13 Views of retailers, distributors and record clubs

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Introduction

13.1. In this chapter we summarize, first, the views of the principal retailers of recorded music in the UK, secondly, those of two leading wholesalers, TBD and Pinnacle, and finally those of the principal record clubs. We begin with W H Smith, in respect of which we had provisionally found that a scale monopoly situation existed in relation to the supply of recorded music, and then summarize the views of the three companies in respect of which we had provisionally found that a complex monopoly situation so existed, namely W H Smith, HMV and Kingfisher (which we together refer to as `the companies'). We then move briefly to other retailers who sell recorded music, to the distributors and finally to the record clubs.

W H Smith scale monopoly

13.2. W H Smith said it accepted that a scale monopoly situation existed in respect of W H Smith and Our Price. Were the proposed transaction for the restructuring of Our Price and Virgin Retail into a single company to proceed,[1] then it also accepted that Virgin Retail would form part of the scale monopoly. W H Smith said that it in no way exploited its scale monopoly position and none of its actions operated against the public interest.

[1] See footnote to paragraph 3.16.

The retailers' complex monopoly situation

13.3. We had provisionally found that a complex monopoly situation existed in relation to the supply of recorded music in the UK at the retail level, in that the companies engaged in the following practice: `securing discounts and promotional support from suppliers of recorded music that are larger than those made available to other retailers'; and that this practice had the effect of preventing, restricting or distorting competition in that supply. We invited the companies to comment on our provisional finding, and on a number of issues arising out of that finding.

The composition of the `group'

13.4. HMV said that it did not know how the MMC had arrived at the membership of the complex monopoly group. The group included one retailer, Woolworths, which to HMV's knowledge did not deal direct with record companies and was therefore not in a position to engage in the practice identified. On the other hand, other retailers who presumably did engage in the practice had been excluded. The choice of persons included in the group therefore appeared to HMV, at least *prima facie*, to lack a rational foundation. Moreover, this irrationality extended to the exclusion of non-retailers. Wholesalers, record clubs and mail order houses which might also be expected to secure discounts or promotional support from record companies had also been excluded. If the securing of special terms by retailers was believed by the MMC to prevent, restrict or distort competition, HMV could not understand why the securing of such terms by other intermediaries was not thought to do so.

13.5. So far as HMV was aware, the MMC had not in the past singled out particular members of a group for identification as persons in whose favour a complex monopoly situation was held to exist. In the reports on beer and motor cars, for example, the group had included not only the largest suppliers, but also companies with very small market shares indeed. To single out particular undertakings in the way the MMC had done in this case was objectionable both as a matter of law and of fact, and gave the misleading impression that the major operators comprised a monopolistic group rather than that, like everyone else in the industry, they engaged in certain industry-wide practices.

The alleged practice

13.6. The companies did not accept either that a complex monopoly situation as provisionally identified existed or that they conducted their affairs in any way which operated to prevent, restrict or distort competition in connection with the supply of recorded music in the UK.

13.7. HMV said that discounts were quite different from promotional allowances, which were linked to particular activities on the part of retailers who received those allowances. Dealing first with discounts, HMV pointed to the treatment of differential discounts by the MMC in their earlier reports, in particular in *Discounts to Retailers* (1981) and *Carbonated Drinks* (1991). In the first of those cases, the MMC had concluded that the practice of granting discriminatory discounts was widespread; the only line of business in which the practice was found to be insignificant was the cigarette trade which was characterized by high concentration on the supply side and very low concentration on the retail side, with many sales made by a plethora of small outlets. Nor had the Government apparently felt inclined to ban or regulate differential discounts generally. Accordingly each case had to be approached on its own facts.

13.8. HMV also pointed to what it considered were important parallels between the carbonated drinks market and that for recorded music, which showed that the allowance of special discounts was not operating anti-competitively in the recorded music market. First, differential discounts were the norm in trades where large multiple retailers accounted for a significant proportion of total turnover. There was therefore nothing abnormal about the practice, and HMV had no reason to believe that the amount of the discounts was abnormal either. Secondly, it was vital to record companies, even more than to suppliers of carbonated drinks, that their products were on sale in prime outlets. Special discounts made an important contribution to the typically higher costs of operating from prime retail sites which were sought after not only by major retailers of records but also by major retailers in other lines of trade, who, in turn, generally secured preferential discounts from their suppliers. Thirdly, HMV was not aware of the existence in the recorded music market of `a degree of market power [such as] may be used in an anti-competitive way' of the kind referred to in *Carbonated Drinks*; in particular, it was not aware of special discounts being related to exclusivity, or of such discounts being granted with predatory intent, in the recorded music market. Fourthly, net trade price differentials had not caused market shares to stabilize at either the supplier or retailer level in the record market and had, indeed, assisted dynamic retailers to expand rapidly. Equally, there was no evidence that the practice had hindered `the development of new brands' (to use the MMC's words in *Carbonated Drinks*) by independent record companies. Finally, there was nothing in the evidence presented by the MMC to suggest that the allowance of special discounts was operating anti-competitively in the recorded music market in any other way.

13.9. Turning to differential promotional allowances, HMV said that not only did such allowances not operate anti-competitively in the recorded music market, but rather they performed their own valuable and pro-competitive function in that market. Promotional allowances essentially recompensed retailers for the cost of specific promotional activity. It was often more cost-effective for the retailer than the record company to undertake the promotion but the main benefit gained was often to the record company, since many promotions led consumers to purchase the promoted records not only at the outlets running the promotion but also from other retailers. The fact that record companies generally bore most of the costs of such promotions confirmed that it was they who received the main benefits.

13.10. HMV said that without discounts, its retail prices would have to rise significantly or else it would have to reduce its costs by, for example, moving to inferior premises in inferior locations, reducing its stock range or employing less knowledgeable staff. The securing of discounts therefore helped to keep prices lower and to maintain overall value for money than would otherwise be the case, all of which was to the benefit of the consumer.

13.11. Kingfisher said that it did not believe the MMC had supplied the factual material to support its provisional finding that the companies were securing discounts and promotional support from suppliers of recorded music that were larger than those made available to other retailers. So far as differential discounts were concerned, Kingfisher said, first, that the information supplied to it in the issues letter overstated the discounts negotiated by EUK with the record companies. Secondly, the record companies achieved a substantial saving in distribution costs by delivering to EUK's warehouse rather than to the hundreds of different outlets serviced by EUK. Any comparison of the discount accorded to EUK with that accorded to other retailers should be calculated on a like-for-like basis. Thirdly, the level of discount was in part a reflection of the distribution costs involved in delivering different quantities of product to different outlets at particular frequencies with particular service obligations. None of this was reflected in the information supplied by the MMC as the basis for the provisional complex monopoly finding. As for the level of promotional support, Kingfisher said that it had not seen any material which supported the provisional finding.

13.12. W H Smith made the following points. First, differential discounts and promotional support were granted by suppliers to their trade customers in the case of almost every class of branded consumer goods, not only in the supply of recorded music. Secondly, the practice reflected competition among suppliers; the absence of such differential terms could indicate the absence of such competition. Thirdly, it was the record companies which individually determined the discounts and promotional support granted to their various trade customers; as the only sources of supply for retailers, it was taken for granted that they should decide their discount policies and implement them in a manner designed to promote their own business objectives. Fourthly, when discussing discounts and terms with a record company, W H Smith did not know the terms which were being granted to their competitors. Fifthly, it would be inconceivable for a trade customer to refuse the offer of a discount simply because it believed some of its competitors were being granted inferior terms. Sixthly, there was no suggestion that the companies had acted together to secure larger discounts or greater promotional support; on the contrary, competition between such companies made such a course of action wholly impractical. Finally, and in consequence, any differences in discounts and promotional support between the companies and other retailers were the result of the operation of market forces in a competitive market.

13.13. W H Smith said that no steps, actions or omissions had been taken by W H Smith, Our Price or Virgin Retail, collectively or individually, for the purpose of exploiting or maintaining the alleged monopoly situations; nor had any of them acted in any way which was against the public interest or likely to become so.

Issues

13.14. We put to the companies a number of issues arising out of the provisional complex monopoly finding. The companies' responses to these issues are set out below.

Competition

13.15. We asked the companies whether competition between them and independent retailers was being distorted by virtue of their securing unduly large discounts from record companies or through joint promotions with them; and whether this resulted in a lack of choice for consumers as independent retailers closed their outlets.

13.16. HMV said that it was important to remember the following points: first, there had been a demand-led restructuring of record retailing in the UK which had reflected much more widespread trends in UK retailing; secondly, the total number of recorded music outlets had, however, increased rather than fallen; thirdly, there had been a trend for some smaller record stores, whatever their ownership, to close and be replaced by larger, better located stores which could better meet changing consumer requirements; fourthly, there had been an increase in total record retailing square footage since 1984; and finally, these trends had contributed to vigorous competition between specialist chains, multiples, independents and newer forms of outlets and to considerable widening of consumer choice.

13.17. HMV said that these trends had resulted from a need to meet consumer requirements for larger stores offering greater choice and an improved, more informed service. In particular, the specialist chains had increased the average size of their record retailing outlets, moved them into prime high street locations, expanded their product range and improved greatly the quality of service and standard of presentation in new and existing stores. HMV's own stores, which had recently increased in number from 90 to 94, provided excellent examples of such developments.

13.18. Competition between retailers was vigorous, as shown by the 2,000 independent outlets which existed alongside the specialist chains and multiples, the significant new entry into UK record retailing of new types of outlets, in particular of US retailers such as Sam Goody and Tower. Price competition was fierce, as was manifested by a variety of pricing initiatives, and non-price competition was also very significant, with different strategies being adopted by the various kinds of outlets; and there was local as well as national competition in the shape of varying product ranges and prices. Overall, competition among record retailers could be regarded as more vigorous than in the past and resulted in an extremely wide choice of products and prices for consumers.

13.19. HMV also stressed that it was not only, or even primarily, the independent retailers who were responsible for breaking new acts. The breaking of new acts involved a number of parties and methods, including media coverage and artist contact with the public. One of the ways in which HMV contributed to this process was by co-operative promotion of new artists and releases, including the personal appearance of, or live performance by, the artist in HMV stores. HMV also encouraged direct contact between local store managers and record label marketing staff, and other distributors.

13.20. Kingfisher said that it did not secure unduly large discounts from record companies. The record companies set the dealer prices from which file discounts were taken. File discounts were granted to EUK, which negotiated with the record companies to improve its trading terms, but changes to the file discount were infrequent. It was important to remember that the record companies were the monopoly suppliers of each product. The prices and terms for all EUK's retailers, including connected retailers, were commercially negotiated and reflected both the size of the business and the supply criteria and service requirements specified by the customer.

13.21. In comparing discounts secured by EUK and independent retailers, it was important to remember that the record companies only had to make one delivery to EUK, send it one invoice and arrange for one representative to contact it, rather than each of the hundreds of retail outlets which it serviced. EUK had, moreover, contributed to increasing both the number of outlets for recorded music and the volume sales of recorded music. It was always endeavouring to further increase the size of the market. For example, it had introduced `CHART STOP' which serviced the impulse market. EUK's success in this respect meant that consumers now had a larger choice of where to shop.

13.22. Kingfisher said that Woolworths was an important retailer of chart product for all record companies. It would only promote new releases when it was setting the lowest price in the high street. Promotions might take one of two forms: first, the promotion might be integrated with the record company's own media schedule; secondly, Woolworths might decide to promote a new release where a record company was not undertaking any equivalent promotion. In each case the promotion was planned in conjunction and in co-operation with the record company. Again, if Woolworths traditionally had a low market share for a particular artist, it might set a low price for a new product from that artist as part of its own price promotion, in order to generate increased sales and traffic through the entertainment area.

13.23. In contrast to the joint funding of promotions between record companies and Woolworths, many independent retailers received free promotional stock, particularly in respect of new artists. This could partly be explained by the fact that the independent retailers' customer base consisted largely of consumers seeking to purchase new trends in music. Once established, these trends were then typically followed by the more general market. Because many independent retailers received free promotional products from record companies, they were able to compete on very different terms from Woolworths on promotions.

13.24. W H Smith said that, in the first place, it did not believe that its stores were granted `unduly large' discounts, whether viewed in isolation or in contrast to the discounts achieved by independent retailers. In themselves, the discounts could not be regarded as unduly large in view of the volumes involved, the substantial stock which specialist record shops had to carry and the costs involved in the provision of the service and in-store ambience which their customers expected. When the discounts were contrasted with the discounts achieved by independent retailers, account had to be taken of the following factors: first, independents sold between 100 and 1,000 units per week, and the larger ones were sizeable operations not dissimilar from the major retailers in their presentation, location and range of products; secondly, the file discounts believed to be granted to the large independents (such as Andys and 4 Play) were broadly the same as those received by W H Smith, Our Price and Virgin Retail; thirdly, the independents received other benefits not granted to the major specialist retailers, such as supply of free stock, favourable payment terms, `car' stocks and product which was relatively cheap because it had been deleted or was not at the height of its popularity; and fourthly, the major retailers had to sustain higher costs in terms of rents, rates, stock size and range, shop fittings and promotional costs than the independent retailers.

13.25. Two other matters reinforced W H Smith's view that the discounts which their competitors received enabled them to be competitive. First, the difference between a large discount and no discount at all was not of such significance that it would, in any event, distort competition either among the major specialists or between all record retailers. Secondly, independent retailers were as a matter of fact able to offer product for sale at prices which were lower than those offered by specialist record retailers. Rival Records and Spinadisc were but two examples.

13.26. When all the above considerations were taken into account, it was clear that independent record retailers did not receive less support from the record companies, nor did they routinely price at higher levels than the major retailers. Moreover, joint promotions with the companies were of benefit to all record retailers, not just those involved in the promotion, because they promoted the advertised product generally.

13.27. As to the decrease in the number of independent record retailers, W H Smith said that to the extent that these had occurred, they were the result of changes in consumer attitude to the purchase of recorded music. This had been happening particularly since the development of large specialist record retailers. Consumers had different demands and expectations. Music enthusiasts wanted a wide range of product in a specialist environment, together with specialist staff and service. Such consumers gravitated towards the specialist retailer. Occasional record buyers, on the other hand, were content with a narrower range and less expertise and were catered for by any number of outlets, including garages, food supermarkets and other non-specialist outlets. Many independent record retailers had adapted to this market development by either operating in a niche to serve particular customer interests (for example, vinyl shops, specialist jazz, dance or classical shops) or alternatively by lowering their cost base and offering low prices (for example, Rival Records, Spinadisc and 4 Play). Those retailers which had not adapted to this market pattern had in many cases been forced to close.

13.28. All these developments had resulted in the widest possible choice for consumers. To the extent that record retailers had closed, this was due to the operation of market forces, and not to any action on the part of the companies.

Prices

13.29. We asked the companies whether the alleged practice resulted in higher prices for recorded music in the UK than would otherwise be the case.

13.30. HMV said that the position was the very reverse of that postulated by the MMC. Retailers competed with each other to secure discounts and support from record companies and where these were obtained, they helped to keep retail prices lower. So far as discounts from suppliers were concerned, it was clear that these had significantly exceeded HMV's operating profits in each of the last three years. The securing of discounts thus acted to the benefit of consumers by helping to keep prices lower, and product and service quality higher, than would otherwise have been the case.

13.31. As for promotions, as already noted, the majority of promotional costs were currently met by record companies, for whom they were much more cost-effective than for retailers. Retailers such as HMV took the risk of committing to media advertising spend and were then in competition with other retailers to secure record companies' finite promotional support resources. Without supplier contributions, levels of promotional activity would fall. This would lead to reduced sales and would put upward pressure on costs and prices because fixed costs would be spread across a smaller volume.

13.32. HMV said that it was important to bear in mind here the strength and variety of the price competition which kept retail prices of recorded music low. National price competition (particularly in the form of discounting of chart product) and local price competition were strong, permanent features of the market. Price campaigns were run by retailers to cover the product of particular artists, sets of artists, record labels or genres. They had become particularly widespread as a further focus for price competition during the 1990s.

13.33. Kingfisher said that the large retailers in the recorded music business competed for market growth on price. Chart products in particular were heavily discounted. In the case of Woolworths, its `Street Value' strategy was that of always being the lowest retailer or as low as any other retailer on any entertainment products, whether chart or catalogue. In terms of chart product, Woolworths monitored the prices of all the other major retailers weekly and adjusted its prices as necessary. This strategy was supported by the Woolworths price promise which meant that if any customer could demonstrate that another retailer was selling the product at a lower price, Woolworths would immediately refund the difference to that customer.

13.34. Kingfisher said that Woolworths' strategy had the effect of holding prices down while increasing sales volume. It had been Woolworths' decision to bring the overall prices of chart material down and over the past five years this had resulted in approximate real reductions in the price of cassettes and CDs of 50p and £1 respectively.

13.35. W H Smith said that retail prices for recorded music were, for all practical purposes, determined by the dealer prices established by the record companies which knew, first, the margin required by the retailer to cover its costs, and secondly, the competitive pressures that would require the retailer to have regard to the proximate `price point'. The material provided by W H Smith to the MMC showed that the retail margin was virtually exhausted by its costs; neither W H Smith nor Our Price generated acceptable, let alone substantial, profits. Further, from their net margins, it was clear that a decrease in retail prices was not viable unless accompanied by a reduction in the dealer price.

13.36. In fact, W H Smith and Our Price had tried to persuade record companies and distributors of recorded music to reduce their dealer prices. They had arranged meetings with them and argued that a reduction in retail prices would lead to an increase in sales of recorded music, improved economies of scale and, consequently, increased profitability for record companies, distributors and retailers. Despite these discussions, none of the record companies or distributors approached had been prepared to reduce its dealer prices; on the contrary, the record companies had increased them. That most record retailers had continued to resist an increase in retail prices was demonstrated by the fact that, despite the increases in dealer prices by numerous record companies in autumn 1993, retail prices were not increased as a result. All the above factors demonstrated that prices for recorded music in the UK were no higher than would have been the case in the absence of any alleged monopoly situation.

Price differences between the UK and other countries

13.37. We asked the companies what the extent of the price differences was between the UK and other countries, and what was the explanation for these differences.

13.38. HMV said that it was very difficult to comment on the extent of any differences in retail prices for recorded music as between the UK and other countries and so far as it was aware, there was no reliable evidence on this issue. But because each national market was quite distinct, no comparison would have any real commercial meaning or relevance. The MMC's own survey, carried out by BMRB, was not reliable, mainly because the sample was small and only full-price records were selected. A different choice of even one title in a survey of this size would have substantially affected the average price differential.

13.39. There were a number of reasons why, in general, retail prices would be expected to differ between countries. These would include the levels of demand for different types of repertoire, major differences in terms of trade between record companies and retailers in different countries, cost differences (particularly in relation to property and staff), differences in sales tax rates and applications, the nature and level of competition and national regulations affecting such matters as prices and copyright.

13.40. Kingfisher said that it was not involved in retailing recorded music outside the UK and could not comment on pricing in other countries. It noted, however, that the BMRB survey had shown the UK to be among the cheapest countries for both CDs and cassettes after the USA, and that multiples tended to be cheaper than independents or specialists.

13.41. W H Smith said that while it was impossible to establish precisely the price differences between the UK and other countries, it accepted the ranking of countries produced by the BMRB survey, in particular the finding that prices for recorded music on the Continent were generally higher than those in the UK and the USA. Commenting on the BMRB survey, however, W H Smith said, first, that the number of titles chosen was very small, particularly in the context of the 100,000 or so titles currently available. Secondly, the survey had not taken sufficient account of discounts in the UK and the different ways in which these were communicated to customers. In the UK, it was usual to reduce the price below that at which it would otherwise have been sold and then promote the record at that lower price but without expressly advertising the discount or its extent.

13.42. With reference to the Management Horizons survey, W H Smith said that it was significant that when the products which had the same characteristics as recorded music, such as electronic games, were singled out from the other products, the differential was greater than the average; in the case of electronic games, prices were some 19 to 20 per cent higher in the UK. More generally the finding of a 12 per cent differential between the UK and the USA contrasted with the results of other surveys, possibly of a broader sample of products, where the differential was generally accepted to be greater, for example the 1993 McKinsey Survey and the 1993 BICOL Indices, both of which showed prices in the UK to be of the order of 30 per cent above those in the USA.

Profitability

13.43. HMV said that it had used Extel's MicroEXTAT to look at the returns achieved by other major retailers and compare them with its own. These calculations had been submitted to the MMC. HMV had found that its returns were not out of line with those achieved by other major retailers, either on a return on sales or ROCE basis. HMV could not, therefore, be regarded as making excessive profits either in relation to sales or in relation to capital employed.

13.44. Kingfisher said that the figures which it had submitted to the MMC showed that it did not make excessive profits. A product group with a low stock turnover, such as resulted from a policy of stocking back catalogue product, would expect to produce relatively high gross margins; Woolworths was reducing its back catalogue stock, since its strategy was to offer chart material, not specialist repertoire. On the other hand, a product group with a high stock turnover, such as was represented by chart products, would expect to have a lower gross margin. However, retailers had to hold substantial stocks of chart material if they were to satisfy the demand from customers, and because stockholding costs were high for chart products, Woolworths' margins were lower than they would otherwise be. Kingfisher said that recorded music produced the lowest gross margins within the Entertainment Division of Woolworths and within Woolworths as a whole.

13.45. W H Smith said it did not consider that, however viewed, the profits of W H Smith or Our Price could be regarded as excessive, whether in relation to the costs of acquiring and selling recorded music or in relation to the capital employed. On the contrary, the figures it had submitted to the MMC showed that these retailers had struggled to make any profits at all in the years to 1991, 1992 and 1993. Furthermore, their ROCE had been low by any normal criteria.

Formats

13.46. We asked the companies whether they were choosing the formats of recorded music which they stocked in a way which was designed to increase their profits rather than meet the requirements of consumers, thus reducing consumer choice.

13.47. HMV said that retailers must meet rather than ignore the requirements of consumers if their profits were to increase or be maintained. Furthermore, the practice described could hardly apply to HMV, whose strategy was to appeal to the committed music purchaser and one of the ways it did this was to stock the widest possible range of products (across genres and formats) in its stores. It had also increased the average size of its stores to accommodate wider product ranges. Thus HMV stocked all available sound carriers (vinyl, cassette, CD, MiniDisc, DCC and LaserDisc) subject to the availability of space store-by-store. This was in spite of poor sales performance of the newer formats, DCC and MiniDisc; however, provided that this remained a commercially viable proposition, HMV would continue to stock them in order to provide customers with a full range of formats. HMV also stocked vinyl to a much greater extent than was justified by sales of vinyl units but its stocking policy would continue to be the same as that for the newest formats.

13.48. Overall, there was a considerable availability of all formats in the UK and the availability of non-CD formats was also almost certainly higher in the UK than in any other country. Consumers of recorded music thus had been and still were able to exercise their changing tastes for recorded music formats and hence determine the pattern of sales across formats.

13.49. Kingfisher said that Woolworths would stock any format of recorded music for which there was a market. Consumers' buying habits were monitored by periodic customer surveys and if consumers demonstrated their requirement for a particular format, it was Woolworths' strategy to stock that format. Woolworths had been the last major multiple generalist retailer to stop stocking vinyl LPs, over a period of seven to eight months in 1991 and 1992, and aimed to be the last such retailer to stop stocking vinyl singles.

13.50. Since Woolworths aimed to be *the* retailer for chart material, it had to offer consumers chart titles in all formats; for this reason, it continued to stock vinyl singles even though it made a net trading loss on them. Woolworths had no return rights for vinyl singles with EUK and had to destroy those it did not sell, which amounted to approximately half its vinyl singles stocks. Woolworths believed that if it stopped selling vinyl singles, the record companies would no longer produce this format. As sales of vinyl dwindled, there would come a point where there would be no risk to Woolworths' consumer base if the format were withdrawn; this point had not yet been reached. But by no longer stocking vinyl LPs, Woolworths was now able to stock a larger range of recorded music and improve its stock depth. Improved stock resources meant that consumers were more likely to be able to purchase the album they wanted, when they wanted it.

13.51. If Woolworths were to charge any less for CDs without any reduction in dealer prices, its margins would be eroded completely and it would have to stop selling CDs. That would significantly restrict consumer choice.

13.52. W H Smith pointed to the steady decrease in the number of full-price mainstream releases in vinyl since the early 1980s, which had led to a reduction in demand for that format. Over the same period, there had been a trend towards `entertainment' stores catering for the video and computer games market. These had put pressure on retailers to reallocate the space formerly dedicated to music to those products which were in demand. These two factors had contributed to the demise of the vinyl format. W H Smith had finally removed all vinyl records from its shops in December 1992; in doing so, it had simply been reacting to trends.

13.53. Our Price's policy had been to continue to stock vinyl records unless and until it became uneconomical to do so. In line with that policy, certain Our Price stores continued to stock vinyl. So far as Virgin Retail was concerned, vinyl records had constituted the major part of its core business until 1988 and, until 1991, sales of such records remained material in sales terms. After that, volumes of sales began to fall and record companies reduced discounts in respect of vinyl records while increasing them for CDs. Virgin Retail nevertheless continued to stock vinyl records despite the ever- declining sales.

13.54. It was clear that the decline in vinyl sales had not been caused by any conduct by companies in the W H Smith group. Rather, the decline was predicted by the record companies and had been caused by the withdrawal of classical vinyl records by PolyGram in 1991, a steady reduction in the number of new releases in the vinyl format between 1989 and 1992, and a decline in consumer demand, caused mainly by the emergence of the CD format. The record companies had a key role to play in the demise of vinyl because they had a vested interest in the promotion of CDs, they were in a position to determine the particular format which new releases took and they were able to set the relative prices of the different formats.

Retailers' record charts

13.55. We asked the companies whether consumers were confused or misled by the display of record charts based on a particular retailer's estimate of future sales, rather than the generally accepted charts produced by Gallup and based on record sales throughout the UK. We also asked them whether such charts distorted competition between record companies and retailers.

13.56. HMV said that this issue only applied to its `HMV Top 60 album chart'; with respect to singles, HMV displayed the Gallup chart in its shops. It was important, HMV said, to recognize the highly promotional role of the charts in the music industry; customers used them as a means of finding out what was new or popular and the retailers used them to provide information and to give priority to the merchandising of different product. In addition, HMV believed, first, that only 8 per cent of consumers would buy an album without having heard one of more of its tracks; and secondly, that the wide availability of alternative charts militated against retailer album charts misleading consumers.

13.57. Nor did HMV believe that competition was distorted by the use of its album charts. They were simply another form of promotion, essentially no different from other forms of music promotion such as in-store displays, or from other forms of promotion generally. That they were non-distortionary could be demonstrated by the fact that 59 of the 60 titles in the HMV chart for the week beginning 25 October 1993 achieved positions 1 to 59 in the actual sales of the week in question. Only one title failed to make it to the actual top 60. HMV told us that it did not wish to mislead any consumer, whether or not charts really contributed to consumer purchases, and it was accordingly considering alternative names for its album chart.

13.58. Kingfisher said that Woolworths' charts were based on a number of criteria: Gallup sales data relating to the previous week, Woolworths' sales data applying to the previous week and historical information on artists (indicating how well a particular product was likely to sell). These charts did not confuse or mislead consumers, but on the contrary were of positive benefit to them. As the Gallup singles chart was only released each Sunday night, if Woolworths' own chart were not available, consumers would have to wait until Tuesday to have a chart offer available. Woolworths' chart ensured that consumers had a chart offer available on Monday morning. In the case of albums, there was no widely accepted chart available and so Woolworths produced its own as a guide for the public.

13.59. Kingfisher said that Woolworths' own charts were of benefit to the consumer, because they could be used to locate products within the stores and they ensured high levels of record availability-as units were sold, they were automatically reordered for next day delivery. Moreover, there was little difference between Gallup's and Woolworths' own charts; the important point was that Woolworths had a chart available on Monday morning.

13.60. W H Smith pointed to the different policies adopted by W H Smith, Our Price and Virgin Retail with respect to in-store charts. So far as W H Smith was concerned, because it was catering for the occasional record buyer for whom the charts were generally of little interest, it produced its own album `Hit Lists' based partly on the Gallup charts, partly on the expected sales of new releases and partly on the tastes and preferences of customers. New entries on the lists were clearly identified as being based on expected sales through W H Smith stores. Consequently, there ought to be no confusion in the minds of customers that the store compiled its own album hit lists or that they were not solely based on previous weeks' sales.

13.61. Our Price displayed the Gallup singles chart in its stores and in addition compiled and displayed its own in-store `Top 40' album chart based on an analysis of its own customer profile. Virgin Retail also displayed a printed version of the Gallup singles chart in all its outlets and also displayed its own album chart, compiled by reference to its stores' sales for the previous week and therefore directly reflecting the tastes of its customers.

13.62. W H Smith said it understood that all the major retailers produced their own in-store album charts and it did not believe such charts confused or misled the customer. In the case of W H Smith and Our Price, the album charts were in a distinct format and bore the relevant company's logo; there was no reference to Gallup; and they had a different title or designation to the Gallup charts. In any case, the Gallup album chart was not widely published and was not well recognized by the public. Finally, as promotional tools, the in-store charts stimulated competition between retailers.

Complaints

13.63. We had put to the companies a number of complaints from consumers and small independent record companies. To the extent that the matters raised by these complaints have not already been covered above, the companies' responses are summarized below.

Consumers

13.64. Responding to the charge that the larger retail chains such as W H Smith and HMV charged higher prices than some smaller retailers, even though they must be obtaining larger discounts, HMV said that it was not aware of any research which substantiated this claim. Overall, prices varied too much for any such conclusion to be drawn. On high-volume chart product, however, HMV believed the major chains were always at the forefront of discounting.

13.65. As to the question whether HMV should be able to offer the consumer some of the benefits of its vertical integration with EMI, HMV said that while both HMV and EMI had the same ultimate parent, trade between them was conducted entirely on an arm's length basis. It was THORN EMI's view that neither company would benefit from operating on another basis. There were accordingly no special savings available to be passed on to consumers.

13.66. Kingfisher did not accept that the large retail chains charged higher prices while failing to pass on larger discounts to customers. This had been shown by the MMC's own BMRB survey, where a high proportion of the pre-selected titles on CD were found to be retailing by specialists at higher average prices than those charged by multiples. Moreover, many independent retailers received free singles from record companies which they could then sell at whatever price they chose, sometimes at prices as low as 99p, at other times at full price. As described above, Woolworths' `Street Value' strategy was always to be the lowest or as low as any other retailer.

13.67. W H Smith said it did not accept that the larger retail chains must be failing to pass on larger discounts to customers. The economics of the larger retail chains gave rise to higher costs compared with those borne by smaller retailers and these had to be taken into account when the relevant store or company set its retail prices. Such costs included those arising from a larger range and volume of stock, the increased rent and rates of prime location retail space and its associated fittings, and the additional facilities expected by customers.

13.68. Responding to the charge that Sony `Nice Price' CDs should be cheaper than the £9.99 charged in Our Price stores, W H Smith said that the £9.99 price was neither surprising nor controversial, since each retailer had to decide the prices which were appropriate for each product title and those in respect of which a higher or lower margin would be made.

Small independent record companies

13.69. In response to the charge that the major retail stores dominated the market and should be broken up in order to remove their dominance and encourage price competition, the companies maintained that price competition was as fierce in the UK as it was in other, less concentrated, markets. Since retail prices were higher in many markets where concentration was lower, there was no obvious connection between concentration and price levels. HMV pointed to the low barriers to entry into record retailing, both by traditional outlets and by foreign music retailers. W H Smith said that the major retailers did not dominate the record retail market; that market, and in particular the price of recorded music, was predominantly influenced by the record companies. Price competition existed at all levels amongst retailers, and major retailers and independents were equally keen and well placed to compete on prices.

13.70. In response to the allegation that the retailers' insistence on substantial margins had sometimes led to a conflict of interest between the small record company and the retailer, HMV said that it stocked a wide range of back catalogue which was offered to it by record companies at a vast range of dealer prices. Its selling prices were always set on the dealer price, taking account of file, and additional, discounts. The complaint was therefore not applicable to HMV. Kingfisher said that Woolworths always passed on all discounts it received from record companies in promotions to its customers. The low stock turnover of catalogue product meant that the associated stocking costs were high.

13.71. The companies responded to a complaint that discounting policies inaugurated by record companies had generally proved unsuccessful because the discount was not passed on by the major retailers to the customers-an example had been Warner's discounting campaign some years ago. HMV said that the Warner campaign had been some time ago. These days, customers always benefited from discounts. HMV had increased the frequency of its price campaigns and sales in the last several years precisely because such discounting campaigns were successful. Kingfisher said that EUK always endeavoured to encourage suppliers to reduce cost prices to enable EUK ultimately to pass those savings on, to the benefit of EUK's customers and the market as a whole. W H Smith said that downward structural changes in dealer prices had rarely been introduced by record companies. Furthermore, where increased discounts had been adopted on particular titles, its group companies had passed on all the benefit to the customer. So far as the Warner initiative was concerned, those companies had followed Warner by reducing their retail prices accordingly. However, when other retailers did not do so, Warner had increased its dealer prices again, returning them to their earlier levels.

13.72. Finally, the companies responded to the charge of collusion between themselves and the large record companies, to the detriment of small record companies and small retailers. The companies said that in their experience no such state of affairs existed. HMV said that it was legitimate and to be expected that record companies and retailers should have the common objective of selling recordings to customers. But the process of negotiation of trade terms was a wholly adversarial one, in which each party sought to maximize its negotiating position. It was in the companies' interests to have as many strong suppliers as possible and the modest profitability at both record company and retailer level was an indication that a balance was being struck. Kingfisher said that Woolworths co-operated with record companies on advertising and promotions, but did not, as many independent retailers did, receive free promotional goods. W H Smith said that the large retailers did not have a commanding position and could not insist on being granted large discounts and other benefits. On the contrary, it was the record companies which determined the terms. Moreover, they did not make sufficient profit to be able to choose whether or not to pass on discounts. Smaller retailers received benefits which enabled them to compete effectively, particularly having regard to their lower cost base.

Other retailers

13.73. Responding to a questionnaire we had sent it, Boots The Chemists Ltd (BTC) said that it did not agree with the public perception that the recorded music industry was highly profitable. From a retail perspective margins were typically low. Probably only in the buoyant 1980s had there been sufficient volume to make up for the low margins, and in that period the market was relatively profitable.

13.74. BTC considered that the only way in which the recorded music market could become more profitable was through greater efficiency, ie creating more sales through more effective artist development.

13.75. Music Discount Centre, an independent classical music specialist retailer with six shops, all in London, said that it failed to understand why the music industry had been singled out for investigation by the NHC, particularly since the perfume industry had been given `a clean bill of health' by the MMC.

13.76. T R Services Inc (Tower) made two general observations. First, the fee charged by the MCPS for importation of parallel recordings, to account for royalties, was unnecessary, as royalties were paid at source. Secondly, the negotiation of price on purchase volume allowed record companies to force smaller retailers out of business by selling at a price which they could not match.

Distributors

13.77. The TBD Division of John Menzies (UK) Limited (TBD), which formerly traded under the name Terry Blood Distribution, responded to our Intermediaries questionnaire.

13.78. TBD said that a number of changes had occurred in the recorded music industry during the last five years:

(a) The market shares and financial muscle of the major record companies had increased substantially due to acquisitions and the purchase of two major record companies by Japanese consumer electronic giants (Sony and Matsushita). One of the five majors, PolyGram, was already 75 per cent owned at the start of the five-year period by Philips, the Dutch electronics conglomerate. This meant that three out of the five majors had become controlled by powerful hardware producers which had thus obtained a dominant influence, not only over sales of music product, but also over the format in which it was sold.

(b) A corresponding increase had occurred in the dominance of the chains in the retail market, with a growth of 20 per cent in the number of outlets owned by specialist chains and a decline of 28 per cent in the number of independent specialist outlets. BPI figures showed that a dominant market share of 56 per cent was now held by W H Smith, Our Price and Woolworths.

(c) The BPI statistics showed that the total number of retail outlets selling recorded music had declined by 13 per cent.

(d) There had been a substantial growth, which was difficult to quantify, in the sales of mail order houses, a significant number of which were controlled by record companies.

(e) The majors had expanded their own operations as prime distributors, in which capacity they offered significantly more favourable terms to the high street chains.

13.79. EMI was vertically integrated through its HMV chain which, according to BPI figures, had expanded its outlets within the last five years by 45 per cent, having previously acquired the Midland-based Revolver chain. Consumers were being offered less choice, because retail sales were increasingly channelled through a limited number of specialist and multiple chains. TBD said that a retailer had the choice of buying recorded music through one of two distribution routes: either direct from a prime distributor or via an independent intermediary. Competition in record distribution had become more intense between, than within, these two channels, and this competition had been active at both price and non-price levels.

13.80. There were clear reasons for the relatively low level of competition within these two distribution channels. The prime distributors were each dealing, by definition, with their own unique products. The independent wholesalers, since they operated on low margins, had little room for price competition amongst themselves. Indeed, due to developments in the distribution sector, there were few independent wholesalers remaining and, largely for historical reasons, they tended to focus on different sectors of the retail market. EUK, for instance, had been set up to service the Woolworths account and this remained its major customer. TBD said that it was in fact the only significant independent wholesaler remaining which serviced the independent specialist retailer.

13.81. TBD suggested that there were grounds for concluding that a complex monopoly situation existed as a result of the major record companies' common approach to: terms of supply, including concentration on sales of largely chart-based product to the chains and amendment of their terms of supply to the disadvantage of the independent wholesalers; pricing policies; and the control of parallel imports.

13.82. TBD considered that:

(a) The policy of the record companies in supporting the chains in preference to the independent specialists had resulted in a restriction in the choice of product. Any retail chain (including John Menzies) would confirm that its interest was in achieving a high turnover in current chart-based titles supported by a high level of record company-backed promotional activity. The decline of the independent specialist, combined with the reduction in the number of smaller record companies and independent wholesalers, meant that it would become increasingly difficult for the public to obtain specialist and back catalogue recordings.

(b) The decline of the independent specialists also resulted in a reduction of choice in recorded music. The BPI figures showed that there had been a fall in the total number of outlets selling recorded music over the past five years of 13 per cent. This principally affected members of the public located outside the larger towns where the chains predominated.

(c) The high prevailing prices for recorded music were clearly against the public interest.

13.83. Pinnacle, a division of Lambourne Productions Ltd, said that it acted as an independent distribution company on behalf of a large number of independent labels in the UK. It observed that, as the five major record companies distributed their own records, there was little competition between them and the independent distribution companies except for third party labels. Pinnacle thought that whilst overall UK record sales might not show further dramatic growth, new entertainment products and new formats would ensure that the public continued to view music as an exciting and important entertainment medium, and that the influence of independent artists and labels would continue to grow.

Record clubs

13.84. BCA (a partnership owned as to 50 per cent by Bertelsmann Books and Magazines Ltd, and as to the other 50 per cent by Reed International Books Ltd) said that it operated a club called Music Direct. It considered that record (or, as it preferred to term them, music) clubs were complementary to the retail music business, by providing an in-house service for those customers who either did not have a convenient music retail outlet or found the environment of music retailers uncomfortable. Some clubs also offered products which often were not available in their local retail outlets.

13.85. Britannia is owned by Polygram. It said that during the past 25 years it had pioneered the development of record clubs in the highly diversified, competitive and dynamic UK market for recorded music. Competition in this market operated at a number of different levels, all of which had a symbiotic relationship with one another, and which ranged from book clubs, record clubs and direct marketing sales through to more traditional retail outlets.

13.86. Britannia considered that the level of activity of the traditional catalogue mail order houses in selling music had probably remained fairly constant, as had that of `own compilation' specialists such as Reader's Digest. Clearly, the fastest growing and most competitive area in direct mail sales was to be found in record clubs. Britannia had doubled its market share during the last five years from 4 to 8 per cent of the total market. In addition, BCA had launched its own music clubs; Odhams and Barclaycard had launched a CD club; and a number of smaller players such as Crescent Direct had also appeared. In 1993 two new big players had appeared on the scene: Great Universal Stores (GUS) under the name of Entertainment Direct, and EUK (owned by Kingfisher plc) under the name of Titles Direct. Both were already considerable players in the industry, EUK mainly as a supplier to Woolworths and GUS through its mail order catalogues.

13.87. Britannia said it was clear that many customers found direct mail a convenient service, particularly those who were too busy, or who were not inclined, to shop, and those who appreciated the guidance on repertoire that direct marketers were able to make by recommending products. The majority of direct mail operators also offered credit terms to their customers which allowed them to satisfy themselves that the product met their expectations before they made payment. Britannia expected an even more competitive market to emerge in the next five years, not just between record clubs and other providers of recorded music but between them and other entertainment and leisure suppliers.

13.88. Britannia also noted the emergence of at least three new formats: CD-I, DCC and Mini-Disc. Exploitation of new technology by record clubs, however, was only possible some years after the launch of new formats, as these required a `critical mass' in home ownership of the requisite hardware to develop before they could become economic.

13.89. Reader's Digest said that direct mail sales in the UK recorded music market appealed to people who typically were older than the regular purchaser through record stores, or who did not generally purchase through such outlets. People belonged to record clubs because they were attracted by the selection of music they offered and by their convenience.