

Planning

1. Introduction

- 1.1 This submission contains Asda's comments on the CC's Barriers to Entry Working Paper in so far as it relates to planning issues.
- 1.2 It also contains Asda's comments on the final results of the CC's LPA survey (see Annex).

2. Summary of Asda's case

- 2.1 Asda considers the planning regime (and in particular the Need Test) to be the main feature of the OSS market inhibiting the evolution of competition.

Need Test acts as an absolute barrier to entry

- 2.2 The Need Test involves a quantitative restriction of capacity outside the primary shopping area of town centres¹, based on an administrative assessment of supply and demand. Companies which have profitable entry strategies may not be able to implement them because there is deemed to be "no need".
- 2.3 The overall effect of this distortion is large. Asda has presented analysis to the CC suggesting the planning regime potentially prevents entry in around 70% of urban areas in GB with restricted choice.²

Need Test favours incumbents and encourages "pre-emptive gobbling"

- 2.4 In addition, as a secondary factor, the Need Test has the unintended consequence of encouraging and facilitating development by incumbents (i.e. without introducing new competition). There are a number of reasons for this:
- (i) incumbents have a natural incentive to bid for stores or to extend their stores in areas of restricted local choice;³

¹ The definition of a primary shopping area ("PSA") in PPS6 is very narrow. It is a "[d]efined area where retail development is concentrated (generally comprising the primary and those secondary frontages which are contiguous and closely related to the primary shopping frontage). The extent of the PSA should be defined on the proposals map. Smaller centres may not have areas of predominantly leisure, business and other main town centre uses adjacent to the PSA, therefore the town centre may not extend beyond the PSA". Edge of centre is "a location that is well connected to and within easy walking distance (i.e. up to 300m) of the PSA".

² See paragraphs 4.31 to 4.34 of Asda's Overview Submission and Asda's response to question 123 of the MPQ. See also Asda's presentation to Commission staff on 5 October 2006 and responses to follow up questions (submitted to the Commission on 14 December 2006).

- (ii) extensions (incumbents by definition) pass the Need Test more easily.⁴ They are also more likely to pass the Retail Impact Assessment (RIA).⁵

2.5 Incumbents can and do on occasion respond reactively to a specific competitor proposal with their own proposal to soak up “need”. But more importantly all incumbents understand that their ongoing expansion including using extensions in local areas (irrespective of any immediate threat of entry) tends to reduce the prospect of future competitive entry through the Need Test mechanism. Asda refers to these effects as “pre-emptive gobbling”.⁶

The effect is to reduce both choice and competition

2.6 As a result of these factors, the normal competitive process does not operate properly in the following ways:

- (i) in a substantial number of local markets, consumers face a restricted number of fascias, and in some cases the absence of their preferred fascia;
- (ii) reduced choice and greater concentration in local markets also implies lower competition in those markets; and
- (iii) retailers are insulated from the “natural selection” process that is present in most other markets. 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.⁷

³ Monopoly profits are worth more than two times non-collusive duopoly profits.

⁴ Partly this is because extensions are generally smaller than new stores. But this is also because in applying the test to extensions it is often assumed that sales density in the extension is only 33% to 40% that in the original store or in an entrant store (thus less “need” is required to justify it). Asda notes that the LPA survey results suggest very few LPAs agree that there is assumed to be a lower sales density for extensions. This contradicts Asda’s experience and that of its planning advisers. Asda believes the question may have been mis-interpreted by LPAs – in particular given that LPAs surveyed had limited experience of OSS extensions. At its Second Hearing, Asda offered to the CC to meet with the CC’s planning experts to discuss this issue further.

⁵ As the effects of an extension to an existing store are inherently more predictable (in the sense of being less disruptive to existing trade patterns) than the effects from an entirely new store.

⁶ The CC recognises in its Planning Working Paper that an application could be made to use up need before a competitor application has been made or in response to a competitor planning application (paragraph 59).

⁷ For a discussion of the importance of the entry-exit process for productivity see OFT, Productivity and Competition, OFT 887, January 2007. The OFT concludes: “Competition ensures that higher productivity firms increase their market share at the expense of the less productive. These low productivity firms may then exit the

- 2.7 The effect on consumers arises both directly at the local level in terms of poorer choice and competition (to the extent the retail offer is set locally) and by way of aggregation to national policies. See Asda's Submission on Market Definition and Competition paragraphs 1.3(ii) and (iii).

The Need Test is Redundant

- 2.8 The Need Test is a redundant policy instrument to advance the Government's Town Centres First Policy. Town centres can be adequately protected without the Need Test. See further Asda's Response to Emerging Thinking,⁸ paragraphs 2.23 to 2.33.
- 2.9 Asda believes that there is no coherent answer to the following question:

Why should a development which is close to a town centre (and where the Sequential Test has been applied) and which does not threaten Town Centre vitality and viability (hence passing the RIA) be blocked on the grounds of lack of "Need"?

- 2.10 Indeed, given the existence of the RIA and Sequential Test, the Need Test can only have the effect of harming town centres. See further Asda's Response to Emerging Thinking paragraph 2.26.
- 2.11 As the Need Test is redundant, the costs to customers associated with the Need Test come with no associated benefit. Asda has provided the CC with suggestions on how it might assess the consumer detriment. See Asda CC Staff Meeting Presentation, slides 21-23. Such an assessment would help inform Government policy.⁹

Flawed policy development

- 2.12 Asda considers that the competition problems discussed above have their origins in flawed policy development. Competition was taken to be a cost in the cost-benefit analysis in the government's Regulatory Impact Assessment of PPS6. Moreover the Regulatory Impact Assessment did not assess elements of the policy (e.g. Need Test) in isolation. See Asda's Response to Emerging Thinking, paragraphs 2.30 and 3.15. Asda is disappointed that the CC has not made reference to this in its Working Paper.

market, and are replaced by higher productivity firms. There is strong empirical evidence of these processes and their effects on productivity" (paragraph 1.8).

⁸ Submitted to the CC on 28 February 2007.

⁹ Asda notes the suggestion of the Inquiry Director in a staff meeting on 27 June 2007 that the CC may consider estimation of consumer detriment at the remedies phase of the inquiry.

Incumbent on the CC to reach a finding on the Need Test

- 2.13 Asda welcomes the Government's proposal (as set out in the White Paper) to remove the Need Test (consistent with the recommendations of the Barker Report).
- 2.14 The White Paper does not however remove the requirement on the CC to identify the distortion created by the Need Test and to propose a suitable remedy.
- 2.15 Asda notes here the CC's concern that "*it is, however, difficult to see how [the Sequential Test and the RIA] could be applied without some concept of need*".¹⁰ Asda agrees that an assessment of capacity and diversion do form part of an RIA. Critically however, applied in this context, capacity is not an absolute requirement and is only relevant to the extent that a lack of capacity might result in a new store having to take so much trade from an existing centre as to harm it.¹¹
- 2.16 This is in stark contrast to the Need Test which (a) has no regard as to whether the impact of a proposed new store is on the town centre or out of town (possibly on sequentially inferior stores) and (b) does not allow for the possibility that a new store outside or on the edge of the town centre may in fact be beneficial to the town centre or that the town centre is healthy and would not be significantly affected by any impact.¹²

Removal of the Need Test to be accompanied by a Competition Test

- 2.17 In addition to recommending the removal of the Need Test, the CC should propose the introduction of a competition element into the planning process.
- 2.18 Such a competition test would encourage new entry (including by smaller/new OSS operators) into areas where choice and competition are insufficient.
- 2.19 There are a number of ways such a competition test could be formulated. As noted by Barker there is no "*in-principle*" impediment to developing a Competition Test within the planning regime.¹³ Asda looks forward to discussing this in more detail with the CC in the "remedies phase" of the inquiry.

¹⁰ Barriers to Entry Working Paper, paragraph 16.

¹¹ Asda disagrees with the position of M&S that the Need Test and the Sequential Test are "inextricably linked" (M&S response to Emerging Thinking, 16 February 2007, paragraph 3.3). A coherent planning policy regime could consist of only one, or any two, of the three main tests.

¹² The CC reports in its Entry/Exit of Small and Specialist stores Working Paper (paragraph 36) that the "growth of independent convenience stores is accelerated by supermarkets entering edge of town sites".

¹³ Barker Review of Land Use Planning – Final Report – Recommendations, paragraph 1.39.

3. Asda Response to CC working paper on Barriers to Entry

3.1 Asda has already responded separately and in detail on the Commission's Emerging Thinking and Working Paper on Planning¹⁴ and comments below on the Barriers to Entry Working Paper.

The Need Test is an absolute barrier to entry

3.2 Asda considers the CC's analysis to be entirely consistent with its position as summarised above. In particular Asda notes the following findings of the CC:

- (i) *The Need Test "involves a pre-judgement of the opportunity and therefore the desirability, of further entry".¹⁵*
- (ii) *"[s]ignificant variation of store margin in relation to local concentration [...] is therefore consistent with the presence of a barrier to entry".¹⁶* The CC should have gone on to recognise that local entry barriers could also result in nationally higher margins under uniform pricing – by way of aggregation (see paragraph 2.7 et seq. above).
- (iii) *LPA survey suggests Need Test acts as actual barrier.* CC reports that in over half of all LPA areas surveyed the Need Test may form a binding barrier.¹⁷ This appears to be consistent with Asda's own analysis.
- (iv) *"Furthermore in those areas where the need test is not currently a binding barrier to entry, it may become one after further entry has occurred."¹⁸*

3.3 The CC then raises three issues in relation to Asda's analysis quantifying the extent of the distortion:

- (i) The CC' commented that the analysis is abstract - compared to obtaining actual need assessments from LPAs. Asda notes however that its analysis has used up-to-date statistics whereas the need assessments of many LPAs are inevitably likely to be out of date. To a large extent, the abstract nature of Asda's method stems from the abstract nature of the Need Test itself.

¹⁴ See footnote 8.

¹⁵ Barriers to Entry Working Paper, paragraph 12.

¹⁶ Barriers to Entry Working Paper, paragraph 2.

¹⁷ Barriers to Entry Working Paper, paragraph 14.

¹⁸ Barriers to Entry Working Paper, paragraph 14.

- (ii) The CC comments that Asda's method took no account of growth. This is correct because Asda employed an overtrading model which examined the retail position at that point in time. Asda has allowed for growth by modelling a sensitivity including growth as well as overtrading and this has a limited impact on the results.¹⁹
- (iii) The CC comments that Asda's method logically implies no need in aggregate across the UK (since over and undertrading areas net off). Asda agrees that this is a feature of the overtrading model which contributes to it being highly restrictive.
- 3.4 Asda has made realistic and transparent assumptions and is prepared to engage further with the CC staff on those assumptions. In any event, as outlined above, the CC's LPA analysis also shows a substantial planning restriction of a similar scale to that identified by Asda.
- 3.5 The CC provides evidence of actual entry: 565 new stores larger than 1400 m² have opened since June 2001, of which 507 were opened by Tesco, Sainsbury's, Asda and Morrison.²⁰ Asda has the following comments on this:
- In order to draw any conclusions as to the extent of barriers to entry, the CC would need to consider the relevant counterfactual. Asda has presented evidence of areas it would like to enter ("MPR") but is not able to because of the Need Test.²¹ The CC has collected similar evidence from other retailers at MPQ 123.
 - 304 of the 507 are acquisitions (as opposed to new builds). These do not represent entry.
 - The remaining 203 appear to include re-sites and re-builds which also do not represent entry. Of [] new builds quoted for Asda, [] are resites/rebuilds.

¹⁹ Asda's analysis showed that 73% of Gazetteer areas had a planning restriction and []% of Asda's MPR areas had a planning restriction. Allowing for 2% demand growth pa and a 5 year planning horizon, the figures would be 67% and []% respectively. Demand growth captures population growth and growth in convenience expenditure per head. Population growth is highly dependent on locality. In terms of expenditure growth, we note the long term trend growth rate of 0.7% for convenience goods reported in the Experian Retail Planner Briefing Note 4.0, October 2006. We exclude any supply growth (increase in sales densities) as a conservative measure. The results are consistent with the CC's finding that there appears to be a restriction due to need in over half of all areas.

²⁰ Barriers to Entry Working Paper, Table 3 page 16.

²¹ See Asda submission to CC of 31 October 2006.

- 3.6 The CC's evidence therefore appears to overstate the extent of OSS entry in the period since June 2001.

Postcode area analysis consistent with “pre-emptive gobbling” and the need for a competition test

- 3.7 The CC reports that of the new floorspace added in areas where one retailer already has large share, a large proportion of this new space is being opened by the retailer that was already in a strong position.²²
- 3.8 The CC also reports that retailers have continued to grow share in areas where they were strong (albeit at a slower rate than in areas where they were relatively weak). The CC suggests that there would not appear to be a functioning adjustment mechanism by which grocery retailers with a strong local position are subject to entry.²³
- 3.9 Asda considers that these findings are consistent with the restrictive and distortionary effects of the Need Test it has identified, and may be remedied through removal of the Need Test and introduction of a Competition Test.

²² Barriers to Entry Working Paper, paragraph 41.

²³ Barrier to Entry Working Paper, paragraph 39.

Annex LPA Survey Results

1. Introduction

- 1.1 Asda has previously commented on the draft questionnaire.²⁴ Many of those comments remain valid. They are not repeated here.
- 1.2 Asda has commented above on key results of the survey²⁵ and also on key interim results (published at Annex A of the working paper on planning issues from January 2007) in its response to Emerging Thinking.²⁶ These comments are also not repeated here.
- 1.3 This submission therefore contains a limited number of additional comments. Asda may comment further if the CC relies on other results from the survey in future work.

2. Number of stores

- 2.1 Asda notes that most LPAs have only a small number of large stores (1,400 m² and above) in their area and agrees that this indicates that most LPAs are likely to receive relatively fewer planning applications for larger grocery stores than for smaller ones. Asda considers that the results to subsequent questions (such as those relating to objections or extensions and mezzanines) must be assessed in this context.

3. Benefits to local areas of grocery retailers

- 3.1 The high proportion of LPAs (83%) that consider large stores can be important to anchoring regeneration reflects the fact that under planning regulations this is a key policy consideration for LPAs. Regeneration is part of the qualitative need assessment, whereas there is no similar policy requirement to bring forward developments to benefit consumers through improved competition.

4. Extensions

- 4.1 In relation to the question (“If there were a like for like situation what would be the preferred choice of your LPA for the addition of new grocery space – as new build, an extension or as a mezzanine?”) Asda notes that most respondents (69%) had no preference. However, Asda considers that LPAs may well have interpreted “like for like

²⁴ See Asda’s submission of 20 November 2006.

²⁵ See paragraphs 2.4(ii) and footnote 4, 3.2(iii) and 3.2(iv).

²⁶ Submitted to the CC on 28 February 2007. See paragraphs 3.17, 3.21, 3.53 and 3.54.

situation” as meaning equal results of the RIA, Sequential Test and Need Test for applications for a new build and an extension. As such, “No preference” might be expected. In addition, it would be rare (if not unique) for an LPA to have a like for like choice. Each planning application must be assessed on its own merits.

- 4.2 However, as noted at paragraph 2.4(ii) above, extensions are more likely to pass the RIA. This is because the effects of an extension are more predictable (in the sense of being less disruptive to existing trade patterns) than the effects from an entirely new store. Asda also considers that extensions are more likely to pass the Need Test (because they are generally smaller than new stores and it is often assumed that sales density in an extension is only 33-40% that in the original store or in an entrant store), though Asda recognises that there is disagreement in this area.²⁷ Therefore the absence of a preference after the tests would still be consistent with extensions being favoured overall.²⁸

²⁷ See footnote 4 above.

²⁸ See paragraphs 4.23 and 4.24 of Asda’s Overview Submission and paragraphs 2.12 to 2.15 of Asda’s response to Emerging Thinking.