COMMENTARY ON COMPARISONS OF SUPERMARKET RETAIL PRICES AND WHOLESALE BUYING PRICES

Background

1 This paper has its origins in a desire by ACS to assist the Competition Commission as far as possible in establishing the differentials which in the view of ACS (and not only ACS) prevail between the prices at which wholesalers are able to buy branded groceries from suppliers and those at which the Big Four supermarkets are able to buy. The CC will be familiar with ACS' view that there are substantial differences between the two, that the advantages that the Big Four enjoy arise from abuse of their buyer power rather than from scale and other economies that they provide, and that the distortions to competition that result work to the disadvantage both of consumers and of independent retailers and wholesalers.

2 Neither ACS nor **** has been able to obtain large-scale hard evidence of the differentials that prevail. In its 2000 *Supermarkets* inquiry, the CC estimated that the average differential between the buying prices obtained by Tesco and those obtained by Budgens, an independent wholesaler/retailer, was of the order of 11 per cent.

3 In ACS' view, the CC must if necessary use its statutory powers to obtain details of the differences that prevail, and of their effects on competition and consumers.

4 In the meantime, and at the prompting primarily of three wholesalers, we have undertaken an exercise which compares the retail prices charged by the Big Four for several hundreds of branded grocery products with the wholesale buying prices achieved by three wholesalers – two large and one medium-sized – supplying independent grocery retailers. The difference between the retail and wholesale price - the gross margin - must be sufficient to cover delivery to store, store operating costs and provide the retailer with an appropriate return on capital.

5 As this document was being drafted we received the CC's "Note on Store Margin Analysis" dated April 10th. We had hoped to see hard data in that note which would inform the analyses attempted here, but were disappointed: the excisions of useful data in that note are so pervasive as to render it useless for this analysis. The CC appears to have been excessively cautious on this count. It should, for example, be possible for weighted averages to be supplied which do not reveal individual positions. It should also be possible to provide the test statistics and significance measures associated with the analysis for each company without revealing any confidential information. The information on revenues and costs that the CC has collected from the Big Four should provide it with adequate data to update the estimates of gross margins that were published in the 2000 report on Supermarkets. (para 8.54) It should also be in a position to distinguish between the gross margin which covers all costs of sales and the mark-up between the cost of goods from suppliers and the retail price. This mark-up is of direct relevance to our comparison of wholesale and retail prices.

The product list

6 The exercise began with a list of 500+ items produced by ******, which three wholesalers (all of whom have asked to remain unidentified) agreed to use as a basis for further analysis. We understand that ***** routinely uses this list for its own price comparison purposes. The original list contained non-grocery items and a number of supermarket own-label products, all of which we have eliminated. We also eliminated items where, for one reason or another, we were unable to get prices from all three of the wholesalers who agreed to take part. In the main, these last eliminations arose either because one or more of the three wholesalers does not stock the item or because one or more buys them in a unique pack size. It was important to begin with a list of items that were completely common across all three wholesalers.

7 The final list covers 317 items in 30 categories. We do not claim that it represents a typical shopping basket. It is more complete in some product categories (alcohol, soft drinks and confectionery) and less complete in others (bread and dairy products). But it is nevertheless a reasonable basis for comparison – more so, we suggest, than the 70 or so still-unidentified SKUs that the CC has relied on so far. We should be very interested to see what, if any, overlaps there are between the CC's 70 SKUs and our own 317, and particularly what prices the CC has for the overlapping items.

The spreadsheet – an explanation

8 The Excel spreadsheet includes a large number of columns, some containing descriptions and price data, others containing analyses conducted by us. The whole thing is rather wide, but for convenience we have divided the columns into blocks which, in combination with the Excel "freeze panes" command, can be viewed on a single screen. All the columns have been set up with "auto filter" so that CC members and staff can see for themselves how the values are distributed. In addition, we have highlighted in colour certain values which we regard as significant.

9 Rows highlighted in grey represent a break of product category and where possible include a summation of the values in that category. Wherever there are missing values, we do not sum the remainder in the category, since that can make for misleading comparisons.

10 The data gathering and subsequent analyses could not be carried out on, or as of, one single day. To the extent that prices change from week to week as well as over the longer term, the comparisons of individual SKUs are open to challenge, though we do not think the exercise as a whole is thereby undermined.

11 Any prices which we regarded as questionable have been highlighted in red, as have any calculations subsequently performed on them. For the most part, prices highlighted in red are those where we think the pack size may have changed.

EAN and description (cols. A and B)

12 The EAN is a unique identifier of a product in a given retail size or quantity. Although the list of products originates with *****, the description used is that of Tesco, which is more easily found on the internet. The saved version of the spreadsheet has frozen the columns containing the EAN identifier and the product description.

Supermarket retail prices (cols. C to F)

13 Column C represents Tesco prices in Cannock, Staffordshire (post code WS12 3YY) noted by ****** as at January 15th 2007.[1] Columns D to F represent prices taken in early February 2007 from the on-line shopping websites of Tesco, Sainsbury's and ASDA in the *********** (Harlow) *************************. ASDA does not deliver to Harlow itself, and the nearest town available for deliveries is Chelmsford. Morrison does not offer on-line shopping at all.

Wholesaler prices (cols. H to M)

14 Columns H, I and J contain prices given to Europe Economics <u>in confidence</u>, using the ******** product list as a basis. Two of the wholesalers are large and one is medium-sized.

15 Column K contains the mean of the three wholesaler prices, all of which date from March 2007. Column L calculates the difference in £/p between the Tesco price identified by ****** on January 15th 2007 and the average wholesale price, and Column M calculated that difference as a percentage of the average wholesale price.

16 The significance of the red and orange highlighting in column L is explained both in the notes at the foot of the spreadsheet and in the Conclusions at the end of this document.

Second retail/wholesale price comparison (cols. O, P, Q)

17 Columns O, P and Q repeat the exercise just described, this time comparing the average wholesale price against the average supermarket retail price found in Harlow or Chelmsford. Again, the significance of the red and orange highlighting in column Q is explained both in the notes at the foot of the spreadsheet and in the Conclusions at the end of this document.

18 Suffice it to say at this stage that columns L and Q provide the basis of our comparison of wholesale prices against supermarket retail prices. In our view the comparison effectively disposes of the CC's provisional conclusion in *Emerging Thinking* that there is no material difference in buying prices as between bigger and smaller buyers.

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1 This is where the agency that carries out the analysis for ******* is located.

Big Four supermarket prices compared nationally (cols. S to AA)

19 Tesco provides on its website (http://www. tesco.com/pricecheck) a comparison, updated weekly, of 10,000 grocery prices culled from its own records and those of Sainsbury, ASDA and Morrison. ACS has for some time been sceptical about the extent of price competition between the Big Four, and it seemed to us that the 300+ items already under consideration could provide a useful basis for an independent check. Accordingly we have captured, in columns S to V, Big Four prices published by Tesco as at April 2nd 2007.

20 Columns W, X and Y identify the minimum and maximum prices and the price spread (dispersion). Column Z calculates the average Big Four prices and column AA calculates the price dispersion as a percentage of the average Big Four price.

21 The yellow and green highlights indicate (in column Y) a price spread of zero (i.e. all price are the same) or a price spread of under 5p. In column AA a zero percentage price dispersion is highlighted in yellow and a dispersion of under 3 per cent in green. By visual inspection one can see that instances of zero or negligible price dispersion are numerous, i.e. that, on the whole, price competition appears not to be very intense.

Big Four supermarket prices compared locally (cols. AC to AJ)

22 The exercise just described is here repeated for Tesco, Sainsbury and ASDA in the Harlow or Chelmsford area. Much the same pattern of nil or minimal price dispersion appears, and the same highlighting convention is used.

23 Comparison at the product category level is frustrated by the fact that the Big Four do not offer an identical product range, even of popular branded goods. In our sample of 317, ASDA is missing a noticeably large number of items carried by Tesco and Sainsbury.

Big Four price increases and decreases (cols. AL and AM)

24 Finally, we compared the prices of Tesco in January (as noted by *******) with the prices we found in Harlow in April; and the prices we found in Harlow in February with those we found in Harlow in April. We then highlighted large price increases (>10 per cent) in red, large decreases (>10 per cent) in green, and zero price changes in yellow. Particularly with Tesco the number of price increases is quite striking. We comment in more detail in Conclusions below.

Conclusions

25 We concentrate here only on the most significant conclusions. The data offered is susceptible to further analysis.

26 We suggest there are two major themes that emerge from the data and comparisons we have done. The first – and the primary rationale for the whole exercise – is the likely difference between average supermarket buying prices and average buying prices achieved by wholesalers serving the independent trade. The second is the extent to

which one cannot rely on the Big Four supermarkets to compete vigorously with each other on price or on range. Even we have been surprised by the lack of price dispersion among them, by price increases during the first few months of 2007, and by the non-availability of some products (well known branded products, not obscure specialist items) in some of the Big Four.

Wholesale buying prices and supermarket retail prices

27 As regards differences between supermarket retail prices and wholesalers' buying prices, the exercise shows that:

- there are 25 line items (8 per cent of the sample of 317) where the average wholesale price is higher than the Tesco retail price noted by ***** in January 2007 (see column M);
- there are 32 line items (10 per cent of the sample) where the same wholesale price was higher than the average supermarket retail price prevailing in Harlow/Chelmsford in February 2007 (see column Q);

28 In other words, in order to match the supermarket retail prices, wholesalers would have to sell these items at a loss to independent retailers and independent retailers would have to sell them on at no profit. Items showing negatives margins on this basis of calculation are highlighted in red in columns M and Q.

29 We then went on to calculate the gross margins available by comparing average wholesale buying prices and average Big Four supermarket retail prices, highlighting in orange those line items where margins fell below certain thresholds explained below. Where margins do fall below these thresholds, the implication is that the supermarkets, on average, are buying at better prices than wholesalers supplying the independent trade are able to achieve. An alternative explanation would be that on the highlighted items, the Big Four are achieving thinner, and in many cases much thinner, gross margins. This seems to us intuitively unlikely on such a large scale.

30 The margin thresholds are taken from Convenience Retailing 2003 (IGD, April 2003), which calculates convenience store average retail margins as in Table 1 below:

Table 1: convenience retailing gross margins by category

Category	Gross margin (per cent)
Spirits	18
All other alcohol	23
Confectionery	28
Frozen foods, household goods	32
Chilled foods, soft drinks, bakery, milk	33
Snacks	35
HBA	36
Average of last 4 categories	**34**

Source: IGD

31 We used thresholds for spirits, all other alcohol and confectionery equivalent to the margins given in the table above, and an average of 34 per cent for all other items.

32 Based on the first comparison (column M) there are a further 153 line items (48 per cent of the sample) whose gross margin falls below the relevant threshold. In other words, if a wholesaler bought these items at average wholesale buying prices and a retailer supplied by that wholesaler sold them at the Tesco retail prices prevailing in January 2007, the wholesaler and retailer together would achieve a smaller gross margin than was the case back in 2002.

33 The second comparison (shown in column Q) does the same calculation, using the same wholesale prices as before but this time using supermarket prices as of February 2007. This second comparison identifies 204 line items (64 per cent of the sample).

34 If we add the number of line items yielding negative margins (highlighted in red in column M) to the number of line items which fall below the margin thresholds (highlighted in orange) the total in the first comparison comes to 178, or 56 per cent of the sample.

35 If we do the same summation in column Q, the total comes to 236, or 74 per cent of the sample.

36 Looking at the figures the other way round, we suggest that, in this sample, at least half and possibly three quarters of SKUs show a strong probability of a wide differential between the buying prices of wholesalers supplying the independent trade and the buying prices of the Big Four. In our view this analysis undermines the CC's suggestion in *Emerging Thinking* that larger retailers obtain much the same buying prices as smaller buyers. If the Big Four bought at the wholesale prices we have shown (which are factual, not estimated) and sold at the retail prices we identified (which are also factual), they would systematically be achieving negative gross margins and/or gross margins lower than convenience stores achieve, which we believe is implausible.

37 We acknowledge entirely that our exercise is based on estimation. But it is more comprehensive than anything the CC has published so far; and, as we have argued

throughout the inquiry it is for the CC to obtain a more complete picture based on hard facts, if necessary by use of its statutory powers. It is of considerable relief to us that the CC has accepted the need to lengthen its inquiry timetable to an extent that ought to allow for the full facts to be unearthed.

Comparisons of supermarket prices and products

38 The various comparisons made in our exercise provide some interesting insights into competition between the Big Four, especially but not only in relation to price.

Product range and consumer choice

39 The most noticeable feature is the lack of comparability of product range. Visual inspection of the product category rows (highlighted in grey) shows how few categories can be compared line-for-line and price differences calculated. In the April 2^{nd} comparison based on Tesco's price check web page, we could find strict comparability only in 8 out of 30 categories. Among the offers available in the Harlow/Chelmsford area at the same time, only 6 out of 30 product categories could be compared. Although we recognise that our sample does not represent a shopping basket, the nature and extent of non-comparable line items leads us to believe that it would be very difficult for even a dedicated shopper/researcher to compare identical baskets of branded goods across the supermarkets covered.

40 We observed that it is most often ASDA which lacks line items available in Tesco and Sainsbury's. To illustrate, we found that in column F, representing ASDA Chelmsford, 113 line items (almost 36 per cent of the sample) were blanks. Seventy seven line items (24 per cent) were blank in column E, Sainsbury's Harlow, and 16 (5 per cent) in column D, Tesco Harlow. We were somewhat surprised even at the 5 per cent difference between items available in Tesco Harlow compared with those available in Tesco Harrow. The conclusion we draw is that even three out of the Big Four supermarkets in one area may not provide quite the extent of product choice that consumers might suppose.

41 In any event, a choice of all four is not possible across the whole of the country. As people who live there know, Morrisons is still poorly represented in the south, even after the acquisition of Safeway. Conversely, although Waitrose is not one of the Big Four, people who live in the midlands and north find Waitrose poorly represented there.

Price competition

42 Tesco provides a price check page on its website in which it claims to compare the prices of 10,000 items every week among the Big Four. We reviewed the comparison on April 2^{nd} 2007 for the 317 items in our spreadsheet. For each line item Columns Y, Z and AA respectively calculate the price dispersion (the difference in £/p between the highest and lowest price), the average price, and the dispersion as a percentage of the average price.

43 Column Y highlights in yellow those items where the prices published by Tesco are identical, and in green items where the price dispersion is less than 5p. In the sample of

317, 111 line items (35 per cent) show zero dispersion and a further 98 items (31 percent) show dispersion of less than 5p. All in all, some two thirds of items show either no price dispersion or dispersion which we suggest is negligible from a consumer's point of view.

44 Column AA uses yellow to highlight a percentage price dispersion of zero and green to highlight percentage price dispersion of under 3 per cent. As we have already reported, in some cases it is not possible to compare four prices. Where only three exist we calculate the average of three, but for two prices or one we make no percentage calculation because the average could be regarded as spurious. For this reason the number of instances of zero in column AA is slightly different from the number in column Y, but it is not very far different, at 96 (30 per cent of the sample). The number of line items where the dispersion us under 3 per cent is 55, or 17 per cent of the sample. Thus, nearly half the sample shows either nil or negligible percentage price dispersion.

45 By comparing Tesco's published prices on its price check web page with those of Tesco Harlow we were able to test Tesco's claim that it prices uniformly. Of the 317 line items, 199 were priced identically, leaving 118 (37 per cent of the sample) that were not.

Price increases

46 Finally, we looked at two sets of price movements. We compared movements in Tesco's prices between January and April 2007 (differences between the January 15th listing supplied by **** and Tesco's own listing dated April 2nd); and movements in Sainsbury's prices between February and April (differences between the Sainsbury's Harlow prices as of February 9th and April 2nd). Columns AL and AM show the results.

47 Tesco shows price increases of more than 10 per cent on 37 of the 317 line items (12 per cent of the sample), and decreases of more than 10 per cent on 14 (4 per cent of the sample). A total of 133 line items (42 per cent) showed no change.

48 Sainsbury's shows 17 items (5 per cent of the sample) with increases of at least 10 per cent and 12 items (4 per cent) with decreases of at least 10 per cent. There are 159 items (50 per cent) showing no change.
