects on consumers have arisen, or might arise, from any of the above effects.

Planning, land use and other barriers to entry

26. The OFT decision document directed our attention to the significance of land and of the planning system to competition in grocery retailing. We recognize that these issues are not wholly independent of others (for example, the availability of land might influence local concentration, which, in turn, might influence the value placed on undeveloped land in the vicinity); we will bear these linkages in mind in our analysis of the issues.
27. We will consider:

¹¹These are defined in the OFT's 'reasons for making a reference' document—see footnote 8.

- (a) whether the planning regime constrains a grocery retailer seeking to enter/expand in an area (and if so, how), specifically:
- (i) whether the 'needs test' (which requires applicants to demonstrate a quantitative need for their proposal) creates a barrier to entry;
 - (ii) whether the 'sequential approach' (favouring development in town centres over edge-of-town and out-of-town locations) may create a barrier to entry for some potential entrants in one or more local areas (for example, if entry in the town centre entails greater costs or has other disadvantages by comparison with other forms of entry);
 - (iii) whether limited availability of suitable sites creates a barrier to entry;
 - (iv) whether the duration and complexity of the planning process for site development acts as a barrier to entry; and/or
 - (v) whether any other aspect of the planning regime, or the way in which it is operated, creates barriers to entry to grocery retailing; and
- (b) whether any such barrier to entry or inhibition to competition operates in a way which advantages or disadvantages particular retailers or types of retailer;
- (c) whether there are significant differences in the operation of the planning system in different parts of the UK and/or between different local authorities, and what impact any such differences have on any barriers to entry and expansion;
- (d) whether any grocery retailer or group of retailers uses the planning regime or land ownership and development in a way that deters or restricts entry or expansion by an actual or potential competitor, specifically:
- (i) by acquiring or retaining land banks (including options over land), in a way which serves to exclude or deter actual or potential competitors from entering a market or expanding their operations;
 - (ii) by acquiring, divesting or developing land in a way which deters competitive entry or expansion in any locality;
 - (iii) by otherwise using the planning system in a way which might exclude rivals from entering or expanding (for example pre-empting an anticipated planning application by a rival by applying for the extension or redevelopment of an existing store);
 - (iv) by paying excessive prices for land in order to prevent an actual or potential competitor from developing it;
 - (v) by restricting the use or development of land for grocery retailing when it is sold; and
- (e) whether there are any other barriers to entry to grocery retailing, and whether these vary depending on the scale or format of potential entry.
28. We will consider, in particular, whether any detrimental effects on consumers have arisen, or might arise, from any of the above effects.

Possible applicability of Articles 81 and 82 of the EC Treaty

29. In accordance with the requirements of EC law,¹² we will consider whether Articles 81 or 82 of the EC Treaty are applicable to any agreements or conduct we identify in the relevant market or markets.

¹²In particular, Council Regulation 1/2003/EC, Article 3(1).