

A convenience retailer

Dear Mr Oyler

**Representations and Provision of Information on
Matters Relevant to the Inquiry**

Thank you for your letter of 16th May 2006. I write to comment on the OFT's decision document and to provide evidence which I believe provides clear support in favour of a reference to the Competition Commission for an investigation into the supply of groceries by retailers in the United Kingdom.

My company operates over 100 stores in the UK, all of which are licensed to sell alcohol and all of which are under 285 square metres in size. We sell general groceries as well as alcohol. We undertake supply negotiations direct with alcohol manufacturers and distributors such as Carlsberg Tetley Ltd and Diageo Ltd.

It has become clear to me during the three years that I have been Managing Director of the company that there are 2 particular features of the 4 large supermarkets in the UK grocery market that prevent, restrict and distort competition in the alcohol category – Below Cost Selling and Disproportionate Buying Power. Below Cost Selling in my view also represents irresponsible retailing of alcohol in the large supermarkets as the selling price is so far below cost it will attract heavy drinkers and under-age drinkers to the stores and encourage binge drinking. I know that the latter comment is outside of the brief of the proposed market investigation but it does put into context the extreme pricing levels. For example, half a pint (approximately 280ml) of Stella Artois is about £1.75 in an average British pub, at the large supermarkets the same product is currently just 40 pence for a 284ml bottle.

As you will see from the following, this is well below the cost of getting the product to the consumer and well below what would be termed in the off-licence trade as a normal price even for a product that is being specifically promoted under a “Hi-Lo” pricing policy.

Feature 1 – Below Cost Selling

The OFT has already identified examples of below cost selling in the large supermarkets but there follows three current examples of supermarket retail pricing being well below the delivered wholesale cost.

1. ASDA, Tesco, Morrisons and Sainsbury are all offering, today, 2 cases of 20 bottles or cans of lager and/or cider for £16. The choice of packs at ASDA follows as an example with the cost price per case from a wholesaler in brackets. It costs roughly £1 per case to deliver a case of beer or cider from the wholesaler to an independent or multiple specialist store and I have added £1 to recently quoted prices. There is no difference in manufacturing or delivery cost of a case of beer between a wholesaler and a large supermarket's central distribution system. There may be a difference in the cost of delivery on to individual shops but these will be relatively small
 - 20-pack of Stella Artois lager 284ml bottles (£8.59 cost inc VAT delivered)
 - 20-pack of Fosters lager 440ml cans (£9.17 cost inc VAT delivered)
 - 20-pack of Carlsberg lager 440ml cans (inc VAT delivered)
 - 18-pack of Strongbow cider 440ml cans (inc VAT delivered)
 - 20-pack of Budweiser lager 300ml bottles (inc VAT delivered)

A normal retail price for any of the cases above would be about £10.99 per case. At the large supermarkets the consumer may choose any 2 of the above and pay a retail price of £16 or £8 for each case which works out at 40 pence for each 440ml standard can of standard strength lager and 40 pence per bottle for each standard bottle of premium strength lager. The usual price for a single can of standard strength lager in the UK is between 95 pence and 99 pence.

2. Tesco Value Whisky retails at £6.86 per bottle. Excluding VAT and excise duty, the price the customer is paying is 36.8 pence per bottle, equivalent to £4.41 per case of 12. The best price available from a wholesaler for a low cost whisky excluding VAT and excise duty is £8 per case so the selling price in Tesco excluding VAT and excise duty is 55% below the wholesale cost price on this product
3. Tesco Pavlov Vodka retails at £6.23 per bottle. Excluding VAT and excise duty, the price the customer is paying is 17 pence per bottle, equivalent to £2.06 per case of 12. The best price available from a wholesaler for a low cost vodka excluding VAT and excise duty is £4 per case so the selling price in Tesco excluding VAT and excise duty is 52% below the wholesale cost price on this product.

Of course, it may be that the large supermarkets are not selling below cost but simply passing on to customers huge discounts available specifically to them because of their huge buying power but it has to be borne in mind that the cost to manufacture and deliver a single palletised container of beer, vodka or whisky to a wholesaler is exactly the same as the cost to deliver to the central warehouse of any of the 4 large supermarkets - Tesco, ASDA, Sainsbury's and Morrisons. The huge disparity in retail pricing between the above examples and normal pricing cannot be explained by lower buying costs due to a larger scale of operations.

In the past there has been strong, healthy competition on price amongst local multiple off-licence specialists, small independent stores and convenience stores on alcohol. This and short-term promotions on certain products has combined in the past to produce great value for local shoppers. However, the bizarre below cost pricing behaviour of the large supermarkets which tends to be concentrated around seasonal festivities such as Christmas and big televised occasions such as the World Cup restricts local competition because there is no point trying to compete with such predatory pricing behaviour.

Over time small, local shops cannot be profitable in a distorted market and are going out of business - further reducing competition at the local and national level. During these periods of extreme below cost pricing, so called top-up shopping is extremely limited on beer because consumers quite rightly stock up at the large supermarkets at the ridiculous price levels and make special trips, attracted by huge palletised displays of beer in the foyers of large supermarkets backed by TV and poster campaigns. Beer represents about 25% of a local off-licence's sales and beer shoppers will of course buy other products in store. The effect of the short-term, predatory pricing behaviour on smaller stores is very evident from the huge swings in alcohol market share towards the big supermarkets during these periods.

The distortion of the beer market is further demonstrated by the fact that all of the big supermarkets move to the same below cost pricing levels with virtually identical pricing offers on virtually the same day.

Finally, in terms of proportionality, the large supermarkets have a dominant share of the off-licence trade in the UK which means that a huge proportion of beer sold during these bouts of below-cost selling is sold below cost price in the major supermarkets

Feature 2 - Disproportionate Buying Power

It is clear from my many discussions with manufacturers and UK distributors of alcohol that they are as exasperated as anybody at the bizarre pricing behaviour of the large supermarkets on alcohol. The pricing undermines branded suppliers' attempts through advertising to position their brands (for example, InBev UK's attempts to position Stella Artois as 'reassuringly expensive') and they are clearly under extreme pressure from the large supermarkets to give extra financial incentives to reduce the impact on the supermarkets of the below-cost selling. For example, ASDA has recently asked all suppliers to give extra, substantial one-off payments simply to remain on the list of suppliers.

The extreme level of buying power in the multiples also adds to the cost of manufacturing as the supermarkets demand more and more 'specific packs' to help reduce the impact on their alcohol profitability eg 15 packs, 18 packs, 20 packs of beer which increases the number of change-overs on production lines, reducing efficiency of production and adding to packaging costs, storage costs and delivery costs.

Although evidence can only be anecdotal, there is a huge body of opinion amongst smaller, local businesses that delivered costs to wholesalers are being increased by manufacturers to help subsidise cost reductions to the large supermarkets. There are also clear reductions in the level of service from suppliers to smaller businesses. For example Tesco demanded extra, free resource from suppliers at busy times to help stack shelves and during the implementation of a new bill payment system at Tesco, the account manager of one of our key suppliers was simply unavailable to us for several months for the specific reason that he was spending 100% of his time at Tesco during that period.

Of course, because of the huge dependence that manufacturers have on the custom of the large supermarkets, it is very difficult for them to be critical in any way of their behaviour. Frankly, I am amazed that there has been no action thus far by central government to curb some of the bizarre pricing behaviour of large supermarkets in relation to alcohol products and a referral to the Competition Commission is long overdue. I hope and trust you will take my observations and comments into account and look forward to the outcome of your investigations. Meanwhile, don't hesitate to ring me for clarification of any point or to discuss the matter further.

Yours sincerely