

**ASDA**

**OVERVIEW SUBMISSION**

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**GROCERIES INQUIRY**

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**10 August 2006**

**Slaughter and May  
(Ref: BJFL/PRR/LJW)**

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## **CC Grocery Investigation Asda Overview Submission**

### **1. Introduction**

- 1.1 Asda considers that there continues to be a distinct product market for one-stop shopping in one-stop shops, consistent with previous CC findings. The factors behind this market definition have not materially changed in recent years.
- 1.2 Asda considers that the most significant factor shaping competition in this market, and in the grocery market generally, is the planning regime. While there has been vigorous competition at the national level, the planning regulation means that the benefits of such competition are not enjoyed by consumers in all local markets because the planning regime directly impedes entry into local markets.
- 1.3 While it is inevitable that the planning regime will entail some restriction of competition in its pursuit of other policy aims (“town centres first”), the current regime has been developed without any reference to its impact on competition or consumers, and without the development of any tools to assess any such impact as part of individual planning assessments.
- 1.4 The significant role of planning in grocery markets has previously been recognised by the CC, and more recently by the OFT in its Reference Decision and by the Barker Review on Land Use Planning in its Interim Report, as well as in a range of other studies.<sup>1</sup> As stated by the OFT, “The planning system can reasonably be suspected of restricting or distorting competition by raising the cost of, and also limiting the scope for, new local market entry, particularly by way of new large format stores.”<sup>2</sup>
- 1.5 Asda believes that the CC should assess the total extent of the restriction and consumer detriment imposed by the planning regime, as well as the extent to which the planning regime limits competition and causes consumer detriment beyond the extent necessary to pursue its other goals.
- 1.6 Asda’s assessment presented in this submission suggests that the restriction of local competition arising from the planning regime is substantial. Asda is concerned that the planning regime (and in particular the Need Test):
  - (i) acts to restrict entry in absolute terms and to impede the normal process of competition;

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<sup>1</sup> For a general discussion of the impact of planning on competition and a listing of other studies, see “Barker Review of Land Use Planning: Interim Report – Analysis”, paragraphs 5.11 to 5.19.

<sup>2</sup> “The grocery market: The OFT’s reasons for making a reference to the Competition Commission”, OFT, May 2006, Executive Summary.

- (ii) results in incumbents in local markets with restricted competition being able to reinforce their position of strength; and
  - (iii) acts to restrict entry and therefore competition beyond that necessary to promote the policy objective of “town centres first”.
- 1.7 As a result of these factors, the normal competitive process does not operate properly in at least three distinct ways. First, in a substantial number of local markets, consumers face a restricted number of fascias, and in some cases the absence of their preferred fascia. Second, local concentration implies that consumers are likely to face higher prices and lower service qualities than if the local market were more competitive. Thirdly, retailers are insulated from the “natural selection” process that is present in most other markets, namely that of a rival entering the market, stealing customers and displacing the least efficient incumbent.
- 1.8 Asda’s analysis suggests that the overall extent of the problem is large. 65% of the urban population in Great Britain (GB) has fewer than four one-stop shop fascias and hence restricted choice according to the CC’s previous approach to assessing one-stop shop competition. Yet the planning regime potentially prevents entry in 72% of urban areas in GB with restricted choice.
- 1.9 Asda believes that practicable changes can be made within the structure of the current planning regime which would promote competitive markets in the future and ultimately act in the interests of consumers. These changes could be made without prejudicing the overall objectives of the planning regime.
- 1.10 Asda recognises that the CC is examining other issues alongside planning, including the operation of competition within the various market(s) and supply chain issues. Asda believes that the market is operating competitively at the national level and that buyer power is exercised to the benefit of consumers.
- 1.11 However, Asda considers that a remedy on planning would also be the most effective way of addressing any concerns for buyer power and pricing practices by ensuring competitive local markets in the future. As a remedy, addressing planning has the attraction of allowing the market to continue to operate in a dynamic fashion by minimising the degree of regulation of the sector.
- 1.12 The remainder of this submission addresses market definition and competition, planning, pricing and purchasing issues in more detail.

## 2. Market Definition

- 2.1 Asda considers that the product and geographic market definition for one-stop shopping reached by the CC in previous inquiries remains the correct approach.

### One-stop shop as a distinct product market

- 2.2 The CC has consistently defined a separate market for one-stop shopping in one-stop shops in its 2000 report on *Supermarkets*, its 2003 report on *Safeway* and its 2005 report on *Somerfield*.<sup>3</sup> In its report on *Somerfield*, the CC indicated that while one-stop shopping missions were distinct, it did not see a distinction between convenience and top-up shopping.<sup>4</sup>
- 2.3 Asda agrees that one-stopping grocery shopping in one-stop shops can be analysed as a distinct product market<sup>5</sup>, while it is clearly the case that one-stop shops face some degree of competitive constraint from outside this market. The essential factors underlying a distinct one-stop shopping market remain as set out below.

### *Customer preferences: customers value the distinct offering of one-stop shops*

- 2.4 Asda's customer research indicates that its customers want [].<sup>6</sup>
- 2.5 One-stop shops are able to provide all of these attributes, whereas mid-range and convenience stores either cannot provide these attributes or cannot provide them as well as a one-stop shop. [Hypothetically] Customers would be prepared to pay a premium for shops able to offer all products under one roof (range and depth), together with other attributes of one-stop shops. The alternatives for such customers (to conduct one-stop shops in less well suited smaller format shops or to disaggregate their one-stop shopping mission into a number of smaller missions) would come at a cost.
- 2.6 This suggests that a hypothetical monopoly of one-stop shops could profitably implement a SSNIP above the competitive price to extract customers' valuation of these

<sup>3</sup> Competition Commission (2000), "Supermarkets: A report on the supply of groceries from multiple shops in the United Kingdom" (CM 4842) ("**report on Supermarkets**"), paragraph 2.53. Competition Commission (2003), "*Safeway plc and Asda Group Limited (owned by Wal-Mart Stores Inc); Wm Morrison Supermarkets PLC; J Sainsbury plc; and Tesco plc. A report on the mergers in contemplation*" (CM5950) ("**report on Safeway**"), paragraph 2.65. Competition Commission (2005), "A report into the acquisition by Somerfield plc of 115 stores from Wm Morrison Supermarkets plc" ("**report on Somerfield**"), paragraph 6.23; see also Table 2.

<sup>4</sup> Report on *Somerfield*, paragraph 6.21.

<sup>5</sup> Asda also considers that one-stop shops (irrespective of shopping mission) could be defined as a distinct grocery market, irrespective of the type of mission.

<sup>6</sup> Based on a combination of bespoke research (customer listening groups) and input from syndicated research from secondary sources such as Verdict and AC Nielsen.

features. Moreover, since one-stop shops are likely to have lower costs than secondary and convenience shops (and hence a lower competitive price), the prospect of a price rise that meets the SSNIP threshold is heightened.

- 2.7 Different catchment areas for mid-range and one-stop shops confirm that they offer a different customer proposition.<sup>7</sup>

*Range: one-stop shop range is increasing*

- 2.8 One-stop shopping requires a minimum range and depth of products, which can only be found in stores of 1,400 metres (15,000 square feet) or more.

- 2.9 In its Reference Decision the OFT found that the data suggested that, in 2004-05, there was an average of around 41,500 lines stocked by ASDA, Tesco, J Sainsbury and Morrison, an increase of 40% over five years.<sup>8</sup>

*Missions: there has been little change in the pattern of missions*

- 2.10 Table 2.1 below shows the average transaction size of selected retailers. This shows that the average transaction size for the predominantly one-stop shop operators (whose smaller format sales are also included) is twice that of the predominantly smaller format operators (Waitrose being somewhat in the middle ground).

**Table 2.1:  
Average Transaction Size for Selected Grocery Retailers<sup>9</sup>**

<b>Retailer</b>	<b>Average Transaction (£)</b>
Asda	[20-30]
Co-op	[0-10]
Morrisons	[20-30]
Sainsbury's	[20-30]
Somerfield	[10-20]
Tesco	[20-30]
Waitrose	[10-20]

<sup>7</sup> In its Report on *Safeway* the Commission adopted 10 and 15 minute isochrones around one-stop shops and 5 and 10 around mid-range shops (paragraph 5. 257), and confirmed this approach in its Report on *Somerfield* (paragraph 6.66).

<sup>8</sup> OFT Final Decision (2006) "*The grocery market, the OFT's reasons for making a reference to the Competition Commission*" (OFT845) ("OFT Reference Decision"), paragraph 4.11.

<sup>9</sup> TNS Till Roll for 52 weeks to 16 July 2006. These data include transactions at all formats of the selected retailers.

- 2.11 [ $>80\%$ ] % of Asda's revenue comes from one-stop shop (trolley) shopping missions.<sup>10</sup> This heavy weighting in one-stop shop missions is shared by the other one-stop shop formats, in contrast to smaller format operators.<sup>11</sup>
- 2.12 Figure 2.1 below shows the cumulative sales of the same grocery retailers according to transaction size and illustrates the greater importance of one-stop shopping missions for larger format operators, noting as above that their smaller format sales are also included. This shows that transactions up to the average size contribute less than a third of revenue for each of Asda, Morrisons, Sainsbury's and Tesco.

**Figure 2.1:**  
**Cumulative Sales Distribution among Selected Retailers 2005/06<sup>12</sup>**

[ ]

- 2.13 There is no evidence of a significantly reduced importance of one-stop shopping:
- (i) Between the 52 weeks to 27 February 2005 and the 52 weeks to 26 February 2006, the share of sales on one-stop shopping missions in the overall market increased marginally [by  $<1\%$ ].<sup>13</sup>
  - (ii) The distribution of transactions has remained approximately constant. See Figure 2.2 below which shows the position for Asda, Morrisons, Sainsbury's and Tesco combined. An equally stable relationship is observed for the entire grocery market.

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<sup>10</sup> TNS "The Impact Of Shopper Mission Trends On Asda's Future Strategy", data 52 weeks to 26 February 2006. "One-stop shop" taken to combined Fully Trolley and Part Trolley. See Asda response to Question 1 of the MPQ.

<sup>11</sup> Asda site visit presentation, "Asda and market context", 20 June 2006, slide 19.

<sup>12</sup> TNS Till Roll data for 52 weeks to 16 July 2006. These data include transactions at all formats of the selected retailers. The general shape of the distribution of transaction sizes is similar according to TNS RST data for the same period.

<sup>13</sup> Asda site visit presentation, "Asda and market context", 20 June 2006, slide 16.

**Figure 2.2:**  
**Cumulative Sales Distribution for Asda, Morrisons, Sainsbury's and Tesco Combined**  
**2003/04-2005/06**<sup>14</sup>

[     ]

*Formats: one-stop shops are getting bigger*

- 2.14 The 2000 report on *Supermarkets* found that one-stop shopping required a minimum range and depth of products, which could only be found in stores of 1,400 square metres (15,000 square feet) and above.<sup>15</sup> The CC followed this finding in its reports on *Safeway* and *Somerfield*.
- 2.15 Figure 2.3 below shows the distribution of stores for the same groups of fascias, for which average transaction size data was presented above.<sup>16</sup> There is a clear discontinuity between players that cater to one-stop shop (Asda, Tesco large, Morrison and Sainsbury large) and players that cater to neighbourhood convenience. Only Waitrose remains in the middle ground.

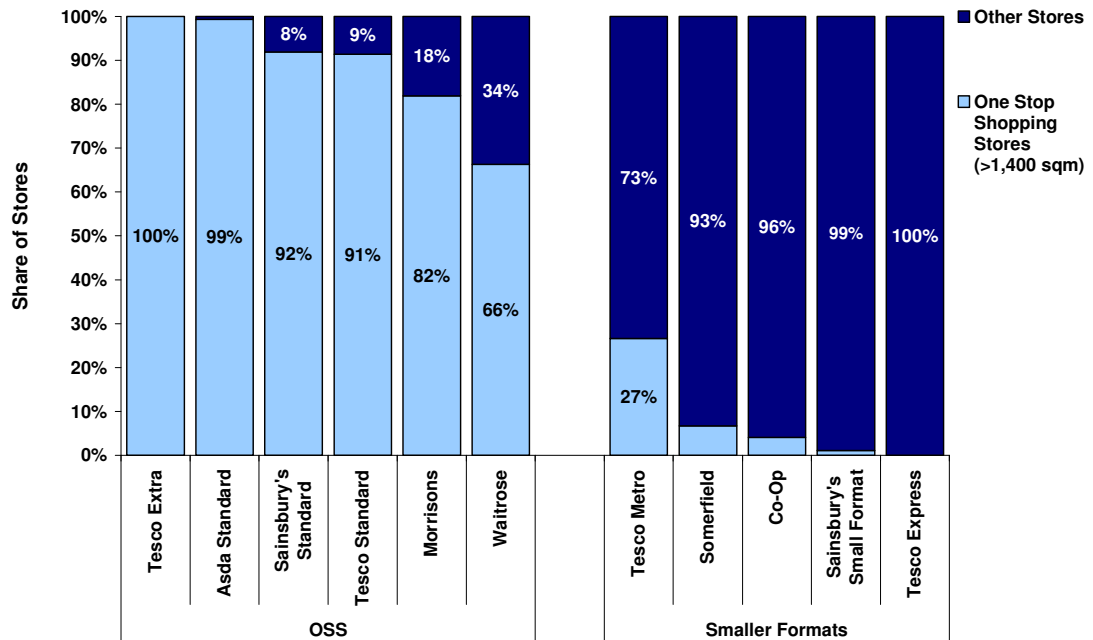
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<sup>14</sup> TNS Till Roll data. These data include transactions at all formats of the selected retailers. A similar result is obtained using TNS RST data.

<sup>15</sup> Report on *Supermarkets*, paragraph 2.38.

<sup>16</sup> Fascias have been grouped according to the size classification within which the majority of their stores fall. Following the CC approach, the cut-off for OSS is 1,400 square metres (15,000 square feet).

**Figure 2.3:  
Store Size Distribution by Format (July 2005)<sup>17</sup>**



- 2.16 Waitrose has shown a trend towards larger stores. Its average store size has increased every year from 1995 (1,320 square metres or 14,100 square feet) to 2005 (1,860 square metres or 19,900 square feet), and Verdict estimates that it might reach almost 1,880 square metres or 20,100 square feet in 2006.<sup>18</sup> Meanwhile, the average size of Somerfield, Co-op or Iceland have stagnated or declined over time.<sup>19</sup>
- 2.17 There is also a polarisation of mission types by size of store, with one-stop shops catering principally to one-stop shopping missions and smaller formats catering principally to secondary and convenience missions.<sup>20</sup> Single format players are increasingly focussing their store portfolios on larger (for one-stop shop operators) or smaller (for convenience operators) stores.<sup>21</sup>

<sup>17</sup> Analysis based on IGD store database 2005.

<sup>18</sup> Verdict on Grocery Retailers 2006, sections on individual players, subsections on "Store Portfolios".

<sup>19</sup> Verdict on Grocery Retailers 2006, sections on individual players, subsections on "Store Portfolios".

<sup>20</sup> Asda site visit presentation, "Asda and market context", 20 June 2006, slide 19.

<sup>21</sup> Examples include Morrisons, which has been divesting many smaller stores, and Somerfield and the Co-Op, which are both reported to focus on the convenience sector in their store development. (*"Morrisons has disposed of around*

*Competition: there is distinct competitive dynamic []*

- 2.18 Asda's strategy for its one-stop shop stores is driven primarily by []:
- (i) Asda's strategy papers compare Asda's performance (e.g. in terms of []) principally as against [].
  - (ii) Asda's price comparisons are also primarily driven by []. Asda develops its own prices with reference to a price index for [], and monitors [] lines in those [] supermarkets (while monitoring a [] at any other supermarket).<sup>22</sup>
- 2.19 Internet competition has grown in importance but it is still less than [] per cent of grocery sales.<sup>23</sup> []<sup>24</sup>

*Impact of the planning regime*

- 2.20 To the extent that there is a degree of blurring between shop formats or missions, Asda considers that this may partly be attributable to the planning regime. For example, in the absence of an adequate choice of one-stop shops, consumers may conduct more shopping in smaller formats than would otherwise be the case. Since planning is among the issues being examined by the CC, Asda considers that it would be inappropriate to allow any such blurring (which in itself in Asda's view reflects a market distortion) to be taken into account in market definition.<sup>25</sup>

Relevant geographic market

- 2.21 The CC previously found that "Taking the evidence as a whole, our view is that the ambit of consumers' search for groceries is essentially local."<sup>26</sup>

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*200 Safeway stores since the acquisition of its larger rival. While it was obliged to offload 52 stores owing to local competition concerns, it has disposed of significantly more, with the major disposal the sale of 114 smaller Safeway stores – that it had rebranded Safeway Compact – to Somerfield.*", Verdict – Grocery Retailers 2006, Morrisons, p.2; *"In recent years the Co-operative Group has focused its expansion on small format convenience stores.*", Verdict – Grocery Retailers 2006, Co-Op, p.1; *"Somerfield plans to focus on developing both the Essentials and Market Fresh formats. It is with this in mind that the large number of forecourt stores were purchased from Texaco at the end of 2004/05. In April 2005 there were around 190 convenience format Essentials stores.*", Verdict – Grocery Retailers 2006, Somerfield, p.6.

<sup>22</sup> See further Asda's response to question 43 of the MPQ.

<sup>23</sup> See further Asda's response to question 25 of the MPQ.

<sup>24</sup> See further Asda's response to question 25 of the MPQ.

<sup>25</sup> Similar considerations apply to restrictions arising from Sunday trading legislation which may cause some consumers to carry out shopping missions in formats they would not otherwise select.

<sup>26</sup> Report on *Supermarkets*, paragraph 2.47.

- 2.22 For one-stop grocery shopping [carried out in stores of 1,400 square metres or more] the CC concluded that “[Shopping patterns are essentially local,] most consumers travelling no more than 10 minutes to the supermarket in urban areas and no more than 15 minutes in non-urban areas.”<sup>27</sup> This finding was confirmed by the Commission in subsequent reports.<sup>28</sup>
- 2.23 Asda agrees that the relevant market is local – customers shop locally and are prepared to travel only small distances. [60-70%] of Asda’s sales across the chain are derived from customers living within [] minutes of the store.

**Table 2.2**  
**Shares of Asda Sales within [] min Drive Time**  
**in Urban and Rural Areas**<sup>29</sup>

Catchment	Urban	Rural	Total
[] min	[60-70]%	[50-60]%	[60-70]%
[] min	[80-90]%	[70-80]%	[80-90]%

- 2.24 Asda provides an assessment of local one-stop shop competition within [] minutes drive time as part of each application to the Wal-Mart Real Estate Committee (REC) for any new development. This drive time threshold has been consistently applied since the inception of the REC process introduced after the acquisition of Asda by Wal-Mart.

### 3. Competition in the One-Stop Shop Market

- 3.1 Asda believes that the one-stop shopping market has been highly competitive at the national level, delivering substantial consumer benefits. However, as the CC has concluded before, there are a significant number of local markets in which choice and competition are inadequate.

#### Competitors

- 3.2 The CC has previously considered the competitors in the one-stop shopping market to be Asda, Booths, Budgens, Co-op, Morrisons, Sainsbury’s, Somerfield, Tesco and Waitrose provided that the stores are above 1,400 square metres (15,000 square feet).<sup>30</sup>

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<sup>27</sup> Report on *Supermarkets*, paragraph 2.53.

<sup>28</sup> Report on *Safeway*, paragraphs 2.57-2.58, and Report on *Somerfield*, paragraph 6.66.

<sup>29</sup> See further Asda’s response to question 27 of the MPQ.

<sup>30</sup> Report on *Safeway*, paragraph 5.238

- 3.3 Asda agrees that its main competitors fall within this group. Its principal competitors are Morrison, Sainsbury's and Tesco. These competitors offer the attributes of one-stop shopping, in particular range and depth of products, which can only be found in stores of 1,400 metres (15,000 square feet) or more. These competitors also offer the other attributes Asda considers are a necessary part of a competitive one-stop shop offer.<sup>31</sup>
- 3.4 This position has not changed since 2000 with the exception of the emergence of Morrisons as a stronger player following its acquisition of Safeway and Asda considers that it is unlikely to change in the foreseeable future.<sup>32</sup>

Market shares

- 3.5 Shares for the four main operators, separated by mission type are presented in Table 3.1 below.

**Table 3.1**  
**Shares by Mission of Main One-Stop Shop Operators (Based on Revenue)**

<b>Mission</b>	<b>Asda</b>	<b>Tesco</b>	<b>Sainsbury's</b>	<b>Morrisons</b>	<b>Other</b>
Till Roll Share <sup>33</sup>	[10-15]%	[20-25]%	[10-15]%	[5-10]%	[50-55]%
Groceries Sold in all Shops <sup>34</sup>	[10-15]%	[25-30]%	[10-15]%	[10-15]%	[35-40]%
One-Stop Shopping Missions <sup>35</sup>	[15-20]%	[30-35]%	[15-20]%	[10-15]%	[15-20]%
Secondary Missions <sup>36</sup>	[5-10]%	[20-25]%	[10-15]%	[5-10]%	[45-50]%

- 3.6 Aside from the merger of Safeway and Morrisons, concentration at the national level has remained broadly constant since 2000 when measured as the sum of the total

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<sup>31</sup> See paragraph 2.4 above.

<sup>32</sup> Asda's answer to questions 4 and 42 of the MPQ contain further details of Asda's performance on price, quality, range and service compared to that of its competitors.

<sup>33</sup> TNS 52 weeks to 21 May 2006, Till Roll sales from all outlets.

<sup>34</sup> TNS 52 weeks to 21 May 2006, Groceries sold in all outlets.

<sup>35</sup> TNS 52 weeks to 26 February 2006, comprising Grocery plus Non-Food, Cosmetics and Baby Products. Market size is given by sales of all grocers, which excludes M&S.

<sup>36</sup> TNS 52 weeks to 26 February 2006, comprising Grocery plus Non-Food, Cosmetics and Baby Products. Market size is given by sales of all grocers, which excludes M&S.

market share of the major players (including Safeway until its acquisition). However, since 2000, Tesco has significantly increased its market share relative to other major players. This is likely to be reflected in an increase in the HHI, an alternative measure of market concentration.

#### Competition at the national level

- 3.7 At the national level there is considerable evidence that one-stop shop consumers have benefited from competition.
- 3.8 Comparing the position today as against that in 2000, the OFT Reference Decision suggests that:
- (i) real food prices fell by 7.3% between January 2000 and December 2005;
  - (ii) the number of product lines stocked by the four largest supermarkets has increased by 40% (to 41,500) since 2000; and
  - (iii) amenities have improved over the last five years.<sup>37</sup>
- 3.9 These changes have had a real impact on consumers through reduced expenditure on food and other groceries:

*“A three year period of grocery deflation is set to save UK consumers a total of more than £3bn by the end of 2006. We expect the third successive year of deflation in the grocery sector in 2006, as intense price competition among the key players continues. [...] These lower prices have saved the UK consumer more than £1bn in 2005 compared with 2003, and these savings will increase to £1.7bn in 2006.”<sup>38</sup>*

#### Competition at the local level

- 3.10 Despite vigorous national competition, in some local areas there are insufficient competitors to deliver effective competition in the one-stop shopping market.
- 3.11 The CC recognised this in the reports on *Supermarkets* and *Safeway*:

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<sup>37</sup> OFT Reference Decision, Chapter 4, paras. 4.2, 4.11 and 4.18.

<sup>38</sup> Verdict, Grocery Retailers 2006, Executive Summary, p10.

- (i) The report on *Supermarkets* identified a number of situations of local monopoly or duopoly conditions.<sup>39</sup> In particular, the CC identified 175 monopoly or duopoly areas which gave it concern.<sup>40</sup>
  - (ii) Similar results can be inferred from the report on *Safeway*. While clearly focused on Safeway stores rather than a comprehensive UK analysis, the CC analysis indicated that of the 349 Safeway shops that were one-stop shops, 128 were in monopoly or duopoly situations and some 92 further stores were in situations of three-way competition.<sup>41</sup> In other words, 63% of Safeway shops were in a situation of restricted competition.
- 3.12 Consistent with this, according to a consumer survey carried out by the Consumers' Association, and identified by the CC in the report on *Supermarkets*, two out of five respondents said that they could not shop at their first choice of supermarket.<sup>42</sup>
- 3.13 Asda has undertaken an analysis of local choice in the one-stop shop market based on the previous approach of the CC.<sup>43</sup> Only [35-40]% of the urban population and only [20-25]% of the rural population has a choice of 4 or more qualifying fascias within the relevant drive-time. See Figures 3.1 and 3.2 below.

**Figure 3.1**  
**Local Choice Available to GB Urban Population**

[ ]

**Figure 3.2**  
**Local Choice Available to GB Rural Population**

[ ]

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<sup>39</sup> The CC's analysis in that case was based on a more restricted set of effective competitors than in the report on *Safeway*, considering just the main parties Asda, Morrisons/Safeway, Sainsbury's and Tesco.

<sup>40</sup> Report on *Supermarkets*, paragraph 2.65-2.78.

<sup>41</sup> Report on *Safeway*, Appendix 5.5.

<sup>42</sup> Report on *Supermarkets*, paragraph 2.81. This may understate the true position, as consumers will tend be more likely to express a lack of first choice supermarket only if they have moved house, or otherwise have a knowledge of supermarkets to which they do not have access.

<sup>43</sup> Asda has provided the methodology for its analysis in an annex to its answer to question 123 in its MPQ response.

- 3.14 Figure 3.3 below shows for each major one-stop shop competitor the number of stores facing inadequate competition (4+ fascias including the selected retailer representing adequate competition).

**Figure 3.3**  
**Extent of Choice in Areas with One-stop Shops<sup>44</sup>**

[ ]

- 3.15 In the next section, Asda sets out how the planning regime has anticompetitive effects and contributes to a restriction of local competition and choice, and comments further on the consumer detriment that arises from this restriction.

#### **4. Planning**

- 4.1 Asda believes that the planning regime has a substantial restrictive and distortionary effect on competition in the grocery market, and the one-stop shopping market in particular, and that it should be central to the CC's inquiry.

##### Role of the CC

- 4.2 The Enterprise Act 2000 ("the Act") requires the CC to decide "whether any feature, or combination of features, of each relevant market prevents, restricts or distorts competition".<sup>45</sup> The Act goes on to define a feature of the market as including "the structure of the market concerned or any aspect of that structure".<sup>46</sup> The CC's guidelines for market investigations make it clear that structural features include government regulations.<sup>47</sup>
- 4.3 Asda believes that planning regulations are the main feature of the market determining the evolution of competition. Asda considers that the CC should address them as the central part of its inquiry.
- 4.4 Asda recognises that government regulations may exist to pursue other (non-competition) policy objectives. In the case of the planning regime, the objective of the

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<sup>44</sup> Asda analysis of its store database.

<sup>45</sup> Enterprise Act 2002 Section 134(1).

<sup>46</sup> Enterprise Act 2000, Section 131(2).

<sup>47</sup> "Market Investigation References: Competition Commission Guidelines", Competition Commission, June 2003, paragraph 1.18.

regime (and PPS6 in particular) has been to promote town centre vitality and viability, and thereby promote social inclusion and reduce private transport usage.<sup>48</sup>

- 4.5 Asda does not question that policy objective<sup>49</sup>, though it must be recognised that protecting town centres is inherently anti-competitive, and recognises that it is outside of the remit of the CC to question them. It is also not the role of the CC to take non-competition policy objectives as given (i.e. to internalise the other policy objectives of government).
- 4.6 In its capacity as a competition authority, Asda considers that the CC should conduct an economic analysis of:
- (i) the total impact on competition and consumers of the planning regime irrespective of other policy objectives (to enable government to make any trade-offs); and
  - (ii) whether the planning regime limits competition and causes consumer detriment beyond the extent necessary to pursue its other goals (since in that case, the planning regime could potentially be changed without any trade-offs).
- 4.7 Asda notes that the CC inquiry will, in its early stages, run parallel to the Barker Review on Land Use Planning. The Interim Report of the Barker review has already suggested that the planning regime may have a significant impact on retail competition and productivity.<sup>50</sup> However, the remit of the Barker review is a wide one and the Interim Report has clearly indicated that more detailed findings should be expected from the CC.<sup>51</sup>

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<sup>48</sup> The town centre first policy is described in "The Barker Review on Land Use Planning: Interim Report – Analysis", paragraphs 5.27 to 5.30.

<sup>49</sup> However, we note that the Barker Review casts considerable doubt over whether the planning regime is actually successful in promoting the intended policy objectives of promoting town centre vitality and viability, promoting social inclusion and reducing road usage. If it is not, any competition and consumer detriment would be a cost to the economy for no corresponding benefit.

<sup>50</sup> "Barker Review of Land Use Planning: Interim Report – Analysis", paragraph 5.51.

<sup>51</sup> "Barker Review of Land Use Planning: Interim Report – Analysis", paragraph 5.49.

Description of the planning regime<sup>52</sup>

*The core tests*

- 4.8 Essentially the planning regime seeks to achieve its objective by leaving the amount of retail space in town centres unregulated while regulating the location and amount of any retail space allowed outside town centres.
- 4.9 In summary, in PPS6 there are four steps in the substantive regulation of retail space outside town centres:
- (i) **Quantitative Need Test** – Proposed capacity must be judged to meet a short-fall in existing capacity (generally either in response to a situation of over-trading<sup>53</sup> by existing shops or consumers having to travel too far for their shopping). This involves projection of future expenditure available and compares it to available retail space.<sup>54</sup>
  - (ii) **Qualitative Need Test** – At this stage, qualitative aspects of the available retail provision are analysed. For example, evidence of over-trading, long queues, car park congestion, old stores, and expenditure leaking from the catchment could in principle be taken into account. However, in practice, the qualitative need test is rarely, if ever, determinative and in practice is often used to show the quantitative Need Test is “right”.
  - (iii) **Sequential Test** – In order to justify retail development out-of-town, it must be shown that the capacity identified in the Need Test cannot be accommodated within the town centre, or failing that edge-of-town, because no suitable site is available. Retailers are required to show flexibility as to store formats when considering sequentially “preferable” sites.
  - (iv) **Retail Impact Assessment (RIA)** – An RIA investigates the impact the proposal will have on existing stores in town centre locations. If the proposal is deemed to divert substantial trade from existing centres, permission will be refused, even if there is assessed “need” for a further store.

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<sup>52</sup> Asda has provided a summary of the evolution of retail planning guidance from 1977 to 2006 as an annex to its answer to question 114 in its response to the MPQ.

<sup>53</sup> “Over-trading” is a planning assumption that a shop is trading above its theoretical sales densities arrived at through publicly available sales densities.

<sup>54</sup> Asda notes that there is no explicit requirement for a quantitative need test within Scottish or Northern Irish planning policy. However, capacity considerations may still be relevant when assessing retail developments (see further the annex to Asda’s answer to question 114 in its response to the MPQ).

- 4.10 For an outside town centre development (of any size) to be allowed all three tests (Need Test, Sequential Test and Retail Impact Assessment) must be passed. As a result, the location and size (capacity) of firms in the grocery retail market is substantially regulated.

*No account of competition or consumer interest*

- 4.11 While the planning regime has tests controlling the size and location of any retail development, it does not take any account of competition or the consumer interest.
- 4.12 This was recognised by the OFT in its decision to refer:

*“The policy guidance outlined in PPS6 makes clear that it is not the role of the planning system to restrict competition....However, a planning authority cannot explicitly consider the strength of local competition when reviewing a planning application”.*<sup>55</sup>

- 4.13 This essentially means a continuation of the situation under PPG6 which in practice also did not take account of competition.<sup>56</sup>
- 4.14 The planning regime applicable to supermarkets appears to be lagging behind the regulations produced to assist Primary Care Trusts in the assessment and determination of applications to provide NHS pharmaceutical services. These regulations, finalised in 2005, have introduced new criteria of “competition and choice” to the regulatory test.<sup>57</sup>

<sup>55</sup> At paragraph 7.7.

<sup>56</sup> PPS6 was introduced following an extensive review of the PPG6 planning rules undertaken by CB Hillier Parker and published by the ODPM. This review identified “elements of internal conflict” within PPG6, most notably, a conflict between the third objective of PPG6, “to maintain an efficient, competitive and innovative retail sector” and the other three objectives which are conventionally taken to seek to concentrate development in town centres. According to the CB Hillier Parker Review, the third objective appeared to be considered to carry less weight than others: it is being pursued in decision-making only to the extent that it was consistent with other objectives.” CB Hillier Parker, Cardiff University, *Policy Evaluation of the Effectiveness of PPG6*, January 2004 (“**CB Hillier Parker Review**”), paragraph 15, p.9; paragraph 5.7, p. 80. CB Hillier Parker is now known as CB Richard Ellis and its website is at [www.cbre.com](http://www.cbre.com).

<sup>57</sup> Department of Health, *The NHS (Pharmaceutical Services) Regulations 2005: Information for Primary Care Trusts Executive Summary*, August 2005. Although the issues in relation to supermarkets and pharmacies are significantly different, it is notable that the pharmacies regime has sought to embed competition and choice criteria.

“In assessing whether or not there is adequate provision of pharmaceutical services in a neighbourhood, explicit criteria of competition and choice are being introduced to the assessment. These criteria are not necessarily all new and Primary Care Trusts may already take some into account. However, in future, clearer emphasis is now placed within the Regulations on certain key factors associated with promoting more competition and choice for patients.” (paragraph 3.68)

“These new provisions are still within the overall test of adequacy. Nonetheless, they enable Primary Care Trusts to take into account additional factors when determining adequacy.” (paragraph 3.71)

- 4.15 Asda is concerned that the planning regime takes no account of competition or the consumer interest, and indeed has detrimental effects on competition beyond those necessary to achieve its policy goals, as set out below.

Anticompetitive effects of the planning regime

- 4.16 Asda believes that the core tests of the planning regime, and in particular the Need Test, have anti-competitive effects. As such, Asda's concerns are more fundamental than a general concern about the complexity and slowness of the planning process.<sup>58</sup>
- 4.17 In Asda's view, the planning regime, and in particular the Need Test:
- (i) acts to restrict entry in absolute terms (often below the level of competition deemed necessary by the CC for fully competitive local markets) and to impede the normal process of competition;
  - (ii) results in incumbents in local markets with restricted competition being able to reinforce their position of strength; and
  - (iii) acts to restrict entry and therefore competition beyond that necessary to promote the policy objective of "town centres first". Asda's position is that there is no need for the Need Test.

*Need Test as an absolute entry barrier*

- 4.18 The Need Test applies an administrative assessment of supply and demand. In practice, this often involves an assumption that they are in equilibrium (i.e. no current "need"). New development is permitted only where and to the extent that assessed demand exceeds supply. This means that each unit of capacity addition (i.e. each square foot of retail space) may only be allowed if justified by expanded demand (or, less likely, reduction in capacity) elsewhere in the local market.
- 4.19 Companies who have profitable entry strategies may not be able to implement them because there is deemed to be "no need". As a result the normal process of entry and exit in a market is fundamentally frustrated as a direct effect of regulation. The role of entry and exit is fundamental to the working of competition. Competitive entry creates excess presence. This leads to intense competition to fill excess capacity, followed by exit of the weakest player(s), i.e. the sorting role of competition. Absent this mechanism, weak players can survive.

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"These new criteria, by promoting more competition, aim to improve the choice of where patients may obtain services. In turn, this will mean more choice in where patients can get advice for self-care, and access the range of services which pharmacies will increasingly provide through the new contractual framework." (paragraph 3.72)

<sup>58</sup> Chapter 3 of the "Barker Review of Land Use Planning: Interim Report – Analysis" has identified extensive concerns in relation to the efficiency of the planning process.

- 4.20 This restriction in out-of-town centre locations is not compensated for by the unregulated state of town centres. There are very significant problems of town centre assembly and availability. Compromised town centre shops (e.g. with inadequate car parking) may be unable to provide effective competition to incumbent one-stop shops. And town centres may not coincide with the location of consumer demand.<sup>59</sup>

*Tendency to favour incumbents*

- 4.21 To the extent that the Need Test does permit new space to be added this tends to favour incumbents, i.e. without introducing more competition.
- 4.22 The planning regime allows incumbents to add a second, or third store in those areas, or to extend their existing stores with the effect of excluding entrants. This reinforces local market power but does not add to choice. Incumbents will have a natural incentive to bid for stores in areas of restricted local choice.<sup>60</sup>
- 4.23 The planning regime not only allows but actually favours expansion by existing operators. Extensions (incumbents by definition) pass the Need Test more easily. Partly this is because extensions are generally smaller than new stores. But this is also because in applying the test to extensions it is generally assumed that sales density in the extension is only 40% that in the original store or in an entrant store (thus less “need” is required to justify it). However, once the extension exists, it is assumed to generate the full average sales density. This means that only 1 square metre of “need” is required to build 2.5 square metres of extension space, which has the effect of removing 2.5 metres of “need” for potential entrants in future applications.
- 4.24 Incumbents are also likely to pass the Retail Impact Assessment more easily as the effects of an extension to an existing store is inherently more predictable (in the sense of being less disruptive to existing trade patterns) than the effects from an entirely new store.
- 4.25 The planning regime thereby allows incumbents to use extensions and town centre developments to soak up capacity (“need”) and frustrate potential competitive entry.
- 4.26 Out-of-centre shops may thus be protected at the expense of sequentially preferable sites contrary to the goals of the planning regime. For example, where there is a one-stop shop incumbent located in an out-of-town location and where town centre entry is not viable (e.g. due to site unavailability), the Need Test could restrict entry in an edge

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<sup>59</sup> CB Hillier Parker found that PPG6 had brought an increase in the number of refusals of applications for out of town development. However, the absence of a clear corresponding increase in the number of applications in town centres suggested an overall restriction of entry. CB Hillier Parker Review, paragraph 4.65.

<sup>60</sup> Monopoly profits are worth more than two times duopoly profits. Thus, if a new store is allowed in a monopoly area, that store is worth more to the incumbent than the entrant.

of town location although this is sequentially preferable to the incumbent site (in terms of being closer to the town centre).

*No Need for the Need Test*

- 4.27 As stated above, the Government's objective is to promote town centre viability and vitality. Albeit at some cost to competition, this policy objective could be fully implemented by the Sequential Test and the Retail Impact Assessment (i.e. given that those tests are applied, the Need Test does not further advance the policy objective). Since the Need Test is redundant, its negative effects on competition and consumers are particularly unfortunate.

Extent of the problem

- 4.28 Asda is not in a position to model all of the effects referred to above.
- 4.29 However, in order to illustrate the detrimental effects of the Need Test, Asda has conducted analyses of the extent to which the planning regime (and in particular the Need Test):
- (i) First, restricts competition in areas of already restricted choice; and
  - (ii) Second, restricts Asda's ability to enter markets where it has identified a profitable entry opportunity.<sup>61</sup>
- 4.30 The second analysis is likely to be broadly indicative of the constraints faced by other market participants and potential entrants.

*Restricted choice and restricted planning*

- 4.31 As shown in Section 3, there is a significant number of local markets in GB with inadequate competition and choice according to the CC's rules.
- 4.32 As illustrated in Table 4.1 below, out of 501 urban Gazetteer areas, 384 have inadequate choice and of these 276 (72%) have a likely planning restriction due to the Need Test. This accounts for around 12.2 million people.

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<sup>61</sup> Asda has provided the methodology for its analysis as an annex to its answer to question 123 in its MPQ response. Asda's analysis of planning and competition restrictions has been conducted for GB. However, Asda notes that, unlike England and Wales, Scotland does not have a formal Need Test (although capacity considerations are still taken into account in some cases). In its MPQ response, Asda has presented corresponding analysis for England and Wales only (i.e. with Scotland removed) which shows a similar pattern of results to overall GB.

**Table 4.1**  
**Choice and Planning Status of 501 Urban Areas**

<b>Need Test result</b>	<b>&lt;4 fascias</b>	<b>&gt;=4 fascias</b>	<b>Total</b>
OSS planning restriction	276	91	367
OSS capacity opportunity	108	26	134
Total	384	117	501

*Restricted choice and restricted planning: preventing actual entry*

- 4.33 In principle, some local areas might only sustain three or fewer one-stop shops. Asda has therefore analysed the areas where it has identified a profitable entry opportunity. As shown in Table 4.2 below, out of Asda's [ ] target entry areas for one-stop shops, [ ] are in areas of restricted choice and of these [ ] ([ ]%) have a likely planning restriction due to the Need Test.

**Table 4.2**  
**Choice and Planning Status of [ ] Asda Target Areas**

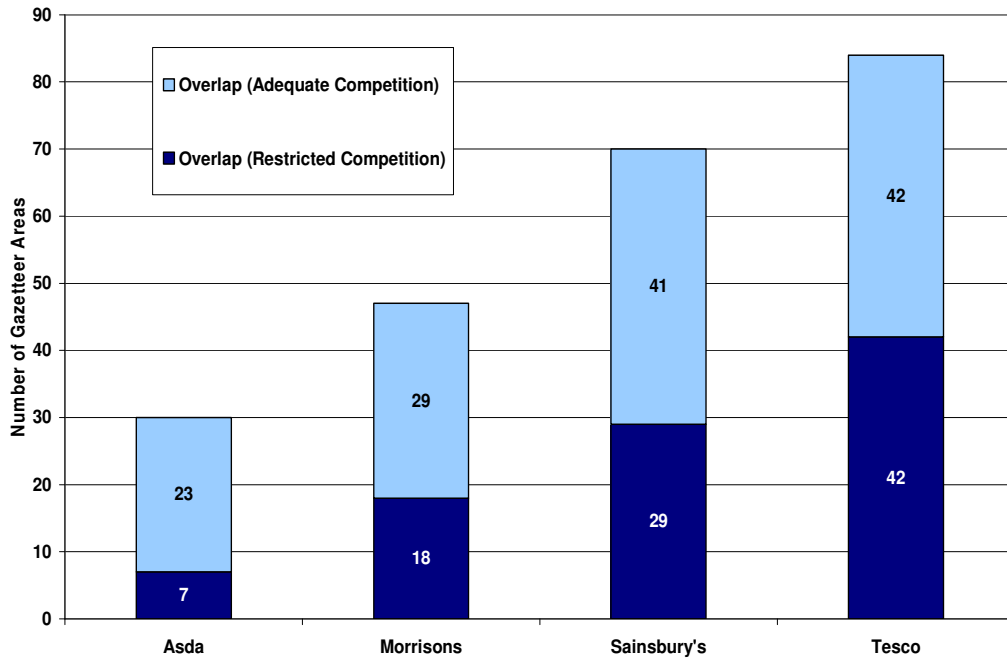
<b>Need Test result</b>	<b>&lt;4 fascias</b>	<b>&gt;=4 fascias</b>	<b>Total</b>
OSS planning restriction	[ ]	[ ]	[ ]
OSS capacity opportunity	[ ]	[ ]	[ ]
Total	[ ]	[ ]	[ ]

- 4.34 These results suggest that the planning regime, and in particular the Need Test, causes a substantial restriction of choice and competition in many local markets.

*Same operator overlaps*

- 4.35 Same operator overlaps in areas of restricted choice provide a further indicator of potential problems with the planning regime. Figure 4.1 below shows the extent of this in the 501 Gazetteer urban areas analysed above.

**Figure 4.1**  
**Overlaps between One Stop Shops of Same Fascia<sup>62</sup>**



4.36 Together, Asda, Morrisons, Sainsbury's and Tesco have [] overlaps of which [42%] are in areas of restricted competition.

#### Consumer detriment

4.37 At the basic level there is some consumer detriment inherent in a lack of choice. Consumers value the ability to choose as between competing fascias.

4.38 Lack of choice can also result in insufficient competition, most obviously through poorer prices but also through poorer quality product (including availability), poorer range and/or poorer service.

4.39 In 2000 the CC found evidence that the presence of Asda stores resulted in lower prices at some operators' stores.<sup>63</sup> However, more generally, Asda acknowledges that the presence of additional relevant fascias is likely to intensify competition to some degree.

<sup>62</sup> The analysis was based on Gazetteer areas, which means an area where an operator has several stores, counts as one area affected for the purposes of this analysis.

<sup>63</sup> Report on Supermarkets, Appendix 7.8, Table 5. The CC found that increased market share of Asda was associated with lower prices at Safeway (1% level of significance), Somerfield (1%) and Tesco (5%).

- 4.40 In concluding that price flexing was against the public interest in 2000, the CC stated that some consumers “tend to pay more at stores that do not face particular competitors than they would if those competitors were present in the area.”<sup>64</sup> However, this shows that detriment can arise from the planning regime (absence of competitors) rather than price flexing (where the relevant comparison should be between local pricing and uniform pricing, for a given configuration of stores).
- 4.41 The CC has recently published its estimate of the consumer savings arising from the CC’s requirement for Somerfield to divest itself of 12 mid-range stores acquired from Morrisons. The CC estimated these consumer savings to be £5.5m per annum.<sup>65</sup> Asda believes that the CC should estimate a corresponding figure for the overall detriment from the planning regime, which, to the extent the CC finds that the planning regime does restrict competition, is likely to dwarf this figure.

#### Possible solutions

- 4.42 Asda recognises that the CC will first need to assess the nature of any competition restriction arising from the planning regime before turning to potential solutions, which in so far as they concerned with the planning regime would be for government to implement. However, Asda considers that the planning regime could be amended in a number of different ways so as to better take into account competition and choice in grocery retailing. This can be done without prejudicing the overall objectives of the planning system.
- 4.43 One solution would be to introduce a competition element into the planning process. Where an area is found to have inadequate competition (fewer than 4 fascias) new entrants could then be given priority. This would be simpler to implement than many existing elements of the planning regime including the Need Test and the Retail Impact Assessments.
- 4.44 The Need Test should also be amended to bolster competition. For instance:
- (i) It could be abolished altogether.
  - (ii) It could be amended to introduce some “excess capacity” so as to stimulate competition.
  - (iii) It could be suspended in areas of limited choice.

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<sup>64</sup> Report on *Supermarkets*, paragraph 1.6(b).

<sup>65</sup> “Estimated costs to consumers of the mergers against which the CC took action between March 2005 and March 2006”, Competition Commission, July 2006.

- (iv) The Need Test could be applied excluding out-of-town stores in the need computation for sequentially preferable sites.
- 4.45 In all cases above, policy objectives for town centres first could still be satisfied by way of application of the Sequential Test and Retail Impact Assessments.
- 4.46 Amending the planning regime in this way would encourage new entry into areas where choice and competition are insufficient – including entry by one-stop shop operators with smaller national market share.

## 5. Pricing practices

- 5.1 Asda considers that local price flexing and pricing below cost on individual product lines are consistent with the operation of a highly competitive grocery market. However, in respect of both practices, Asda urges the CC to look at all forms of pricing tools – including the use of vouchers.

### Local price flexing

#### *Extent of the practice*

- 5.2 In its 2000 Report the CC found that local price flexing was carried out by Budgens, the Co-op, Netto, Safeway, Sainsbury, Somerfield and Tesco.
- 5.3 Asda [].

#### *Impact of the practice*

- 5.4 In 2000, the CC found that the practice of local price flexing tended to focus some elements of price competition into localities where particular lower-priced competitors were present and away from other areas, contributing towards a situation where the majority of grocery products were not fully exposed to competitive pressures. The CC concluded that this practice operated against the public interest.<sup>66</sup>
- 5.5 Asda believes that the public interest finding by the CC was flawed and on the contrary considers that local price flexing can be a potentially pro-competitive feature of the market.
- 5.6 The CC appeared to consider local price flexing against the wrong counterfactual in 2000. The CC concluded that the practice of local price flexing operated against the public interest because some customers “tend to pay more at stores that do not face particular competitors than they would if those competitors were present in the area”.<sup>67</sup>

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<sup>66</sup> Report on *Supermarkets*, paragraph 1.6(b).

<sup>67</sup> Report on *Supermarkets*, paragraph 1.6(b).

This is the wrong counterfactual in that it fails to make the relevant comparison, i.e. between uniform and flexed prices for a given configuration of stores. As stated above, the counterfactual used is more relevant to considering the detriment of the planning regime, which prevents various stores being present in local markets. To the extent that price flexing is a result of weak local competition, this can be addressed by reducing restrictions introduced through the planning regime since as previously noted by the CC this should result in better consumer outcomes in areas that attract entry.

- 5.7 Applying the relevant comparison, the CC did not establish that abolishing local price flexing (and requiring uniformity) would lead to lower prices overall. In Asda's view price flexing in many circumstances may tend to intensify competition by allowing supermarkets to target their rivals' customer bases more effectively, where it would not otherwise be so attractive if supermarkets had to maintain national uniform prices.
- 5.8 The CC also failed to consider the benefits that the ability to flex prices locally might provide in terms of creating uncertainty in the competitive process. In its Report on *Safeway*, the CC considered that strategic diversity was conducive to competition.<sup>68</sup> Asda considers that price flexing on the part of some retailers would contribute to strategy diversity, and to this extent should be seen as pro-competitive.

#### Selling below cost

##### *Extent of the practice*

- 5.9 Over the past four years the overall share of total sales accounted for by low margin products in Asda's stores has [].<sup>69</sup>

##### *Impact of the practice*

- 5.10 In the report on *Supermarkets*, the CC indicated that its main concern with persistent below cost sales was the impact that the practice had on smaller stores, hence concluding that the practice was against the public interest.<sup>70</sup> In reaching this conclusion, the CC considered that the majority of products were not fully exposed to competitive pressure.
- 5.11 Asda disagrees that the majority of products are not fully exposed to competitive pressure. Customers form their perception of price competitiveness in multiple dimensions: not only KVIs, but also their overall perception of the cost of a category

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<sup>68</sup> Safeway Report, paragraphs 2.88 – 2.89.

<sup>69</sup> Based on margin data submitted to the OFT on 19 January 2006, Asda estimated that its share of sales below 0% margin was [0-5]% in 2005. The comparable figures for previous years were as follows: 2002 ([0-5]%), 2003 ([0-5]%), 2004 ([0-5]%).

<sup>70</sup> Report on *Supermarkets*, paragraph 1.6(a).

(e.g. frozen) and the overall cost of their trolley (i.e. one-stop shop). Thus while there may be intense competition focused on KVIs, there are strong competitive forces applicable to the entire trolley. It would be incorrect to assume that there are certain prices that are shielded from competition. The broad nature of competition is reflected in the breadth of Asda's price monitoring<sup>71</sup> as well as Asda's pricing practice [].<sup>72</sup>

5.12 The CC also concluded that the focusing of competition on relatively few lines (KVIs), whilst a distortion of competition, was not against the public interest.<sup>73</sup>

5.13 Asda considers that persistent pricing below cost can be a necessary feature of competitive pricing for an individual grocery retailer: either because competition on various products is particularly intense and all retailers price below cost or because one retailer has a better cost price and another retailer considers it must match.

5.14 The OFT recognised that persistent below cost selling could be a pro-competitive feature of the market in its Reference Decision:

*"it is also possible that below-cost selling on a small number of KVIs is part of a strategy that drives increased competition and thereby is an important feature of the market that benefits consumers."<sup>74</sup>*

## **6. Purchasing and the Supply Chain**

6.1 Asda believes that to the extent that supermarkets have been able to obtain lower cost prices from their suppliers this benefits consumers.

### Impact on consumers

6.2 Where Asda can improve its purchasing terms with suppliers, customers benefit from lower prices and investments in other areas such as better service. This is central to Asda's EDLP/EDLC (every day low price/every day low cost) strategy. It is also reflected in the linkage between Asda's "We Sell for Less" goal and its initiative to [].<sup>75</sup>

6.3 That is to be expected in a market that is competitive overall. In the presence of competitive markets, lower input prices translate into lower final prices to the consumer as firms try to undercut prices of competitors. As outlined above, competition in the

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<sup>71</sup> Asda's competitor price monitoring covers []% of Asda's total sales. See Asda's response to questions 4 and 43 of the MPQ.

<sup>72</sup> See further Asda's response to questions 4 and 28 of the MPQ.

<sup>73</sup> Report on *Supermarkets*, paragraph 1.6(c).

<sup>74</sup> OFT Reference Decision, paragraph 5.17.

<sup>75</sup> Asda's strategy is described further in its answer to question 4 of the MPQ.

retail sector at the national level is high. Therefore, Asda expects that any improvement of buying terms through the exercise of buyer power by large retailers overall to be passed through to a large extent to the final consumer.

- 6.4 To the extent the market is not competitive (at the local level) that is best remedied by way of changes to the planning regime.

Impact on suppliers

- 6.5 Asda strictly adheres to the SCOP. It sees the SCOP's principles as reflecting sound business practice as applied by Asda before the SCOP was introduced.

- 6.6 The CC's Issues Statement has raised the issue of whether any buyer power possessed by the supermarkets may limit the amount or range of products supplied, or cause reduced levels of supplier innovations and investment, or ultimately threaten supplier viability, in spite of the operation of the SCOP.

- 6.7 Asda has not seen evidence to suggest that improved purchasing terms limits the amount or range of products supplied, or causes reduced levels of supplier innovations and investment.

- 6.8 Regarding the range the supermarkets offer, the OFT Reference Decision indicates that from 2000 to 2004/05 the number of product lines stocked by the four largest supermarkets increased by 40%.<sup>76</sup>

- 6.9 Clearly, the process of supplier competition is likely to mean that some suppliers prosper while others fail. There are a number of alternative reasons why a supplier might go out of business.

(i) *Demand factors*: broader economic trends have an impact on demand for particular categories. For example affluence while positive for bottled water, champagne and barbeque foods is negative for canned meals; busier lifestyles while positive for chilled ready meals and cooked meat is negative for home cooking ingredients such as edible oils; and, health concerns while positive for reduced fat/reduced calorie foods, non-sweet biscuits and cereal bars, is negative for crisps, ice cream and sweet biscuits.

(ii) *Competition*: competition from overseas is intensifying in some sectors, for example in the supply of cooked meat, fresh poultry, mushrooms, onions, tomatoes and peppers.

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<sup>76</sup> OFT Reference Decision, paragraph 4.11.

Impact on competitors

- 6.10 The CC's Issues Statement has also raised the issue of whether the prices raised by the supermarkets have an adverse effect on competition due to the "waterbed" effect.
- 6.11 Asda considers the "waterbed theory" as originally outlined in 2000, and as developed by Europe Economics on behalf of ACS, to be without theoretical foundation or empirical support.

Impact on wholesalers

- 6.12 Nor has Asda seen any evidence of a threat to the viability of the wholesale distribution network. Available evidence suggests that the wholesale sector is growing and profitable.
- 6.13 At the core of the ACS' argument is a reduction in the customer base of the wholesale sector, in particular the sales volume demanded by independent retailers. Evidence from IGD suggests the opposite market trend:
- (i) Whilst the number of independent retailers (this includes non-affiliated and symbol group retailers) decreased from 41,158 to 40,694 from 2002 to 2003, the value of sales attributed to this segment increased by 4.1% in the same period.<sup>77</sup>
  - (ii) From 2003 to 2004 the number of outlets in the same two categories increased to 40,858, with sales value increasing by 6.8%.<sup>78</sup>
  - (iii) In addition to their core retailer business, wholesalers have successfully opened up new segments of demand, for example in food servicing, which in 2003 accounted for 6% of overall grocery wholesaling activity<sup>79</sup> and in 2004 already represented 10% of sector sales.<sup>80</sup>
- 6.14 Developments in the wholesale sector are consistent with continued viability:
- (i) In 2004 total grocery wholesaling sales grew by 1.9% to £16.7bn<sup>81</sup> and IGD expects growth to continue at an annual compound rate of 1.8% to £18.3bn by 2009.<sup>82</sup>

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<sup>77</sup> IGD Grocery Wholesaling 2005, p.73-74.

<sup>78</sup> IGD Grocery Wholesaling 2005, pages 73 and 74.

<sup>79</sup> IGD Grocery Wholesaling 2004, p.49.

<sup>80</sup> IGD Grocery Wholesaling 2005, p.25.

<sup>81</sup> IGD Grocery Wholesaling 2005, p.11.

- (ii) In 2005, the majority of wholesalers predict positive sales growth within the core customer segment of convenience stores as well as forecourt stores and foodservice.<sup>83</sup>
  - (iii) Despite Mintel's estimates that the number of wholesalers declined by 4.1% to 12,357 in 2005, the growth in total turnover of food wholesalers is forecast to be around 2% in 2005.<sup>84</sup>
- 6.15 In addition, there is evidence of support for the wholesale segment from suppliers which reflects a strong belief in the relevance and continued viability of this sector:
- (i) In 2004, 79.2% of suppliers agreed with the suggestion that the wholesale sector would still have a role to play in the supply of grocery products in 10 years time.<sup>85</sup>
  - (ii) In 2005, 88% of suppliers said that they would continue to invest in the wholesaling sector and 66% intended to invest more than in the previous year.<sup>86</sup>

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<sup>82</sup> IGD Grocery Wholesaling 2005, p.147.

<sup>83</sup> IGD Grocery Wholesaling 2005, p.44.

<sup>84</sup> Mintel: Wholesaling and Cash & Carry, Retail Intelligence, July 2005, p.12 and 13.

<sup>85</sup> IGD Grocery Wholesaling 2004, p.169.

<sup>86</sup> IGD Grocery Wholesaling 2005, p.161.