

4 Conclusions: Hi-fi systems

Contents

	<i>Page</i>
Background	173
The market	175
The product	175
Market size and definition	176
Suppliers	176
Wholesalers	181
Diverters	181
Warehouse clubs	181
Retailer buying groups	182
Retailers	183
Rental supply	184
Nature of competition in the market	185
Forms of competition	185
Extent of competition	186
Consumer behaviour	186
Market entry	188
Suppliers	188
Retailers	188
Profitability	189
Pressures on prices	190
Price trends	190
International comparisons	191
Overview of competition	191
Evidence relating to prices	192
Sources	192
Issues	193
Discussions between suppliers and retailers on prices	194
Recommendation of retail prices	194
Suppliers' terms to retailers	195
Margin maintenance	195
Margin support	196
Advertising and promotion support	196
Retrospective volume-related discounts	197
Variations in terms	198
Non-price offers	198
Other special offers	198
Pressure by suppliers on retailers' prices	199
Retailers' complaints about price-cutting, and suppliers' responses to them	199
Mail order recommended prices	200
Retail transaction price distributions	201
Survey of small retailers	201
Multiple retailers questionnaire	202
Observations on suppliers' behaviour	202
Evidence relating to withholding of supply	204
Sources	204
Issues	204

Criteria used to select dealers	205
Extent of withholding of supply	209
Observations on suppliers' behaviour	210
The monopoly situations	213
Findings on a scale monopoly situation	213
Suppliers	213
Acquisition of goods by retailers	213
Findings on complex monopoly situations	214
First complex monopoly situation	216
Views of parties on the first complex monopoly situation	216
(a) Suppliers	216
(b) CIH	217
(c) Retailers	217
Conclusions on first complex monopoly situation	218
Second complex monopoly situation	221
Views of parties on second complex monopoly situation	221
(a) Suppliers	222
(b) Retailers	222
Conclusions on second complex monopoly situation	222
Public interest issues	224
Effects of the practices in relation to prices	224
Variation in retail prices	224
Association between RRP and transaction prices	225
Influence of RRP on transaction prices	229
Influence of RRP on displayed prices	230
Influence of the larger retailers on RRP	231
Non-price competition	231
Retailers' and suppliers' margins	231
Misleading consumers	233
Innovation in retailing	233
Pricing practices of CIH and its local groups	233
Public interest findings on influence on dealers' selling prices	234
Effects of the practices relating to withholding of supplies	237
Multiple retailers	237
Small retailers	237
Wholesalers	238
Retailer buying groups	238
Warehouse clubs	238
Sales through mail order	239
Sales promotion incentive voucher schemes	239
CIH and its local groups	240
Public interest findings on withholding supply	240
Warehouse clubs	241
Small retailers	242
CIH and its local groups	243
Public interest findings on scale monopoly situation	243
Summary of findings	243
Recommendations	244
Influence on dealers' selling prices	244
Resale Prices Act	248
Withholding supply	248
Effects of EC law on selective distribution	250
Suppliers' and dealers' views on remedies	253
Overview of recommendations	254

Background

4.1. On 27 April 1995 the DGFT referred to us the supply in the UK otherwise than by retail sale or hire of hi-fi systems. Our terms of reference (see Appendix 6.1) require us to investigate and report on the questions whether a monopoly situation exists in relation to such supply and, if so:

- (a) by virtue of which provisions of sections 6 to 8 of the FTA that monopoly situation is taken to exist;
- (b) in favour of what person or persons that monopoly situation exists; and
- (c) whether any action or omission on the part of that person or those persons in respect of either of the matters specified in paragraph 3 of our terms of reference operates, or may be expected to operate, against the public interest.

4.2. The matters specified in paragraph 3 of our terms of reference are:

- (a) steps taken, by recommending or suggesting prices to be charged by dealers, or otherwise, to influence the prices at which dealers resell hi-fi systems; and
- (b) withholding supplies of hi-fi systems from dealers.

The fact that we are limited to looking at these two specific matters distinguishes our inquiry from a full public interest monopoly reference and means that our report does not reach comprehensive findings about all aspects of competition in the UK hi-fi system market.

4.3. At the same time as making this reference the DGFT made separate references on three other 'brown' goods, namely televisions, VCRs and camcorders. (We refer to all four goods as the 'reference brown goods'.) He also made separate references on four 'white' goods, namely washing machines, tumble driers, dishwashers and cold food storage equipment ('the reference white goods'). The scope of all these references is the same as that set out in paragraphs 4.1 and 4.2. Since these are eight separate references, we are required to reach separate conclusions on each. The conclusions on each of the reference brown goods are in this volume. Much of the supporting material for these conclusions is common to all of them. Hence, to avoid repetition, this material has been consolidated into a single set of chapters, the text of which relates to all four reference brown goods unless otherwise specifically stated. Our conclusions on each of the four reference white goods are in a separate report.

4.4. In his press release announcing the references, the DGFT said:

Our information indicates that some manufacturers, accounting for well over 25 per cent of the supply of the specified goods in the UK, have been engaging in practices designed to sustain retail price levels. These include refusing to supply to retailers who sold the goods below the manufacturers' recommended retail price (MRRP) and outlets such as discount warehouse clubs, which typically sought to sell at 15 to 20 per cent below MRRP. Normally a supplier is free to decide with whom he will deal and on what terms but that freedom should not be used to restrict competition unduly at retail level. It will be for the MMC to determine whether there is any justification for restrictive policies which, on the face of it, lead to higher prices in the shops.

4.5. Our terms of reference refer to 'dealer' as defined in section 24(1) of the RPA, namely a person carrying on a business of selling goods, whether by wholesale or by retail. We use the term dealer in that sense in this report. Where we intend to refer only to retailers or only to wholesalers (see paragraph 4.36) we describe them as such.

4.6. We use the term 'supplier' to mean a person carrying on a business of selling hi-fi systems other than a business in which these goods are sold primarily by retail.

4.7. We use the term 'RRP' to refer to any retail price which a supplier suggests or recommends that dealers (other than mail order companies)¹ charge, advertise or display. Suppliers themselves use a wide

¹We use this name to designate only those mail order companies that sell through agents.

variety of different terms for such prices, including MRRP, 'manufacturer's retail price', 'manufacturer's maximum recommended retail price' and 'suggested selling price'.

4.8. Our terms of reference require us to investigate whether a monopoly situation exists in relation to supply in the UK of hi-fi systems 'otherwise than by retail sale or hire'. We take this to mean supply to retailers, other dealers and rental companies and to exclude supply by retailers and rental companies to consumers and other end-users. However, if we conclude that a monopoly situation exists, we are also required to consider whether any steps taken, by setting RRP's or otherwise, to influence the prices at which dealers resell hi-fi systems operates or might be expected to operate against the public interest. It follows from this requirement that we must necessarily look at retailers' selling prices in order to assess the influence of RRP's on them. Thus, although supply to consumers is outside our remit, the prices charged to consumers are central to our inquiry.

4.9. In the remainder of this chapter we describe the UK hi-fi system market; then the evidence about the practices of suppliers and retailers in the setting of prices and the withholding of supply; we go on to examine the evidence regarding, and reach conclusions on, the monopoly situations; we then turn to our public interest findings on the two matters specified in our terms of reference; and we conclude with our recommendations.

The market

The product

4.10. Our terms of reference say that a 'hi-fi system' means a system (whether or not it includes a radio receiver):

- (a) which is designed when connected to an electricity supply but without otherwise being linked to apparatus not forming part of the system, to reproduce sounds recorded on both:
 - (i) compact or vinyl discs or both; and
 - (ii) digital or analogue tapes or both; and
- (b) which is intended primarily for the use of consumers within the meaning of section 137 of the Act, but does not include a system:
- (c) which is designed to reproduce recorded visual images; or
- (d) which is designed to be carried about easily while being used; or
- (e) which is designed for use in a motor vehicle.

'System' means a machine or a group of machines sold as a single package.

4.11. This definition of 'system' implies an important qualification of the scope of our inquiry. It means that the components of hi-fi systems, for example amplifiers, tuners, cassette decks and compact disc (CD) players, which are commonly sold separately, and bought in large quantities by consumers, are not addressed by us at all. The provision in paragraph 4.10(d) is also an important qualification, since it excludes from our inquiry all portable models, sold in large quantities. These qualifications bear on the question of market definition (see paragraph 4.19).

4.12. Hi-fi systems (commonly called 'audio systems' in the trade) fall into three categories of size: micro, mini and midi. A micro system usually incorporates a single tape deck, compact speakers, a relatively low output amplifier, a limited function CD player and a radio tuner. We were told that micro systems are the fastest-growing part of the market. Mini systems are larger and usually offer greater sound

output, but rarely include a record turntable. Midi systems are physically the largest; they often include a record turntable, and other features such as two tape decks, or a multi-play CD deck, or both.

4.13. Retail prices of hi-fi systems cover a wide range, reflecting size and features. Popular models of well-known brands are broadly from £200 to £500, with own-label and secondary brands rather less; the average unit value was about £260 in 1995. Systems with higher specifications can cost £800 to £900, but sometimes much more.

4.14. We were told that most models would be on the market for between one and two years. Then they would be replaced: the successors would be restyled, incorporating such technical changes as were appropriate to their price level.

Market size and definition

4.15. Because our inquiry is limited to two 'matters' (see paragraph 4.2) we are concerned only with the supply of new (or second-hand) hi-fi systems, and not with supply by (as distinct from to) rental companies. In 1995 about 2 million new hi-fi systems were sold in the UK. Their total retail sales value, including VAT, was about £520 million. There has been a steady growth in volume since 1992, which marked the low point of a decline from the peak of 1988.

4.16. Given the level of ownership, the purchase of new equipment will in part reflect the need to replace a system which has reached the end of its useful life. (We were told that the average length of life of a system was about ten years.) In many cases, however, the purchase may be made to secure a better system, or to add to the quality or amount of sound reproduction equipment in the home. In consequence, most purchases are likely to be postponable, and few would be urgent.

4.17. According to a report published in April 1995 by Market Assessment Publications Ltd, about 60 per cent of all households in the UK had at least one hi-fi system and many had more than one.

4.18. Because of technical changes in recent years it is reasonable to think that virtually all the hi-fi systems in domestic use will have been purchased new by the users. (We took it, as a corollary, that we could disregard the second-hand market.)

4.19. We are required to look at the market for hi-fi systems as they are defined (see paragraph 4.10) in our terms of reference. These terms impose two constraints when we consider to what extent the reference market coincides with what, for purposes of economic analysis, constitutes a separate market. First, we are not required to consider assemblies of separate components (which we understand will be regarded by at least some consumers as readily substitutable for ready-made hi-fi systems). Second, we cannot take account of equipment 'designed to be carried about easily while being used' (which may be used chiefly in the home, where it could be a direct substitute for models of micro hi-fi systems). Hence we do not think that hi-fi systems, as defined for this inquiry, can reasonably be regarded as forming a distinct economic market. However, we do not believe that this affects our analysis of the two matters referred to us, and none of the suppliers suggested otherwise.

4.20. We were told by some suppliers that the hi-fi system market is segmented into low-price, mid-market and premium models. We recognize that for business purposes it may be convenient for the industry to segment the market in this way. But we do not believe that the segments represent distinct economic markets that we should consider in the context of the two matters referred to us.

Suppliers

4.21. The suppliers of hi-fi systems with UK market shares of more than 1 per cent by value in 1995 were:

- (a) Aiwa, which supplies the Aiwa brand; it is owned by Aiwa, in which the Sony Corporation is the majority shareholder;

- (b) Sony, which supplies the Sony brand; it, too, is owned by Sony Corporation, but we were told that it operates wholly independently from Aiwa;
- (c) JVC, which supplies the JVC brand; it is owned by Victor, in which Matsushita is the majority shareholder;
- (d) Panasonic, which supplies the Panasonic and Technics brands; it, too, is owned by Matsushita, but we were told that it operates wholly independently from JVC;
- (e) Kenwood Electronics UK Ltd (Kenwood), which supplies the Kenwood brand;
- (f) Pioneer, which supplies the Pioneer brand;
- (g) Alba, which supplies the Alba and Bush brands;
- (h) Sanyo, which supplies the Sanyo brand;
- (i) Hayden Laboratories Ltd (Denon), which supplies the Denon brand;
- (j) Samsung, which supplies the Samsung brand;
- (k) Amstrad, which supplies the Amstrad brand;
- (l) Sharp, which supplies the Sharp brand;
- (m) Philips, which supplies the Philips, Marantz and Pye brands; in Table 4.1 we have grouped the UK hi-fi system sales of the Grundig brand under Philips NV because until 31 December 1996 that company effectively controlled Grundig AG, which owns the Grundig brand (see paragraph 8.30);
- (n) Akai, which supplies the Akai brand; and
- (o) B&O, which supplies the B&O brand.

4.22. Of these 15 suppliers only two, Aiwa and Amstrad, manufacture hi-fi systems in the UK but JVC is supplied by Victor from its UK factory. These and the other suppliers named in paragraph 4.21 manufacture or procure hi-fi systems for the UK market in several countries, including China, Japan, Taiwan, South Korea, Malaysia, Singapore, France, Germany, Spain and Denmark.

4.23. There have not been many changes in the structure of the hi-fi system supply industry in recent years, though a minor supplier, Nokia, withdrew from the UK market in August 1996, selling the brand to a Canadian company, Semi-Tech (Global) Ltd, which continues to supply it in the UK through its subsidiary, Akai.

4.24. In addition to brands owned by suppliers, hi-fi systems are also sold under brand names owned by, or licensed to, retailers. For these brands, retailers undertake many of the functions normally undertaken by suppliers, for example they determine the features of each model and the quantities in which it is manufactured or imported.

4.25. In relation to the two matters we are investigating:

- (a) retailers choose the manufacturers of the products sold under their own brand names and can purchase elsewhere if they do not like the prices offered by their existing manufacturer; the influence of manufacturers on the retail prices of brands owned by retailers is therefore limited; and
- (b) manufacturers produce own-label models on the basis of a contract with the retailer which owns the brand, and the question of the withholding of supplies does not arise.

4.26. We did not identify any brands of hi-fi systems supplied exclusively to particular retailers. Exclusive brands must be distinguished from exclusive models. With the latter, a particular model is supplied only to one dealer but other models of the same brand are supplied to other dealers. For convenience, in the remainder of this report we refer to both retailer-owned brands and exclusive brands (but not exclusive models) as retailers' 'own-label' brands.

4.27. Retailers' own-label brands had about 10 per cent share of the UK hi-fi system market by value in 1995. Comet's Goodmans and Proline together had 5.2 per cent by value and Dixons' Matsui, Logik and Saisho together had 4.2 per cent. (But their shares, measured by numbers of units, were much greater: about 10 per cent in both cases.) Matsui, Logik and Saisho accounted for nearly 20 per cent by value of Dixons' hi-fi system sales; and Goodmans and Proline for about 20 per cent of those of Comet.

4.28. Under our terms of reference we are concerned with supply other than by retail sale or hire. However, consistent and reliable figures for the value of suppliers' sales to dealers are not available in all cases. We therefore measured the market shares of suppliers in terms of the retail sales of their products, which were the best available data. We do not believe that the use of retail sales as a proxy has any important consequences for the matters we are investigating. Because the range of hi-fi system retail prices is quite wide we preferred to measure the market by the value of sales rather than by the numbers of units sold. The data we used, provided by GfK, are described in paragraphs 7.128 to 7.135.

4.29. At its simplest the supply chain for hi-fi systems consists of a manufacturer selling to a retailer who in turn sells to a consumer. In practice the chain can be more complex. For example, some overseas manufacturers of hi-fi systems sell to importing suppliers in the UK, which sell to other suppliers, which sell to retailers. And many hi-fi system manufacturers sell to CIH, a retailer buying group, which in turn sells to retailers (see paragraphs 4.45 to 4.50).

4.30. We considered whether to use manufacturers' market shares as the basis for our finding on whether a monopoly situation existed. We decided that this would not be the most appropriate measure for our purpose as some manufacturers sell hi-fi systems to other suppliers which in turn sell on these products, under their own brand names, to retailers and other dealers. It seemed probable from the outset that it was these suppliers (rather than the manufacturers) that decided the terms on which dealers were supplied, and none of the evidence put to us suggested otherwise. We also had to exclude wholesalers and retailer buying groups from our market share figures because they purchase from manufacturers and other suppliers and could not be included without double counting.

4.31. In view of these complexities in the supply chain, we decided to use brands as the basis for determining market shares, aggregating the sales of those brands which were owned by the same supplier. But, as we have already noted, some retailers have own-label brands. Although such retailers are not suppliers, we concluded that the market share of own-label brands was not sufficient to affect our findings about the existence of monopoly situations.

4.32. The shares in excess of 1 per cent of retail sales by value in the UK hi-fi system market in 1993, 1994 and 1995 of suppliers and retailers' own-label brands are shown (in 1995 order) in Table 4.1 (and in greater detail in Table 7.4). The shares in excess of 5 per cent are shown in Figure 4.1.

TABLE 4.1 Market shares in excess of 1 per cent of UK hi-fi system retail sales by value, 1993 to 1995: suppliers and retailers' own-label brands

	<i>per cent</i>		
	<i>1993</i>	<i>1994</i>	<i>1995</i>
Sony Corporation	26.6	29.7	33.1
Of which:			
Aiwa	10.9	16.9	21.7
Sony	15.7	12.8	11.4
Matsushita	19.1	19.2	17.9
Of which:			
JVC	10.8	10.9	9.9
Panasonic (inc Technics)	8.3	8.3	8.1
Kenwood	11.4	9.0	8.2
Pioneer	5.1	4.3	6.0
Alba	6.5	6.2	5.5
Goodmans	4.6	4.2	5.2
Matsui	1.4	3.1	4.2
Sanyo	3.8	3.0	2.6
Denon	2.3	1.8	2.1
Samsung	1.8	1.4	2.1
Sharp	3.0	2.6	1.8
Philips NV	4.7	3.4	1.7
Amstrad	1.7	1.7	1.6
Akai	2.9	2.3	1.2
B&O	0.9	1.0	1.2
Others*	4.3	7.0	5.7
Total	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
Total sales (£m)	454.0	520.0	521.6
Average unit value (£)	283	267	257

Source: GfK, suppliers, and MMC.

*All less than 1 per cent each.

Note: All figures are rounded.

4.33. The hi-fi system brands with UK market shares by value in 1995 of 5 per cent or more are shown for 1993 to 1995 (in 1995 order) in Table 4.2 and Figure 4.2. A full list of brands is given in Table 7.4.

TABLE 4.2 Principal brands' shares of UK hi-fi system retail sales in excess of 5 per cent by value, 1993 to 1995

	<i>per cent</i>		
	<i>1993</i>	<i>1994</i>	<i>1995</i>
Aiwa	10.9	16.9	21.7
Sony	15.7	12.8	11.4
JVC	10.8	10.9	9.9
Kenwood	11.4	9.0	8.2
Panasonic (inc Technics)	8.3	8.3	8.1
Pioneer	5.1	4.3	6.0
Alba	6.5	6.2	5.5
Goodmans	4.6	4.2	5.2

Source: MMC, based on GfK data of retail sales.

Note: All figures are rounded.

4.34. In 1995 the four largest suppliers of hi-fi systems had 65.2 per cent of the UK market; a further 10 had more than 1 per cent each; and we identified about 25 with lesser shares.

FIGURE 4.1

Shares by value of total hi-fi system market: suppliers and retailers' own-label brands, 1995

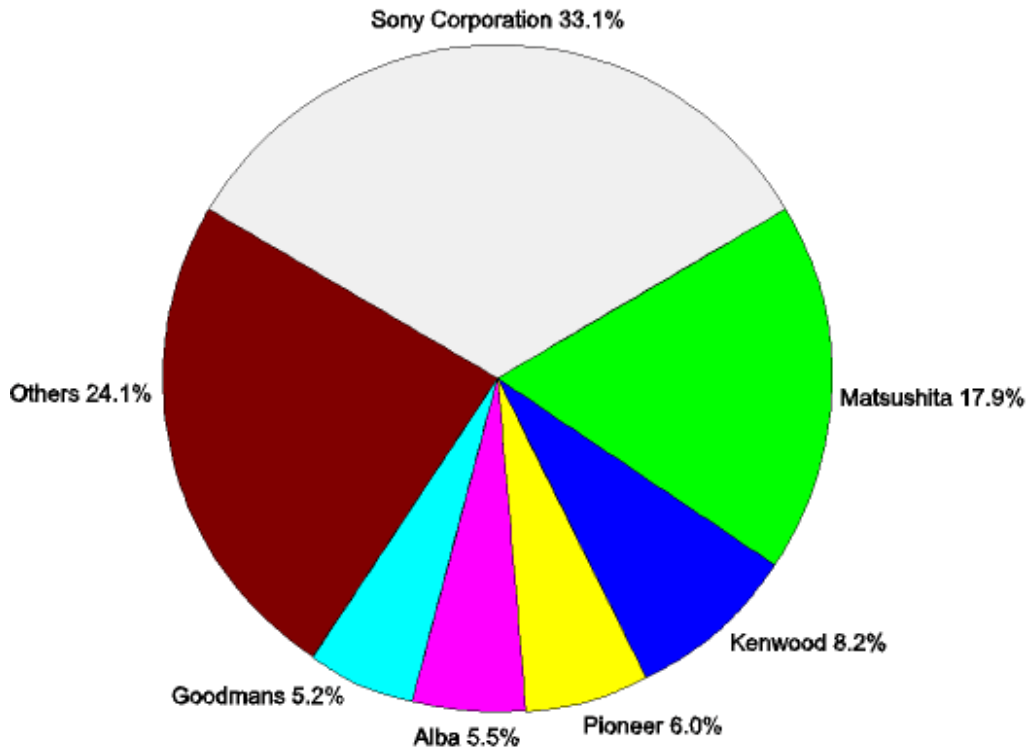
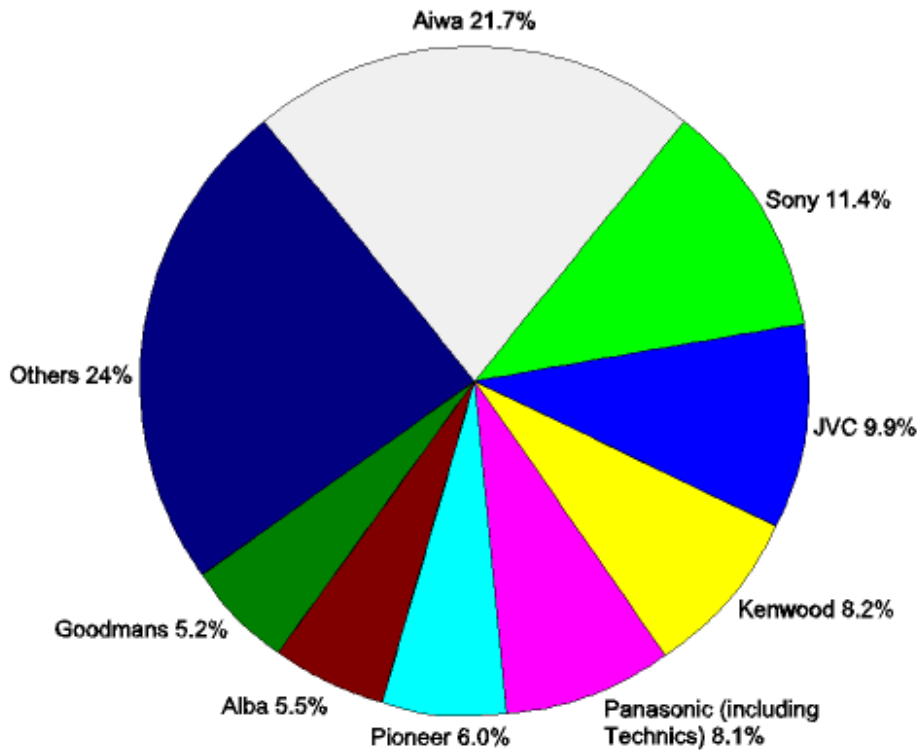


FIGURE 4.2

Principal brands' shares by value of total hi-fi system market, 1995



4.35. Most of the larger suppliers of hi-fi systems are also important suppliers of brown goods generally and of the other reference brown goods. In particular, Sony Corporation (through Sony and Aiwa) and Matsushita (through JVC and Panasonic) are two of the three leading suppliers of televisions, VCRs, camcorders and hi-fi systems. Dealers also normally stock hi-fi systems alongside other brown goods; hence suppliers and dealers typically deal with one another over a range of brown goods, including some that are not the subject of our concurrent inquiries.

Wholesalers

4.36. For the purposes of our inquiry, a 'wholesaler' is a person, other than a manufacturer or importer, who buys hi-fi systems to hold in stock in the expectation that in the ordinary course of business he will be able to sell them to retailers, or other wholesalers of hi-fi systems. That definition excludes warehouse clubs (see paragraph 4.39) and the greater part of the hi-fi system turnover of CIH (see paragraphs 4.46 to 4.50). Wholesalers do not handle retailers' own-label brands.

4.37. There are many hundreds of wholesalers of electrical goods in the UK but we were able to identify only 11 that supply hi-fi systems (see paragraph 8.101). Apart from CIH none of them is large in hi-fi systems and we saw no evidence to suggest that in 1995 in total (excluding CIH) they accounted for more than 1 per cent of the hi-fi systems purchased by UK retailers. Suppliers' use of wholesalers varies widely: JVC, B&O, Pioneer and Sanyo do not supply wholesalers at all; and Panasonic does not supply hi-fi systems to outlets in Great Britain whose primary business is wholesaling. Philips, on the other hand, sold about 7 per cent of its hi-fi systems through wholesalers in 1995. In Northern Ireland suppliers place markedly greater reliance on wholesalers than in the rest of the UK (Panasonic uses them exclusively). It appears that large retailers may occasionally fall back on wholesalers to meet shortfalls in stock-JLP told us that it did so-but we believe that the bulk of sales by wholesalers are to small retailers whose volumes are deemed by suppliers to be insufficient to justify the costs of direct supply, or who buy from wholesalers occasionally, if asked by customers for goods they do not stock.

Diverters

4.38. A minor source of supply is from 'diverters'. These are firms or individuals who buy up batches of hi-fi systems (and other goods) usually because they are surplus to the requirements of manufacturers, importers or retailers, in the UK and abroad. The diverters sell these goods on to warehouse clubs (see paragraphs 4.39 to 4.44) or dealers which may want them because they have been refused supply through the usual trade channels. A diverter told us that he had supplied one UK warehouse club alone with reference brown goods to the value of over £1 million in 1995, and that all the goods he sold to it carried the manufacturers' guarantees.

Warehouse clubs

4.39. We use the term 'warehouse club' to refer to dealers which operate a membership scheme and sell only to their own members, but which do not restrict membership solely to retailers. The term includes 'cash-and-carry' businesses as well as newer formats which aim for a wider range of members. We understand that warehouse clubs are classified as wholesalers for planning law purposes but they are not only, or even mainly, wholesalers in our terms (see paragraph 4.36) as many of their customers are not retailers or wholesalers. Nor are they all necessarily 'warehouses': several of these stores are little different in their layout from conventional retailers; but others are austere in their fittings and display, and may be housed in extremely large shed-type structures, with the stock on high racks.

4.40. We identified five warehouse club businesses (as defined in paragraph 4.39) operating at the beginning of 1995 which sold domestic electrical goods. Since then one has closed and two have merged. They have only a small share of the UK hi-fi system market but they are of particular interest to us because of the difficulties they have had in securing supplies (see paragraphs 4.351 to 4.357).

4.41. In this context the most important warehouse club is PriceCostco. It is part of a group operating a chain of warehouse clubs in North America, where the concept was first introduced. In 1996 it had five outlets in the UK. Membership is open to businesses and to individuals who fall within specified groups, for example government employees, and individuals employed in health care or education. There is a basic annual fee of £15 for business membership, plus a further £10 for up to six additional members from the same business; individual membership costs £20 a year. Some 70 per cent by value of PriceCostco's turnover is with business customers (broadly defined) and the balance with individual members. It aims to stock a selection of hi-fi systems, but it has been unable to secure direct supply from most of the leading suppliers except Aiwa. Hence it is largely dependent on diverters. Its policy is to sell at low margins, which results in its prices being well below RRP's.

4.42. Next there is Makro. It is a subsidiary of SHV Holdings NV, of Utrecht. Makro does not charge a membership fee but limits its membership to traders and persons with a business identity. It had 27 outlets in 1995, receiving supplies of Aiwa, Sony, JVC, Kenwood, Sharp, Pioneer and Panasonic hi-fi systems, through its associate company Business-to-Business, which acts as its buying agent. It obtains other brands through diverters, if they are available. (Kenwood told us that it did not regard supply to Business-to-Business as supply to Makro.)

4.43. In 1995 two warehouse club businesses were owned by N&P, but only one is now operating, under the name of Trade & Business Warehouse. In 1995 it had 56 outlets, but not all of them stocked hi-fi systems. Membership is open to trade customers (broadly defined, as for Makro) and there is no membership fee. N&P has obtained some direct supplies of hi-fi systems but is also supplied by wholesalers and diverters. N&P's other warehouse club, Cargo Club, opened in 1994 and closed in 1995, shortly after our inquiry began. Its membership criteria were much broader than those for Trade & Business Warehouse and it charged an annual membership fee of £25. It sold some hi-fi systems but, we understand, obtained no direct supplies, except from Aiwa. N&P merged with Booker late in 1996 (see paragraph 4.44).

4.44. Booker is much the largest of the warehouse clubs: in 1995, prior to the merger with N&P, it had 155 outlets. Booker told us that it had not attempted to purchase hi-fi systems direct from manufacturers or importers, but was supplied with them by Bridisco Limited, a large wholesaler. (Bridisco's price list does not refer to RRP's, and we were told that it will supply any creditworthy customer.)

Retailer buying groups

4.45. We identified several retailer buying groups; of these, CIH and the five CIH local groups (see paragraph 4.49) that act as retailer buying groups independently of CIH were of importance to our inquiry.

4.46. CIH is a private limited company, all the shares in which are owned by 21 local groups of electrical goods retailers (henceforward referred to as 'local groups'). CIH is a buying group acting on behalf of about 800 small or medium-sized retailers, each of which is a member of one of the local groups. These local groups, not CIH, decide whether applicant retailers may become members. CIH uses its collective buying power to obtain better terms from suppliers than the retailers could secure individually.

4.47. For most of its hi-fi system business (£3.3 million turnover in 1995), CIH facilitates, and (subject to certain limits) guarantees, payment to suppliers for orders placed on them by individual retailers: the retailer orders direct from the supplier, using CIH headed paper, and the supplier delivers the order direct to the retailer. CIH keeps a record of all such transactions and settles monthly with each supplier, billing individual retailers for the goods they have received. CIH takes title to the goods ordered but it does not handle them physically.

4.48. For the rest of its hi-fi system business (£1.0 million turnover in 1995), CIH buys in bulk from suppliers and resells to individual retailers. For this operation, which it calls 'central stock' but which in effect is wholesaling, CIH takes title and physical possession of the hi-fi systems ordered and is responsible for distributing them to retailers.

4.49. In 1995 five of the local groups purchased goods on behalf of their members. The local groups concerned are Birmingham Combined Independents; CITER (Wales & West); CI(CNS), covering

Cambridgeshire, Norfolk and Suffolk; CI North; and CIR(NI). Like CIH, these local groups take title to the hi-fi systems they purchase for their members.

4.50. Thus CIH and these local groups are suppliers in our terms.

Retailers

4.51. In February 1996 we identified about 5,500 retail businesses concerned with one or more of the eight domestic electrical goods that were the subject of references to us (see Appendix 6.1, paragraph 14). We estimate from the responses to the survey of small retailers (see Appendices 6.3 and 9.1) that about 4,000 of these businesses were small retailers (ie they had fewer than five retail outlets each) which sold hi-fi systems. In addition there were about 60 multiple retailers which sold hi-fi systems (see Table 7.6). An expensive and protracted study would have been needed to arrive at a more precise figure. We did not think this was necessary, given our limited terms of reference.

4.52. There has been extensive restructuring among electrical goods retailers in the UK in the period immediately preceding this inquiry and during its course. Dixons¹ remains the largest, with Comet (owned by Kingfisher) in second place. Three RECs have changed hands: NORWEB, bought in late 1996 by Comet, Manweb, bought by ScottishPower, and Powerhouse, a management buy-out; and one, Powerstore, closed after going into administration in 1996.

4.53. In addition to developments affecting the RECs, the Clydesdale chain closed in 1994 and Rumbelows in March 1995 (it was the third largest electrical goods retailer at the time); and Colorvision went into administration in 1996. Some of the stores owned by companies ceasing to trade were acquired by other electrical retailers.

4.54. In parallel with these developments, we were told by Dixons, quoting data from GfK, that there had been a net decline of over 800 smaller electrical retailers in the period between 1991 and 1995. But it did not say how many of them sold hi-fi systems.

4.55. These various changes are likely to increase the market share of the surviving multiple retailers, so the market share data we record for 1995 should be read against that background. Dixons' share of the hi-fi system market has increased from 20.4 per cent in 1993 to 22.6 per cent in 1995 (paragraph 7.195).

4.56. Recent years have also seen a shift by multiple retailers of electrical goods away from high street to out-of-town locations. It is now common to find several such retailers on a single retail park. Data on trends in the amount of retail floor space, and its allocation between goods, are not available. We were told that some multiples were devoting much of the additional space in their out-of-town stores to relatively new lines such as computers and mobile telephones. But Dixons, as well as developing its Currys out-of-town stores, has also retained a strong high street presence, with many shops specializing in the smaller brown goods.

4.57. Our estimates of retailers' shares of the UK market for hi-fi systems in 1995 are set out in summary in Table 4.3 and Figure 4.3. (More detailed figures are in Table 7.7.) Dixons had 22.6 per cent. It was followed by Comet with about 11.5 per cent, and ScottishPower with 5.3 per cent. Collectively the five mail order companies, GUS, Littlewoods, Empire, Freemans and Grattan (see paragraphs 9.59 to 9.68) had 12.9 per cent and the two catalogue retailers (see paragraphs 9.69 to 9.74) had 5.6 per cent. We estimate that, again collectively, small retailers, ie those with fewer than five retail outlets, accounted for perhaps 19 per cent.

¹Operating under the store names of Dixons, Currys, PC World and The Link.

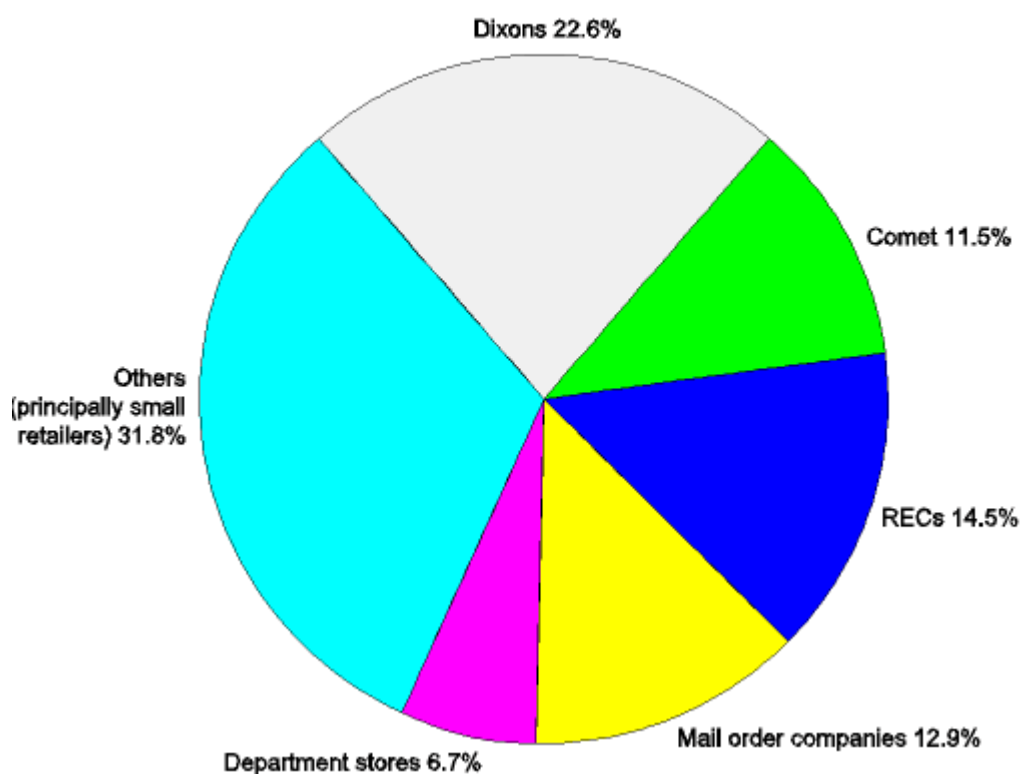
TABLE 4.3 Retailers' shares of UK hi-fi system sales by value, 1995

	1995 %
Dixons	22.6
Comet	11.5
RECs	14.5
Mail order	12.9
Department stores*	6.7
Others (principally small retailers)	31.8

Source: MMC, based on data from GfK and multiple retailers.

*Including Co-operative societies.
Note: All figures are rounded.

FIGURE 4.3
Retailers' shares by value of hi-fi system sales, 1995



Rental supply

4.58. The supply of hi-fi systems to rental companies, or retailers engaged in rental, as distinct from the supply of hi-fi systems by rental to consumers, is within our terms of reference. The fragmentation of the rental market makes it impracticable to establish accurately how many new hi-fi systems are supplied into rental each year, but such evidence as we could obtain suggests that the number was not significant for our purposes.

Nature of competition in the market

4.59. We have examined the way in which competition operates in the hi-fi system market, distinguishing between inter-brand and intra-brand competition, and considered the contention that the market is highly competitive. We deal with these two matters in turn below.

Forms of competition

4.60. Competition occurs both between suppliers and between retailers. Competition between suppliers is by definition inter-brand, but as all retailers do not stock the same brands (indeed, a few, like the Sony Centres, stock only a single brand), competition between them is both inter- and intra-brand.

4.61. Competition between suppliers is conducted at two levels: suppliers try to persuade retailers to stock and sell their hi-fi systems, and they try to persuade consumers to buy them. Important elements of competition between suppliers for retailers' attention and for retail space may involve suppliers in:

- (a) seeking to establish themselves as an essential brand to stock: because of the large number of hi-fi systems on the market each supplier must obtain sufficient retail display space for its own range of models;
- (b) offering their products to retailers at attractive net prices;
- (c) offering margin maintenance (see paragraphs 4.114 to 4.116) to retailers;
- (d) offering a wide range of different models from which retailers can choose (see paragraphs 4.74 and 4.75 for the significance of range stocking);
- (e) offering promotional or other support services, for example point-of-sale material; and
- (f) offering training in new products for retailers' staff.

4.62. Suppliers compete for hi-fi system sales to consumers by putting particular stress on new technical features at attractive prices. Other principal ways in which suppliers may compete for sales to consumers include:

- (a) seeking to establish a strong brand image;
- (b) offering consumers a choice of models with different features;
- (c) financing promotional offers by retailers, for example interest-free credit or free gifts;
- (d) initiating special price promotions, for example by 'sales-out' allowances (see paragraph 4.137); or contributing to promotions initiated by retailers;
- (e) financing retailers' advertisements of their products; and
- (f) advertising the brand on their own account, unrelated to named retailers.

4.63. Retailers may compete by:

- (a) advertising or displaying prices below those charged by their rivals; they may (commonly now) promise to match or beat the price of any competitor; they may advertise to give the impression that they offer keen prices and may be willing to bargain over price with individual customers to close a sale;
- (b) offering consumers the choice of a wide range of models or brands, or both;
- (c) differentiating their product ranges from those of local competitors;

- (d) providing pre-sales service and advice, and an attractive display;
- (e) providing delivery and installation, sometimes at no extra charge;
- (f) offering other non-price benefits (which may be partly financed by the supplier) such as interest-free credit or free gifts;
- (g) offering post-sales servicing; or
- (h) offering extended warranties.

Extent of competition

4.64. It was put to us by many suppliers and retailers that the market for hi-fi systems is highly competitive in both the supply and the retail sectors. It was argued in support of this claim that:

- (a) prices in the market were highly visible, in part as a result of advertising by suppliers and the major retailers, and in part because consumers typically shopped around before buying;
- (b) there were no significant barriers to entry to the UK market for either suppliers or retailers;
- (c) the profitability of suppliers and retailers was low; in recent years four major retailers, Clydesdale, Rumbelows, Powerstore and Colorvision, and many smaller ones had been forced to withdraw from the market;
- (d) suppliers and retailers continued to be under pressure to cut their prices in response to competition from rivals;
- (e) the widespread use of price-matching policies, interest-free credit and other promotional offers was indicative of a highly competitive market;
- (f) prices for hi-fi systems had fallen in real terms over the past decade; and
- (g) prices in the UK were below those in other European countries.

4.65. If the market were as competitive as has been claimed it could be argued that any steps taken by suppliers to influence retail prices and to withhold supply from dealers (the two matters we are required to investigate) would have little effect on the level of retail prices or of consumer choice. However, we have reservations, set out in paragraphs 4.66 to 4.98, about the arguments for the existence of a highly competitive market.

Consumer behaviour

4.66. Dixons told us that in its view customers tended to seek the lowest prices, perhaps visiting four stores, and many suppliers spoke of the UK consumer seeking low-cost products.

4.67. But Sanyo presented a different view. It had commissioned a survey,¹ by SRU, of recent or would-be purchasers' attitudes towards the purchase price of each of the reference brown goods. The survey covered about 500 people who had purchased one or more of these goods in the previous six months, or were planning such a purchase or purchases in the next six months. The survey, conducted in August and September 1995, reported (see paragraph 7.115) that the three most important purchase factors cited by respondents were a 'reputable brand' (26 per cent), a 'competitive, reasonable price' (24 per cent) and 'product features and facilities' (23 per cent).

¹The purchase of certain brown goods in the UK: consumer attitudes and the role of price, SRU Ltd, September 1995.

4.68. Comet drew our attention to a survey of consumer search behaviour, carried out on its behalf, that is of some relevance to hi-fi systems (see paragraph 7.111). A sample of about 1,500 buyers of 'audio-visual and major appliances' at selected Comet, Currys and REC stores were interviewed between April and June 1995. Rather more than 30 per cent of those interviewed said that they did not shop around for these appliances; between about 21 and 35 per cent said that they bought at their normal store but visited one or two others; and rather more than 20 per cent said that they visited four or more stores.

4.69. Sony put to us the results of a telephone survey,¹ that it had commissioned from GfK, of consumers' attitudes to various competition matters in the four reference brown goods markets (see paragraph 7.110). This survey (unlike that of Comet-see paragraph 4.68) covered both actual and prospective purchasers; the panel consisted of 302 individuals aged 16 to 65. Just under 60 per cent of respondents said that they disagreed, and just over 40 per cent said that they agreed, with the statement that 'there is very little real competition between electrical retailers'. About 18 per cent of respondents said that they thought they would visit only one store before buying, and 62 per cent said that they thought they would visit between two and four. 6 per cent of respondents said that they had read *Which?* magazine before buying, and 4.3 per cent said that they had consulted specialist magazines (see paragraph 7.19).

4.70. The differences in the results of the Comet and Sony surveys with respect to shopping around reflect, among other things, the precise nature of the questions asked and the range of goods covered. For instance, the Comet survey did not distinguish between different types of 'appliance' and it cannot be assumed that consumers spend the same amount of time shopping around for one product as they would for another. We note, too, that in the larger stores the sound quality of a hi-fi system can be compared directly with that of many other hi-fi systems, which may well reduce the incentive to spend time in the shops.

4.71. Nor can brand loyalty be ignored: Comet told us that 20 per cent of Sony customers were extremely loyal to the Sony brand (although not all suppliers thought brand loyalty could be relied on). The Sony survey (see paragraph 4.69) asked respondents to rate, on a scale from 0 to 10, the importance to them of the manufacturer's good reputation when they were deciding on a purchase. About 80 per cent of respondents gave a rating of seven or more.

4.72. Those consumers who wish to search systematically will not find their task particularly easy. We have been told by retailers that they try to stock a distinctive range of models in order to distinguish themselves from their competitors. This is understandable, but given the large number of different brands and models on offer it makes the task of comparing the prices of the same model more difficult for the consumer.

4.73. We asked multiple retailers about the range of their stocks in June 1995 (see Table 9.6). Dixons listed 86 hi-fi systems from 13 brands; Comet, 71 from 12; Tempo, a smaller multiple, 93 from 16; and James H Donald (Darvel) Ltd, a multiple with seven outlets, 85 from 19. Even so, these retailers stocked fewer than one-half of the available models.

4.74. In our questionnaire to multiple retailers we asked respondents to name their six best-selling models of hi-fi systems during the second quarter of 1995. Fifteen retailers replied and named between them 66 separate models. If the best-selling models had been the same for each retailer then only six would have been named, and if each retailer had named a different set of six the total would have been 90. The fact that 66 were named indicates a significantly low degree of overlap (see Table 9.6). A similar picture emerges from our price analysis (see Appendix 11.3). Of two of the 12 popular models whose prices we analysed there were no sales by Dixons, the largest retailer. One of these two, and four others, were not sold by Comet, or only in very small quantities. The model not sold by Dixons and Comet was principally sold through 'other retailers'. In one case Dixons had over 70 per cent of the market, with 'other retailers' accounting for virtually all the rest, and thus only very low sales by the remaining outlets. For only a few models were sales recorded as broadly approximating to each channel's average market shares for the 12 hi-fi systems taken together.

¹*Attitudes of consumers to manufacturers' RRP's*, GfK, December 1995.

4.75. Several of the larger retailers have own-label brands or supplier-branded models, or both, that are exclusive to them. According to GfK figures, some 26 per cent of models of hi-fi systems sold in October 1996 were exclusive models or own-label brands (see Table 9.5). This further reduces the scope for intra-brand comparisons. The move of major retailers to out-of-town sites, too, has made it more difficult for consumers to compare prices there with those of high street outlets (though comparisons may be helped where retail parks contain more than one electrical retailer).

4.76. Inter-brand comparisons by consumers are also restricted by the fact that no two models from different suppliers have exactly the same specifications. And although sound quality can be subjectively assessed, most consumers will have no objective means of establishing the intrinsic quality and reliability of different hi-fi systems. Even the small minority (perhaps 10 per cent-see paragraph 4.69) who read consumer magazines will often find the information out of date by the time they come to purchase, or hard to relate to what is on display. Consumers' difficulties will be compounded because they are unlikely to know whether a model has been recently introduced or is coming to the end of its product life. As a result, price apart, and since all the models may appear to be of much the same quality, the majority of consumers will be influenced by experience, brand image and brand loyalty, thus making market entry and penetration more difficult for unknown or weakly-established suppliers of hi-fi systems.

4.77. Consumer comparisons, both inter- and intra-brand, are impeded by the variety of non-price promotional offers available (see paragraphs 4.88 to 4.90). They are hard to evaluate and their effect is to limit the transparency of the market for the consumer.

Market entry

Suppliers

4.78. It is outside our terms of reference to investigate the extent to which over-capacity, sunk costs, economies of scale, and other factors, might inhibit suppliers' entry to the global hi-fi system market. So far as the UK market is concerned we think the brand strength of the established manufacturers is not such as to prevent entry, but it is likely to constrain the ability of a new entrant to achieve a substantial market share. We note that, although there are 40 or so hi-fi system brands competing in the UK market, Aiwa and Sony together had one-third of it in 1995, and another four brands together had a further one-third. But we also note that brands' market shares can change rapidly over relatively short periods (see Table 4.1). Dixons told us that no retailer had space to display all the models available at any one time (see paragraph 4.72); inevitably retailers concentrated on leading brands that were familiar to consumers; so the lesser, unfamiliar, brands must be at a disadvantage.

Retailers

4.79. As far as entry at the retail level is concerned, it might be judged quite easy to set up in a small way, but it is likely to be difficult to grow beyond that level. In part, no doubt, this difficulty reflects problems common to all newly-established small businesses, but in part it may be the result of procurement conditions. More particularly, suppliers require a minimum turnover which may not be within the retailer's capacity (see paragraph 4.166); wholesalers may not be able to offer the brands that the retailer wants (see paragraph 4.37) or at prices as favourable as those obtained by larger competitors; and purchasing through CIH (which passes on to its retailer customers the discounts it secures through buying in bulk) may be ruled out because of the conditions of membership: these require audited accounts for three years as proof of satisfactory trading; many local groups also require a minimum turnover (usually around £75,000-see paragraph 4.187); and some stipulate acceptability to existing members.

4.80. We were told by many suppliers that the electrical goods retail market was much more concentrated in the UK compared both with other European countries and with many other retail markets in the UK. The shape of the UK retail hi-fi system market, namely two leading firms, one twice the size of the other in sales of hi-fi systems, a great many small firms and a diminishing number in between, throws Dixons into prominence. Dixons, however, denied that this amounted to any form of market dominance; it told us that its significance for individual suppliers should not be overstated. Nevertheless several suppliers

expressed unease about the structure of the retail market and what they saw as movement towards even greater concentration.

Profitability

4.81. Companies that manufacture about 95 per cent of the hi-fi systems supplied to the UK market are foreign-owned. We looked at examples of the published accounts of their UK subsidiaries and, in two cases (Aiwa and Sony), the accounts of the parent company (Sony Corporation); and we considered whether to undertake a more detailed investigation of supplier profitability. We decided that it would not assist us in our inquiries for the following reasons:

- (a) One of these suppliers (Aiwa) manufactures hi-fi systems in the UK in addition to supplying hi-fi systems that it imports from fellow subsidiaries. Other suppliers obtain hi-fi systems (and other brown goods, including non-reference items) wholly from outside the UK. In either case the statutory accounts of such suppliers did not distinguish between hi-fi systems and other products. Arbitrary allocations of overheads and operating assets would be required to estimate hi-fi system profitability.
- (b) Because of the effects of intra-group transactions, including transfer pricing, the accounts of the UK subsidiaries do not permit the overall profitability of supplying hi-fi systems to the UK market to be identified.
- (c) The published accounts of Sony Corporation gave no indication of the contribution of the UK market to overall financial performance nor of the contribution of hi-fi systems within the UK market (nor, for that matter, of the overall profitability of supplying hi-fi systems world-wide).
- (d) We would not be able to interpret any financial information we did obtain without knowing the parent company's strategic objectives for the UK market within its overall portfolio of markets.

4.82. These problems of assessing profitability apply also to the information, given to us by Sony, that in the 12 months to 31 March in each of the years 1992 to 1995 the average net profit margins of UK consumer electronics firms had not exceeded 1.05 per cent (and in two of those years net losses had been incurred). Moreover, these data do not specifically relate to reference brown goods, still less to hi-fi systems. Most of the considerations in paragraph 4.81 do not apply in the case of the two small UK-owned hi-fi system suppliers (Alba and Amstrad) from which we could expect to obtain comprehensive financial information (although Alba does not manufacture in the UK). But we thought it would have been invidious and burdensome to impose this demand on them and most unlikely to yield any information that would relate usefully to the companies controlled from outside the UK which supply over 90 per cent of the UK market in hi-fi systems.

4.83. In the absence (save in part for Alba and Amstrad) of any direct measure of profitability of hi-fi system supply we took foreign-owned companies' willingness to enter the UK market, and their continuing presence in it, as a surrogate, since it implies that both those that come and those that stay expect to achieve their financial objectives here, at least in the longer term. Using that yardstick, we noted that no Far Eastern hi-fi system supplier has withdrawn from the UK market in the last decade, and several have joined it. However, as mentioned in paragraph 4.23, in 1996 the hi-fi system interests of the (Finnish-owned) Nokia Oy, including the Home Products Division of Nokia Consumer Electronics (UK) Ltd, were sold to a Canadian-owned company; and the future ownership of Thomson has been under discussion for some time following reported heavy losses.

4.84. On the retail side, the withdrawal of Clydesdale, Rumbelows, Powerstore and Colorvision, and a net reduction in the number of smaller electrical retailers (see paragraphs 4.53 and 4.54), appear to indicate that it is not always easy to make profits in this market. However, these withdrawals were not necessarily a consequence of competitive pressures alone. We were told of management failures in some of the businesses concerned. The recession in the early part of the decade will have been an important factor. Colorvision experienced difficulties over its credit licences. The privatization of the RECs led to their retail businesses being placed on a much more commercial footing with consequences both for their own survival and for the rest of the market.

4.85. But Dixons' financial results (see Table 9.1) indicate that profitability is not a problem for everyone in electrical retailing: its retail operating profit increased by 38 per cent between 1994/95 and 1995/96, and by over 50 per cent in the following half-year (mainly, we understand, because of increased sales of products that have not been referred to us). We also noted that Kingfisher's published results for 1996/97 indicated that there had been a strong recovery in Comet's profits.

4.86. Like suppliers, retailers of hi-fi systems sell a range of other products, many of which are not the subject of our inquiries. We received limited information about the profitability of retailing hi-fi systems. It would be hard to assess because arbitrary allocations of overheads and capital employed would be necessary to arrive at any figures. Before it withdrew from the UK market in August 1996, Nokia told us that UK dealers' margins for brown goods were probably the highest in Europe, particularly those of the major multiples.

4.87. Finally we had to consider the importance to us of an assessment of the profitability of supplying or retailing hi-fi systems in the UK both for individual companies and for suppliers and retailers as a whole in the context of our terms of reference. The two matters which we are required to investigate could lead to practices with effects adverse to the public interest whether the suppliers and retailers of the goods concerned were earning high or low profits. If such practices exist, that might reflect, at one extreme, attempts to prevent high profits from being eroded or, at the other extreme, attempts to prevent losses from being increased when there is excess capacity at supplier or retailer level that is slow to be eliminated. It seemed to us that the level of profit either for an individual supplier or retailer, or for all suppliers or retailers taken together, is not necessarily directly and solely determined by the degree of competition, and did not bear to a material extent on the matters referred to us.

Pressures on prices

4.88. Several suppliers mentioned models whose RRP's they had reduced as a result of competition with other suppliers. But price cuts may also reflect the need to move older or slow-moving stock.

4.89. When we looked at price cuts by retailers we found that many of them involved passing on suppliers' promotional price cuts and thus were not examples of intra-brand price competition (see paragraphs 4.114, 4.115 and 4.137). Suppliers told us that when they initiated promotions, in the form of reductions in RRP's, they were available for all their retail outlets. In the responses to the multiple retailers questionnaire (see paragraph 10.75), retailers accounting for 84 per cent of respondents' sales of hi-fi systems by value in 1995 said that suppliers were involved in funding or supporting promotions.

4.90. We were told by Dixons that, as retail prices were so visible, a price cut by one retailer would be matched quickly by its competitors; it therefore brought no lasting competitive advantage. Instead retailers sought to compete by offering non-price benefits which would be less easy to copy and so brought a longer-lasting competitive advantage. A Verdict report in April 1996,¹ observing the same behaviour, commented that most promotional investment by electrical retailers was 'directed towards everything apart from price', though elsewhere Verdict said that it regarded the electrical goods market as highly competitive. We will return to the subject of pricing behaviour in paragraphs 4.103 to 4.162. For the present, we merely comment that avoiding retail price cuts because they would be matched by competitors is not self-evidently an indicator of a wholly competitive market.

Price trends

4.91. The ONS publishes a price index for 'audio-visual equipment'. This includes hi-fi systems but also covers many other goods. The index fell by nearly 40 per cent between 1985 and 1995. A price index for hi-fi systems (also provided by the ONS) confirms that, as suppliers have suggested, prices have declined in real terms in recent years. The ONS suggests, however, that these indices should be used with caution, since they are not based on extensive samples.

¹Verdict on *Electrical Retailers*, Verdict Research Limited, Table 19.

4.92. We are not greatly impressed by the argument that this price trend is indicative of a highly competitive market in the UK. We would expect hi-fi systems to be among those products for which improvements in manufacturing efficiency can still be realized, leading to a relative decline in the cost of production. There should also be opportunities for spreading the costs of research and development (see paragraph 7.140). It would require a severe restriction of competition to prevent these lower costs from being reflected in prices. We also note that for hi-fi systems, more than most domestic electrical goods, comparisons over time are of doubtful validity because of the effects of technical improvements.

International comparisons

4.93. Some suppliers claimed in general terms that prices for brown goods were lower in the UK than in other European countries, but they gave no evidence specific to hi-fi systems. We have also seen claims that electrical goods generally are cheaper in the USA than in the UK.

4.94. We therefore examined the possibility of undertaking systematic international price comparisons and discussed with GfK the data that it had available or could obtain. But we decided (particularly having regard to experience gained in the MMC's Cars and Recorded Music inquiries¹) that the complex process of comparing hi-fi system models (on a rigorous like-with-like basis), and taking full account of different indirect taxes, exchange rate fluctuations, the various marketing strategies of the Far East suppliers, and differences between national markets, would be a costly and protracted exercise that would be most unlikely to reach meaningful conclusions. We thought, too, that even if these obstacles could be overcome the conclusions would not bear closely on the two matters that our terms of reference require us to examine. In the absence of information on the prices at which suppliers sell into overseas markets, of a detailed understanding of the extent of supplier influence on retail prices in those markets, and of the distribution arrangements which apply, we did not believe that international price comparisons were illuminating for our task.

4.95. The questionnaires we sent to suppliers and multiple retailers asked about their knowledge of comparable overseas markets, and the notable differences between them. The responses we received (set out in paragraphs 10.153 to 10.159) increased our scepticism about the usefulness of international comparisons for our purposes. Dixons (which has had extensive experience of retailing electrical goods in the USA) identified several reasons why US hi-fi system prices should be lower (see paragraph 10.159). GUS and Littlewoods gave similar advice about the USA. Several suppliers and retailers spoke of the preponderance of small retailers, the strength of hypermarkets, and the relative weakness of the larger multiples in the domestic electrical goods retail market in other EU member states. We were also shown GfK data² indicating that hi-fi system prices were higher in other European countries than in the UK. However, we believe the methodological difficulties that we identified in the previous paragraph had not been fully solved in these price comparisons and the results must be treated with caution.

4.96. We also approached the competition authorities in France, Germany, the USA, Canada and Australia. The responses (see paragraphs 10.160 to 10.163) contained interesting background, but the information provided did not contribute to our conclusions.

4.97. All in all, we do not believe that international comparisons cast much light on the competitiveness of the UK market for hi-fi systems one way or the other.

Overview of competition

4.98. To sum up our view on this market, we agree that competition between suppliers and between retailers is always present to some degree and can at times be vigorous, but we do not think it is as unconstrained as was claimed by many of those who gave evidence to us. There are limits on both inter-

¹*New motor cars*, HMSO, Cm 1808, February 1992, and *The supply of recorded music*, HMSO, Cm 2599, June 1994.

²Contained in *Competitiveness in the reference brown goods market*, prepared by Lexecon Ltd for Sanyo (which drew it to our attention).

brand and intra-brand competition. More particularly, price competition among retailers seems to us (for the reasons set out in paragraphs 4.88 to 4.90) to be less vigorous than is sometimes claimed. Other evidence, which we examine in the next section, reinforces this assessment.

Evidence relating to prices

4.99. Before considering whether a monopoly situation exists, we examine evidence about the setting of prices for hi-fi systems (paragraphs 4.100 to 4.162) and about withholding supply (paragraphs 4.163 to 4.192).

Sources

4.100. The first matter specified in our terms of reference concerns the steps taken, by setting RRP's or otherwise, to influence the prices at which dealers resell hi-fi systems. We obtained information on suppliers' and dealers' practices in relation to this matter from:

- (a) responses to postal questionnaires that we sent to suppliers, multiple retailers, mail order companies, wholesalers, warehouse clubs, CIH and its local groups;
- (b) suppliers' and retailers' responses to our issues letters (see Appendix 6.1, Annex A);
- (c) hearings and meetings with suppliers and dealers, followed up in some cases by further written submissions from them;
- (d) responses to our survey of small retailers (see Appendix 9.1);
- (e) observations by dealers and others about suppliers' behaviour;
- (f) retail price distribution analyses, based on sales data from GfK, and price histories of selected models (see paragraphs 11.4 to 11.36 and 11.94 to 11.116 respectively); and
- (g) examination of media reports, the trade press and specialist publications (including reports by Verdict and the EIU).

4.101. On 4 April 1997 we received from *The Sunday Times* some tape recordings that had provided the basis for articles in that newspaper on 30 March 1997. Each tape recorded an hour-long discussion between, on the one hand, representatives of each of eight suppliers of one or more of the reference brown goods, and on the other hand journalists purporting to represent a nascent electrical goods retail consortium that was planning to establish initially 15 retail outlets in the UK. At the time, the suppliers' representatives did not know the discussions were being recorded. The journalists, *inter alia*, sought to establish each supplier's views on the consortium's proposal to sell its goods at prices below RRP's. Some of these views were reported in the articles in *The Sunday Times*. After listening to the recordings we decided that it would be unreasonable for us to ask the suppliers to comment, and for us to examine their responses with due care, in the short time that would remain between our securing transcripts of the recordings and the submission of our report. Without receiving any comment from the suppliers, we thought it would be inappropriate for us to take any account of the material provided by *The Sunday Times* in reaching our conclusions on the matters contained in our terms of reference. Nor, having regard to the extensive evidence on those matters that we had already received from many other sources, did we think we would be justified in seeking a further extension of our reference period. (We noted that the electrical retail trade journal *ERT*, reporting this incident, said '*The Sunday Times* has pulled an elaborate hoax ... merely to reveal what retailers know already-most suppliers discourage long-term discounting'.)

Issues

4.102. The issues put to suppliers and retailers relating to pricing practices are recorded in Appendix 6.1, Annex B. They include the following questions:

Suppliers and retailers

- (i) Do suppliers' recommended or suggested retail prices (including minimum advertised prices) influence retailers' advertised, displayed or transaction prices for hi-fi systems?
- (ii) Does the practice of suppliers recommending or suggesting retail prices lead to less variation in retailers' advertised, displayed or transaction prices of hi-fi systems than would otherwise occur?
- (iii) Does this practice restrict or reduce intra-brand competition and/or inter-brand competition at the retail sale level?

Suppliers

- (iv) Do suppliers of hi-fi systems use recommended or suggested retail prices, together with adjustments in trade prices, to protect retailers' margins when products have to be 'repositioned'¹ in the market?
- (v) Do suppliers attempt to control the prices advertised by retailers for hi-fi systems?
- (vi) Do suppliers influence retailers to observe their recommended or suggested prices for hi-fi systems by:
 - (a) threatening to withhold supplies permanently or temporarily, or failing to supply models in the numbers, or at the time, expected;
 - (b) threatening to limit the numbers supplied of all or selected models;
 - (c) threatening to alter adversely the terms of supply, eg credit terms, or levels of discounts or allowances, or advertising cost contributions;
 - (d) providing some benefits retrospectively, eg margin payments or promotional allowances;
 - (e) offering financial or other inducements, eg increased discounts or preferential supplies;
 - (f) providing price tickets and other point-of-sale material; or
 - (g) other means?

Retailers

- (vii) Do retailers put pressure on suppliers to ensure that competing retailers observe suppliers' recommended or suggested prices for hi-fi systems by:
 - (a) threatening not to stock the suppliers' brands or models;

¹ 'Positioning' involves a supplier, probably in consultation with retailers, taking a view on where a model that is about to be introduced stands relative to competing models, and it normally leads to the setting of an RRP, having particular regard to the RRP of competing models. Hence 'repositioning' normally entails the RRP being changed from the level earlier thought appropriate.

- (b) attempting to persuade suppliers to alter adversely the availability or terms of supply to competitors, eg by withholding supply temporarily or permanently, or by adjusting levels of discounts or allowances or advertising contributions;
- (c) requiring compensation for harm to the retailers' interests caused by other retailers' non-observance of the suppliers' recommended or suggested prices; or
- (d) other means?

Discussions between suppliers and retailers on prices

4.103. Suppliers of hi-fi systems seek to maintain a close relationship with their larger multiple retailer customers. In particular, before launching a new model, most suppliers (but not Pioneer or B&O) will seek the views of these customers on the positioning, and hence the price, of the model in the market. Retailers bring to these exchanges knowledge of existing and planned competing products. Suppliers understand that a retailer will not stock a model unless it is competitive in terms of its features and above all its expected retail price. The price the model is expected to fetch in the market lies at the heart of these exchanges. We were told that, throughout this process, the larger retailers almost invariably argue for lower rather than higher RRP than suppliers initially propose.

4.104. Virtually all RRPs are set at conventional 'price points', often referred to as 'charm prices'. Retailers habitually adopt them because, Dixons told us, 'emotion transcends intellect', so that the charm price is felt to be significantly less than the neighbouring round sum. The practice is not confined to the reference goods nor to the UK. For the cheaper hi-fi systems the charm price is usually set 1p below a figure which is commonly a multiple of £10.

Recommendation of retail prices

4.105. Virtually every supplier of hi-fi systems that sets RRPs informs its retailers of the initial RRPs of its models at their launch; many suppliers also periodically issue price lists which contain and, if necessary, update RRPs. Hitachi-albeit only a small supplier of hi-fi systems in 1995-told us that it believed the use of the RRP was the most important element in an 'orderly market'. On the other hand Aiwa, the hi-fi market leader, abandoned RRPs on 1 April 1997, and Kenwood told us that it did not see any compelling commercial benefit in having them. Discussion of new models in the trade press is commonly in terms of RRP, not a trade price.

4.106. CIH and the local groups that act as suppliers (see paragraphs 4.45 to 4.50) pass on to the retailers they supply details of the RRPs notified to them by their suppliers. We were told by CIH that when its suppliers did not notify an RRP it would decide on one itself and issue it to retailers.

4.107. In our survey of small retailers, 93 per cent of the respondents who sold hi-fi systems told us that they took account of RRPs in setting their own prices. Multiple retailers gave a range of responses (see paragraph 4.157(a)). Dixons and Comet denied that they were influenced by RRPs but agreed that their own prices often coincided with them. Argos told us (see paragraph 10.63) that, with the exception of end-of-line items and products that its competitors promoted through vouchers, it sold all primary and most secondary brands at RRPs, and that 'it was not undercut on those lines'.

4.108. Before a major retailer such as Dixons, Comet or one of the larger multiples decides to include a particular model in its range, typically it will agree with the supplier a business plan, covering the expected sales values and volume, and the marketing plan for the model, including advertising, price and non-price promotions. Once a model is on sale, there are continuing exchanges to monitor performance and agree on actions to maintain the volume of sales at the planned level. These may result in a consensus that the RRP needs to be reduced. Revised RRPs are issued periodically by suppliers and sent to retailers. This is most clearly seen at the traditional retail sales periods after Christmas and in the summer.

4.109. We were told that, in addition, suppliers' sales representatives normally kept their retailer customers abreast of the suppliers' thinking on RRP. But it was emphasized by suppliers that their sales representatives were not permitted to put pressure on retailers to adhere to RRP. However, we note that regularity of contacts between suppliers' sales representatives and retailers enhances the representatives' ability to monitor price discounting.

4.110. Observations by dealers on the influence of particular suppliers on dealers' hi-fi system selling prices are set out in paragraph 4.159 and Appendix 10.15, cases C1 to C16.

Suppliers' terms to retailers

4.111. The RRP is typically the starting point for the annual negotiations between suppliers and retailers on the size of retailers' gross margins (for those who sell at RRP) and suppliers' selling prices to retailers. Nearly all the major suppliers (but not Aiwa, Pioneer or B&O) work down from the retail price to the price at which they sell to the retailer. We find this top-down approach to the determination of retailers' buying prices to be a striking feature of this market.

4.112. When retailers sell hi-fi systems at RRP, their average gross margins, after all discounts from suppliers have been taken into account, are concentrated around [*] to [*] per cent of RRP excluding VAT, representing a mark-up of between [*] and [*] per cent on retailers' buying prices (see paragraph 10.125 and Table 10.10).

4.113. When determining a retailer's net buying price, suppliers typically apply a range and variety of different discounts. Suppliers acknowledged that this gives rise to a degree of complexity. The elements are described in detail in paragraphs 10.105 to 10.120, and are set out in Table 10.9.

Margin maintenance

4.114. Most suppliers will agree to maintain, for most if not all of their dealers, the gross margin which the discount from the RRP affords. If a model is not achieving the desired volume of sales and the supplier sets a lower RRP, the supplier will also in such circumstances reduce the price to the retailer by an amount that provides the retailer with, at least broadly, the same percentage gross margin. The practice is also followed during the January and summer sales periods (see paragraph 10.132).

4.115. Suppliers told us that, if they do not provide this assurance to retailers, their brands will be displaced from the shop floor by a competitor which does offer it. Multiple retailers explain their requirement for margin maintenance in terms of the need to share with suppliers the risk they take in committing themselves to forward business plans for models (see paragraph 10.29).

4.116. For most of the period of our inquiry, Dixons' standard terms and conditions of purchase from suppliers contained the following clause 1:

In the case of UK orders it is a condition that if the supplier's recommended retail price is reduced within 98 days from the date of delivery, the full monetary difference based on the supplier's new cost price, and using the buying formula agreed in this order, will be immediately credited to Dixons.

Dixons told us that it could not recall any occasion when this clause had been invoked and that the clause had been deleted at the end of June 1996 (see paragraph 10.133).

4.117. ScottishPower's conditions of contract for the supply of goods contains a similar provision.

*Figures omitted. See note on page iv.

Margin support

4.118. In addition to the maintenance of retailers' margins when suppliers change RRP's, we received evidence that retailers sometimes sought margin support from suppliers to enable them to match price cuts by competitors without loss of margin.

4.119. Dixons' standard terms and conditions included for the first 14 months of our inquiry the following clause 13:

Dixons reserves the right to renegotiate prices and delivery dates in the event that disorderly market forces are allowed by the supplier to prevail which are to the detriment of Dixons' profitability or sales rate. If this condition is not met, Dixons reserves the right of cancellation.

4.120. Dixons told us that it traded with suppliers on a partnership basis and that its terms and conditions were no more than a fallback in the rare event of the relationship breaking down. It could not recall clause 13 being invoked. Like clause 1 (see paragraph 4.116), clause 13 was deleted from Dixons' terms and conditions at the end of June 1996. However, Dixons also said that, where competition between retailers or between suppliers led to prices that it believed would permanently affect the margin it could achieve from a particular product, it would seek to renegotiate terms with the relevant supplier (see paragraphs 10.140 to 10.143).

4.121. During a visit to Dixons' headquarters we had an opportunity of seeing Currys' divisional management implementing this policy in the context of its weekly review of the prices for which it was responsible.

4.122. Notwithstanding Dixons' leading position in the hi-fi system market in 1995 with its 22.6 per cent market share, none of the suppliers we consulted took the view that clause 13 was in itself material to its own relationship with Dixons. But we noted (see paragraph 10.141) the objections that Sony had expressed to it, and that Dixons had in effect accepted them as valid. Sanyo told us that Dixons had insisted on margin support arrangements but that (although these were still in place) no payments had been made under them (see paragraph 10.138). Sanyo has a similar contractual relationship with [*], a [*] retailer (and had had such an arrangement with Colorvision).

4.123. We were told by suppliers that many other retailers sought *ad hoc* margin support when faced with price discounting by competitors but it was the policy and practice of most suppliers to reject such requests. However, we noted several examples of such *ad hoc* support being provided to small retailers: JVC, Sanyo and Sharp were all reported to have responded to requests of this sort.

Advertising and promotion support

4.124. Suppliers frequently support retailers' advertising and promotion activities. Potentially this provides an opportunity for suppliers to influence retailers' prices. It is common for a supplier to commit a much higher proportion of its total advertising and promotions budget to financing the advertising of its models by retailers than it does to its own promotion of its brand. Advertising expenditure by the largest electrical goods retailers is substantial. In 1995 Dixons was the fifth highest-spending advertiser in the UK; over 90 per cent of its advertising was in the press (see paragraphs 9.131 and 9.132). Every week Dixons and Comet take large spreads in national newspapers advertising their current price and non-price promotions. Comet also provides information about its promotions on Channel 4 Teletext.

4.125. We were told that this prominent investment in advertising reflected the fact that consumers were generally in the market for hi-fi systems only briefly every few years and took no continuing interest as prospective purchasers of the product in the intervening period. Intensive and repeated advertising was necessary to capture the interest of those in the market at a particular point in time. Some of this advertising is on the retailer's own initiative. In other cases, the retailer and supplier will agree that a model needs to be promoted to boost the volume of sales to the desired level, and the supplier may initiate the campaign

*Details omitted. See note on page iv.

and bear some or all of the cost. CIH told us that it organized national promotion campaigns for some of the hi-fi systems it bought on behalf of the retailer members of its local groups. These campaigns gave prominence to the RRP of the models being promoted but CIH said that retailers were free to charge another price if they wished, and that some did so.

4.126. Where a supplier contributes to the cost of an advertisement it will try to ensure that the presentation supports its own objectives in terms of brand positioning, protection of the logo and description of the technical features of a model. Some suppliers told us that they would have preferred-although their views rarely prevailed-to see advertisements draw out the features of models and focus less on the price. We were assured by most suppliers that they did not attempt to control the price at which models were advertised. However, the former Chairman of Powerstore told us that most suppliers would not pay an advertising and promotion allowance to a retailer who was advertising prices of which they did not approve.

4.127. None of the suppliers appears currently to prohibit or otherwise restrain retailers from POA advertising. Sony, however, told us (see paragraph 10.44) that it had previously done so on the grounds that POA advertising could lead to 'switch-selling' (when the customer, having been attracted to the shop, would buy a different model from the one advertised). POA advertisements are not uncommon, but we understand that under the Price Marking Order 1991 an advertisement for a specific model that refers to the price must say what that price is, although a generic advertisement, for example 'hi-fi systems, price on application' would be permissible. Enforcement of the Order is a matter for local Trading Standards Officers.

4.128. Suppliers' support for retailers' promotions includes the provision of point-of-sale display material, which commonly specifies the RRP. We were told that multiple retailers prefer to use their own displays and that the suppliers' material is of most use to small retailers.

4.129. The value of the advertising and promotion allowances obtained from suppliers varies. Figures for expenditure on promotion of hi-fi systems are rarely available. However, across all the reference brown goods we estimate that advertising and promotion allowances account for between [*] and [*] per cent of RRP (excluding VAT); we were given no reason to suppose that this does not apply to hi-fi systems (see paragraph 6.15). These allowances are normally paid retrospectively (see paragraphs 10.115 and 10.116) and sometimes at the discretion of the supplier. However, some suppliers told us that they did not regard these allowances as discretionary. They would be paid if they had been agreed as part of the annual negotiation of terms.

Retrospective volume-related discounts

4.130. Some suppliers use retrospective volume-related discounts as an incentive to retailers to achieve sales targets (see paragraphs 10.113 and 10.114). Suppliers told us that retailers frequently over-estimate their expected sales. So it was prudent to keep the money in hand until hoped-for volumes had been achieved. Retrospective volume-related discounts also meant that retailers were more inclined to push the supplier's brand to the exclusion of others when the achievement of the relevant sales target came within reach. Suppliers told us that once the terms for retrospective volume-related discounts had been agreed with a retailer, in the usual annual negotiation of terms, they had no choice but to pay it if the target volumes were achieved. It is not possible to isolate the contribution that retrospective volume-related discounts made to retailers' profits on hi-fi systems, but across all the reference brown goods we estimate that they average between [*] and [*] per cent of RRP (excluding VAT). Again (see paragraph 6.15), we were given no reason to suppose that this does not apply to hi-fi systems.

*Figures omitted. See note on page iv.

Variations in terms

4.131. We were told that the terms agreed between suppliers and retailers in their annual negotiations would not normally be changed during the course of the year. But if a model was under-performing the RRP might be reduced, or larger discounts granted, or both.

4.132. We were unable to measure how much variation in terms occurs from year to year. Inevitably both parties to the annual negotiations will go into them with the aim of achieving the terms most favourable to them, each recovering if possible any advantage conceded to the other in the previous round. Suppliers thought their bargaining positions would be strengthened if retailers had been devoting some of their agreed margins in the previous 12 months to purposes not contemplated when business plans had been agreed. Suppliers told us that in recent years multiple retailers had been increasingly successful in pushing costs and risks back on to them. But multiple retailers pointed to what they described as the low net profit contributions from their hi-fi system sales as evidence that they did not have the upper hand in negotiations.

Non-price offers

4.133. The retail sale of hi-fi systems is characterized by a great deal of competitive activity which does not involve price adjustments. The extensive press advertising to which we have referred (see paragraph 4.124) makes clear how often retailers promote hi-fi systems with associated offers which consumers would have to evaluate before they could assess the net purchase costs of the product.

4.134. These offers include flexible terms such as 'buy now, pay later' and interest-free credit. Delivery and installation may or may not be provided free of charge. The stated selling price of a hi-fi system normally includes a one-year guarantee provided by the manufacturer. Retailers may extend the guarantee without additional charge to the customer, or at a reduced charge: PriceCostco offers a three-year free maintenance and repair service, and others offer a free one-year extension.

4.135. Interest-free credit and other non-price promotions may be initiated by retailers or suppliers. All the leading hi-fi system suppliers have contributed to all or some of the cost of such promotions at one time or another. Financing by the supplier is usually through the retailer's advertising and promotion allowances (see paragraph 10.115).

4.136. The information we received from suppliers and retailers did not indicate the cost of all these non-price and other special offers. Subsidized credit in various forms is the most widely used of these offers and very likely the most expensive for retailers and suppliers. The cost of subsidized credit for hi-fi systems sold by Dixons in 1994/95 (including the part funded by suppliers) was about [*] per cent of total sales (see Table 9.8). The corresponding figure for Comet's 'audio products' in 1994 was about [*] per cent (see Table 9.9). We believe the RECs have been among the largest suppliers of subsidized credit. One REC told us that such credit cost it 5 per cent of the sales value of the eight reference goods (see paragraph 9.118).

Other special offers

4.137. In addition to non-price offers, competition commonly involves special temporary reductions in the RRP. These take three forms, each of which may be financed in whole or part by the supplier:

- (a) Reductions may be combined with what suppliers call a 'sales-out' allowance to retailers, in the form of a lump sum contribution by the supplier for each unit sold, paid retrospectively (see paragraph 11.13).
- (b) Another form, now less common than it was, is a supplier's 'cash-back' promotion: the displayed price of the hi-fi system remains unaltered but it is coupled with the offer of a stated amount which the customer can obtain by completing a claim form and sending it to the supplier. We were told that with cash-back offers of under £30, many purchasers did not bother to send in claims so that

*Figures omitted. See note on page iv.

the cost to the supplier was a good deal less than might appear at first sight. But suppliers told us that nonetheless cash-back offers were costly to administer and hence were falling into disuse.

- (c) The third form is the voucher (usually offered in press advertisements). It is adopted extensively by Dixons and Comet: Dixons told us that vouchers reduced pressure on its margins, since the price reduction attracted purchasers, but only those who presented vouchers would qualify for the reductions.

Pressure by suppliers on retailers' prices

4.138. Chapter 10 sets out several ways in which suppliers bring pressure to bear on retailers to adhere to RRP. For example:

- (a) Sony said that it tried to influence retailers to set their prices at or near to RRP (see paragraph 10.35), and that it did not encourage dealers to use Sony goods as promotional inducements (see paragraph 10.47). More particularly, Sony told us, in responding to an observation by Comet (see Appendix 10.15, case A18) that if a retailer were to offer a customer an inducement to buy a Sony product the value of the inducement should not exceed 10 per cent of the value of the first purchase, and that the customer should contribute at least 10 per cent of the imputed value of the inducement; any greater inducement would be detrimental to the Sony brand.
- (b) Sanyo, in its guidelines to sales staff (see paragraph 10.34), said 'to assist Sanyo in identifying market trends you should inform the person to whom you report of any retailer who discounts Sanyo products so that proper consideration can be given to the issue by management'. The guidelines also say 'heavy discounting of Sanyo products will tend to confuse customers, as this can impact adversely on the reputation of the Sanyo brand' (see paragraph 10.50). Sanyo further said that it would point out to retailers that selling below RRP meant less profit, and that it did not allow retailers to offer its products at such low prices that display, demonstration and after-sales service were sacrificed.
- (c) Most suppliers told us that RRP were guide prices, and that they did not actively encourage retailers to adhere to them. But many suppliers, including Sony, Panasonic, JVC and Samsung (together supplying nearly one-third of the UK hi-fi system market in 1995), engage in what may be called passive encouragement in that, apart from issuing RRP lists, they provide point-of-sale material and particularly to small retailers which specifies current RRP. JVC told us (see paragraph 10.15) that it was not unusual at Christmas for it to print up to 8 million personalized catalogues for retailers, giving RRP. We think that the inclusion of the RRP in suppliers' point-of-sale material of this sort serves to convey to the small retailer that this is the price he is expected to charge and to the prospective purchaser that this is the price he is expected to pay.

4.139. Respondents to the multiple retailers questionnaire, responsible for about 72 per cent of respondents' sales of hi-fi systems, indicated that they had experience of suppliers monitoring their prices for hi-fi systems (see paragraph 10.38). Respondents to the multiple retailers questionnaire responsible for 19 per cent of hi-fi system sales said that suppliers had stopped them advertising hi-fi systems at less than the RRP (see paragraph 10.46). Some of the observations from small retailers of hi-fi systems implied that suppliers had on occasion discouraged them from advertising below RRP. Philips, Sanyo, Amstrad and B&O appear to discourage price-cutting on the grounds that it may damage their brand image.

Retailers' complaints about price-cutting, and suppliers' responses to them

4.140. It is clear that retailers are quick to complain to suppliers about any apparent price-cutting by competitors, and press suppliers to do something about it, either by compensating them or by persuading the competitor to put the price back up to the recommended level. Of the 454 respondents to our survey of small retailers who sold hi-fi systems, 250 (58 per cent) said that they had complained to their suppliers about their competitors' prices (see Appendix 9.1, Table 41). Of those respondents who complained, 20 (8 per cent) said that their complaints had produced a result. Price-matching promises inspire many of these retailers' complaints. JLP, for example, has its 'never knowingly undersold' slogan, and Comet has

promised not only to match but to improve on a competitor's lower price. Many small retailers make price-matching promises on hi-fi systems (Verdict told us that this was 'more common' than discounting on ticket prices).

4.141. Suppliers respond in different ways to retailers' complaints about price-cutting. Some suppliers said that they ignore them, and take no action. Hitachi (a small supplier of hi-fi systems) told us (see paragraph 13.336) that it made a practice of contacting any retailer selling below the current recommended or suggested price: it would then discuss the matter with the retailer and with the competitor who had lodged the complaint, perhaps offering recompense to the latter and urging the former to increase his prices. 10 per cent of the respondents to our survey of small retailers who had sold hi-fi systems at a price below the RRP said that the supplier had commented. We believe that such comments-even if suppliers do no more than note the retailers' actions-will influence retailers as they wish to maintain good relations with their suppliers. This influence is not confined to small retailers: we were told by the former Chairman of Powerstore that no retailer wanted to upset its suppliers and that, if it did so, the supplier would withhold stock.

4.142. More generally, suppliers seek to defend their contacting retailers selling below RRP on the grounds that they might not have realized the significance of their actions for their profitability, or that the activity might clash with the suppliers' advertising, or that it might indicate cash-flow problems and poor creditworthiness against which the supplier would need to safeguard itself. Suppliers deny that their seeking to establish the facts constitutes pressure to adhere to RRP, but JVC accepted that its sales representatives might sometimes put too much pressure on retailers to sell at RRP (see paragraph 10.35). Sanyo told us (see paragraph 10.55) that 'significant price discounting has serious commercial implications' for it; that 'retailers expect [it], indeed require [it], to take prompt and responsive action'; and that 'tit-for-tat action by retailers can easily extend to other Sanyo products thereby adversely affecting Sanyo's perception in the eyes of other approved dealers'.

Mail order recommended prices

4.143. The distinctive features of the mail order market are described in paragraphs 9.58 to 9.68, and the hi-fi system pricing practices of the mail order companies and their suppliers in paragraphs 10.85 to 10.93, 10.100 and 10.103.

4.144. We were told by the five mail order companies which sell hi-fi systems that major suppliers provided them with MORPs, up to 20 per cent higher than the RRP for the same models sold by high street retailers. Most major suppliers (but not Kenwood or Panasonic) confirmed that they suggested a MORP, although several emphasized that this was not a price that they themselves were recommending, but merely a price calculated from their selling price to the mail order company coupled with the known margin requirement of that company. Aiwa ceased to recommend MORPs on 1 April 1997.

4.145. According to the responses of the five mail order companies to our questionnaire, 86 per cent of their aggregate sales of hi-fi systems were at MORPs (see Table 10.7).

4.146. Mail order companies frequently stock ranges of hi-fi system models that differ from those of their competitors. Of the 147 models featured in the companies' autumn/winter 1995 catalogues, only 47 were sold by more than one company. Of these 47 models, 32 had the same price in all the catalogues in which they appeared (see paragraph 10.103). In our view, MORPs contribute to this uniformity.

4.147. GUS, Grattan and Empire ask suppliers whether an item is exclusive to them and, if not, whether it is being supplied to other mail order companies. These questions are answered by some suppliers.

4.148. Empire asked suppliers about the prices being charged by its competitors (see paragraphs 10.94 to 10.97). It told us that the purpose of this practice was to ensure that it did not include false claims about prices in its catalogue. If it wished to say that its prices were lower than those of its competitors, it had to check with suppliers that this was in fact the case, as the long lead times involved in printing catalogues precluded it from waiting until its competitors' prices had been published. It said that, for some three-quarters of its lines of the eight reference goods, the suppliers did not reply to the questions it asked about

prices and exclusivity, or else answered them after its catalogue had gone to press. It argued that as its catalogue prices were not in practice set by reference to what suppliers told it about its competitors' prices, asking for this information was not anti-competitive. Nevertheless, it told us that 'as a gesture of goodwill', it would cease to ask suppliers about competitors' prices with effect from 30 September 1997.

Retail transaction price distributions

4.149. To obtain evidence of the distribution of retail prices we analysed GfK sales data for 12 best-selling models of six brands of hi-fi systems from leading suppliers, representing about 8 per cent of hi-fi system sales for the period chosen. We had hoped to be able to take models that were in mid-life, and therefore unaffected by special launch or end-of-line price promotions, but (because of the frequency of model changes) this proved impracticable, and only 7 of the 12 were unaffected in this way. However, all the end-of-line models had identifiable RRPs (one model had two RRPs in the survey period). We chose the period from 19 February to 25 March 1995, this being the most recent period for which pricing behaviour was in principle unaffected by the announcement of this inquiry. Rumbelows withdrew from the market during this period, and its pricing behaviour was likely to have been influenced by its imminent closure. We therefore excluded sales through Rumbelows from the data (though any effects of these sales on prices charged by other retailers would be covered). We also excluded sales through mail order companies because typically they are at higher prices than those prevailing in the generality of retailers. According to GfK, rather more than half the prices in our analysis were EPOS-recorded transaction prices. But transaction prices were not available from those dealers (chiefly small retailers) that did not have EPOS systems, so in those cases displayed prices were used by GfK.

4.150. Our pricing analysis is described in detail in paragraphs 11.94 to 11.107; the price distribution charts for 12 models of hi-fi systems, from six brands, are at Appendix 11.1, Figures 25 to 36; and the pricing data are at Appendix 11.6. The charts show price observations grouped in £5 bands and also give the suppliers' RRPs. The main statistical measures we have used in this analysis are the modal band, ie the most frequently observed price band, the percentage of sales within plus or minus 5 per cent of RRP, and the covar, defined as the standard deviation divided by the mean value expressed as a percentage.

4.151. The total volume of sales (and price observations) included in the analysis was just over 16,000 units. Of the 12 models analysed, the modal value band was at the RRP in nine cases. Two of the remaining three were end-of-line models. For six of the seven current models 60 per cent or more of the price observations were within 5 per cent of the RRP. For all but two (end-of-line) models the covars were in the range 4.5 to 7.1; the two exceptions were 8.5 and 8.1. Dixons accounted for 43 per cent of sales of the models in our sample, and Comet for 9 per cent.

4.152. We carried out a study of the price histories of two of these 12 models (the Sony COMP 190 and the JVC ADG S20), and also of the Sanyo DCD8. In selecting them we took into account the need to examine products from different suppliers, the relative importance of the models in terms of overall sales and the nature of the price distribution data and other information available. A detailed account of these price histories is in paragraphs 11.108 to 11.116.

4.153. We give our view of the implications of these findings in paragraphs 4.266 to 4.287.

Survey of small retailers

4.154. Our survey of small retailers, ie those with fewer than five retail outlets, was carried out during August and September 1995 by a team of interviewers, who visited 454 hi-fi system retailers. (The methodology of the survey is described in Appendix 6.3 and the results are analysed in Appendix 9.1.)

4.155. We have already referred to some of the findings of the survey. The following results are of particular relevance to our conclusions later in this chapter about the recommendation of retail prices for hi-fi systems:

- (a) 93 per cent of respondents said that they took account of RRPs or suppliers' suggested prices in setting their prices; 7 per cent said that they did not.

- (b) 77 per cent of respondents said 'no', and 23 per cent said 'yes', to the question 'Do you ever charge prices higher than RRPs or suppliers' suggested prices?' But respondents were not asked how frequently they charged higher prices.
- (c) 92 per cent of respondents said 'yes', and 8 per cent said 'no', to the question 'Do you ever charge prices lower than either RRPs or suppliers' suggested (or promotional) prices?' But respondents were not asked how frequently they charged lower prices.
- (d) 50 per cent of respondents said 'no', and 44 per cent said 'yes', to the question 'When your prices are lower than RRP do you advertise that fact (except where a supplier is sponsoring a reduction)?'

Multiple retailers questionnaire

4.156. In August 1995 we sent questionnaires to multiple retailers (which we defined as retailers with five or more retail outlets). We received complete responses from 29 of them which sold hi-fi systems. They accounted for 61 per cent of total sales by value of hi-fi systems for 1995 and about 90 per cent of these sales by multiple retailers (see paragraph 10.7, footnote 1).

4.157. The replies that are of particular relevance to our findings on RRPs later in this chapter were as follows (some of these points have already been referred to):

- (a) Multiple retailers accounting for 33 per cent by value of respondents' sales of hi-fi systems in 1995 said that they always adhered to RRPs; a further 10 per cent said that they did so on models not subject to discounting by competitors or subject to competition; 6 per cent said that RRPs had some influence on their prices; and 45 per cent said that they set their retail prices without reference to RRPs but that the two often coincided (see Table 10.4).
- (b) Multiple retailers accounting for 71 per cent of respondents' sales said that they were involved in discussions with suppliers about retail prices (see Table 10.1).
- (c) Multiple retailers accounting for 72 per cent of respondents' sales said that they had experience of suppliers monitoring their prices (see Table 10.2).
- (d) Multiple retailers accounting for about 19 per cent of respondents' sales said that suppliers had stopped them from advertising prices below RRPs; but those accounting for 77 per cent said that suppliers had not tried to stop or control them (see Table 10.3).

4.158. These replies do not include those which were unclear or which we received from mail order companies.

Observations on suppliers' behaviour

4.159. We received a total of 93 observations by dealers and others on the influence of particular suppliers on dealers' selling prices for hi-fi systems. We judged that 76 of these lacked sufficient detailed evidence for us to pursue them further, in particular because many retailers were unwilling to be specific about suppliers or because the observations were about matters outside our terms of reference (see paragraph 6.6). The remaining observations (with one exception), and suppliers' comments on them, are set out in Appendix 10.15. (The exception is set out in paragraph 10.41.)

4.160. In seven of these cases the retailer making the observation asked for the name of the business not to be divulged to the supplier. We carefully considered each retailer's request for anonymity, mindful of the potential risk that disclosure of that retailer's identity could adversely affect his relationship with suppliers and thereby damage his business. Initially, we put the substance of the observations made by retailers wishing to remain anonymous to the suppliers named by those retailers for their comments. However, in each case, the named supplier declined to comment without knowing the full facts, including the identity of the particular retailer. We decided in each of those seven cases to preserve the anonymity of the person who had sought it, since we accepted that there was a risk that the disclosure of his identity could

harm his business. To complete our record of the evidence we received, we have included these anonymous observations in Appendix 10.15 together with five other cases which we were unable to substantiate owing to an irreconcilable conflict of evidence between retailer and supplier. We have not relied on those cases in reaching our conclusions.

4.161. However, in reaching our conclusions, we have relied on the following five cases (set out alphabetically, by supplier) where we accepted the retailer's account, either because the supplier had effectively conceded the substance of the retailer's observations, or because we find the supplier's comments unconvincing:

B&O

- (a) Amadeus Sound and Vision, Sutton Coldfield, told us that B&O would have been concerned if it had found it was discounting hi-fi systems (although it did so very rarely).

Hitachi

- (b) Savacentre told us that Hitachi had implied that adherence to its RRP's was a condition of continued supply of its hi-fi systems.

Panasonic

- (c) Mr J Fishlock, of Bath, said that Panasonic's (named) representative had told him that Panasonic did not wish him to advertise its hi-fi systems at discounted prices.

Pioneer

- (d) Sonics Hi-Fi, of Windsor, was told by Pioneer's representative that it should not sell its hi-fi systems at discounted prices (see paragraphs 10.41 and 10.42).

Samsung

- (e) GUS told us that it had complained to Samsung that another mail order company was selling a hi-fi system at £10 below Samsung's RRP. Samsung had agreed to reduce the cost price to GUS to a level that would allow GUS to reduce its selling price to match that of its competitor.

4.162. In assessing the significance of these cases we have borne in mind the following points.

- (a) Small retailers were commonly reluctant to come forward in the course of our survey with observations that suppliers could construe as critical of them; this concern was reflected in the wish for anonymity expressed by seven who gave detailed evidence; we are satisfied that there is what we called a climate of apprehension that influences the conduct of many small retailers whose constant and understandable-concern is not to alienate their suppliers (see paragraphs 6.6 and 6.7).
- (b) One of the observations comes from a multiple retailer and one from a mail order company, thus indicating that the practices referred to are not solely about the relationship between suppliers and small retailers; another large retailer initially gave us relevant comments but subsequently was unable or unwilling to follow them up with specific information.
- (c) The case of Pioneer and Sonics Hi-Fi came to our attention because it was reported in a *Panorama* television programme; the evidence available to us from the BBC's transcript of what had been said in an oral exchange between the parties was of a kind that, in the nature of things, rarely occurred in the context of these inquiries. We believe that *mutatis mutandis* this illuminates the relations that many small retailers of hi-fi systems told us-but were unable to substantiate-that they had with

suppliers' representatives, and which generate the climate of apprehension we have referred to in subparagraph (a) above.

- (d) The evidence we have received suggests to us that most retailers, of all sizes, like most suppliers, appear to have a marked preference for 'orderly markets' and to frown on habitual price discounters; 58 per cent of the hi-fi system retailers responding to our survey of small retailers said that they had complained to their suppliers about local competitors' prices. Against that background we think it likely that many small retailers thought it not in their interests to comment on suppliers' pricing practices.

Evidence relating to withholding of supply

Sources

4.163. The second matter specified in our terms of reference is the withholding of supply (defined as in section 12(1) of the RPA) of hi-fi systems from dealers. Steps taken by suppliers to influence retail prices by limiting or threatening to limit supplies to dealers who have an account with them were covered in our earlier consideration of their relationships. In this section we examine the withholding of supply through a refusal of a supplier to open an account with a new dealer. This takes us into questions of selective distribution. The sources of the evidence we considered are the same as those listed in paragraph 4.100 in relation to prices.

4.164. We use the term 'selective distribution' to mean a distribution system adopted by a supplier in which it selects dealers to be directly supplied with hi-fi systems by taking into account criteria that it deems appropriate. For the purposes of this definition we think creditworthiness and minimum turnover are criteria that may be excluded (see paragraphs 4.165 to 4.167). The most important respect in which our definition differs from the concept adopted by the European Commission (see paragraph 12.5) is that the latter also encompasses suppliers stipulating that authorized dealers may resell only to other authorized dealers or to end-users.

4.165. We excluded creditworthiness as a criterion for supplying dealers from our definition of selective distribution because it seemed to us no more than commercial prudence that a supplier which operated on the basis of extending credit to its customers should take reasonable steps to establish their creditworthiness. As virtually all suppliers operate on the basis of credit, the inclusion of this criterion in our definition would have meant that it caught suppliers that in practice were unselective about the dealers they supplied.

4.166. We excluded a minimum turnover criterion from our definition because it also seemed reasonable commercial practice for suppliers not to supply uneconomically small amounts of their goods directly to retailers.

4.167. Creditworthiness and minimum turnover are, like any other criteria for supply, susceptible to being applied in ways which have adverse effects for competition. For instance, if minimum turnover is set too high, it may impede entry to the market by retailers. However, we have not found any adverse effects from the use of these two criteria.

Issues

4.168. The issues put to suppliers and retailers relating to the withholding of supplies are set out in Appendix 6.1, Annex B. They included the following questions:

- (a) Does the application by some suppliers of the criteria listed in [paragraph 7 of Annex A to Appendix 6.1] in selecting their dealers limit the number of retailers supplying hi-fi systems? Does this restrict consumer choice between brands, retail outlets, and levels of service provided by retailers?

- (b) Do retailers put pressure on their suppliers of hi-fi systems to limit the number of other retailers supplied by them, or to refrain from supplying specified retailers or wholesalers by:
 - (i) threatening not to stock the suppliers' brands or models;
 - (ii) attempting to persuade the suppliers to alter adversely the terms of supply to competitors (for example, by reducing the levels of discounts or allowances or advertising contributions);
 - (iii) requiring compensation for any harm to the plaintiff retailer's interests; or
 - (iv) other means?
- (c) Do any of the criteria used by suppliers for assessing applications for supply have the effect of unreasonably limiting the numbers of wholesalers or retailers selling hi-fi systems? In particular, do suppliers withhold supplies from dealers:
 - (i) whose pricing policies they think unacceptable, or
 - (ii) who are located in an area which in the supplier's view is already adequately served?
- (d) Are the criteria used by suppliers for assessing retailers for supply applied in a fair and non-discriminatory manner?

Criteria used to select dealers

4.169. On the basis of the evidence we received, chiefly from responses to our suppliers questionnaire (see paragraph 4.100(a)) and the survey of small retailers, we prepared a comprehensive list (see Appendix 12.1) of the selection criteria that appeared to have been used in 1995 by some or all of the suppliers that had 2 per cent or more of the UK hi-fi system market. We then tried to establish which of these criteria were actually used by each such supplier. This was not always easy to do (because of the imprecision of the criteria). The results are set out in paragraphs 4.170 to 4.186.

Aiwa

4.170. Aiwa had 21.7 per cent of the UK hi-fi system market by value in 1995. It operates a selective distribution system, requiring (in its 'Dealer Agreement' with certain retailers) 'adequate' standards for the retailers' premises; demonstration and display facilities; a range of Aiwa products to be held; minimum purchases; and trained staff. Other small retailers were set different requirements.

4.171. Aiwa told us that if a wholesaler sought supply it would consider its existing dealer base and decide whether the additional costs would be covered by increased sales. Aiwa supplied CIH but no longer had direct accounts with retailers who were members of its local groups. Aiwa supplies PriceCostco.

Sony

4.172. Sony had 11.4 per cent of the UK hi-fi system market by value in 1995. It operates a selective distribution system. Sony submitted its PEDAs to the European Commission in February 1993. The PEDAs created a selective distribution system for Sony electronic products in EU and European Free Trade Area countries. But the European Commission deemed that some aspects of the agreements were anti-competitive and Sony entered into negotiations with the European Commission which resulted in four changes being made. These concerned:

- (a) the establishment of a two-tier distribution agreement to preserve the wholesaler level; wholesalers had to undertake to supply only Sony authorized dealers;

- (b) a clause added to the agreements to the effect that Sony might not refuse to supply authorized dealers without written justification;
- (c) the introduction of an arbitration scheme, with access to an independent professional arbitrator or panel; and
- (d) for mail order companies selling Sony products, a stipulation of home delivery and a trial period, without obligation to purchase.

The European Commission gave Sony a comfort letter (see paragraph 4.431) in July 1995 to the effect that there were no further grounds for action by the European Commission in respect of the PEDAs. The construction that the European Commission put upon this is set out in paragraph 4.432.

4.173. Before Sony introduced its PEDAs, its retailers were selected *inter alia* on the basis of geographic location. Four retailers told us that they had been refused supply by Sony because the location was already supplied (see paragraph 4.191). Sony's criteria for supply include:

- (a) the appearance of dealers' retail premises;
- (b) qualified staff;
- (c) pre- and post-sales service; and
- (d) the promotion of Sony products in an appropriate manner.

Sony does not supply PriceCostco with hi-fi systems, but has offered to supply non-reference goods (see paragraph 12.122).

JVC

4.174. JVC had 9.9 per cent of the UK hi-fi system market in 1995. It operates a selective distribution system which includes the following criteria:

- (a) the dealer to be a specialist retailer of consumer electronics equipment;
- (b) the provision of suitable premises;
- (c) range-stocking and display requirements;
- (d) qualified staff;
- (e) pre- and post-sales service;
- (f) prohibition of resale to non-authorized retailers; and
- (g) commitment to the brand.

JVC has refused to supply PriceCostco, nor does it supply wholesalers. JVC's parent company, Victor, secured a comfort letter from the European Commission in 1988 in respect of the operation of its subsidiaries within EU member states (see paragraph 4.423).

Panasonic

4.175. Panasonic had 8.1 per cent of the UK hi-fi system market by value in 1995. It told us that it operated an 'open' selective distribution system, ie its authorized dealers remained free to supply its products to non-authorized dealers. Until 1 April 1997 it selected its authorized dealers on the basis of:

- (a) the standard of the premises;
- (b) staff training;
- (c) range-stocking requirements; and
- (d) pre- and post-sales service.

Panasonic told us that after 1 April 1997 it intended to introduce two new dealer agreements. One small retailer told us that it had been refused supply by Panasonic on the grounds that the location was already supplied (see paragraph 4.191(xvi)). Panasonic's response was that it would supply new dealers irrespective of locality if the effect was to increase Panasonic's volume of sales. In some areas, however, the effect of a new dealership would be to reduce the sales of existing dealers to a level where their commitment to marketing Panasonic products would be damaged.

4.176. Panasonic told us that it did not supply wholesalers with hi-fi systems other than in Northern Ireland, but it did not attempt to control wholesaling by its dealers, many of which had substantial wholesale businesses in addition to their retailing interests. Panasonic believed that a dealer whose sole wish was to wholesale products, to the exclusion of any retail sales activity, was unlikely to meet its criteria for appointment, in particular any service obligation. Panasonic has refused to supply PriceCostco with reference brown goods.

Kenwood

4.177. Kenwood had 8.2 per cent of the UK hi-fi system market by value in 1995. It operates a selective distribution system, requiring its dealers to provide approved premises; sufficient technically trained staff; demonstration facilities; after-sales service; an adequate range of Kenwood products; and to promote Kenwood's products. Kenwood supplies CIH but no other wholesaler. It had obtained undertakings from CIH to restrict the selling-on of Kenwood hi-fi systems to retailers willing to conform to Kenwood's selection criteria (see paragraph 12.61). Kenwood does not supply PriceCostco. It supplies Business-to-Business (Makro's procurement associate) but does not regard this as supply to Makro.

4.178. Kenwood told us that retailers' complaints that it had refused supply because the area was already supplied indicated that its sales staff might have acted in a way inconsistent with its policy.

Pioneer

4.179. Pioneer had 6 per cent of the UK hi-fi system market by value in 1995. The information it gave us about its distribution policy implied that it operates a selective distribution system.

Alba

4.180. Alba had 5.5 per cent of the UK hi-fi system market in 1995. From the information it gave us we are satisfied that it does not operate a selective distribution system.

Sanyo

4.181. Sanyo had 2.6 per cent of the UK hi-fi system market in 1995. It said that it operated a selective distribution system and that in May 1995 it had filed a notification of it with the European Commission, with a view to obtaining a comfort letter. (The European Commission told us that Sanyo's submission was still under consideration.) Sanyo said that its approval criteria for retailers included:

- (a) the nature and appearance of the premises;

- (b) display and demonstration of products;
- (c) the employment of trained staff; and
- (d) the offer of point-of-sale and after-sales service.

In addition, under the terms of its selective distribution dealership agreement Sanyo required approved dealers to:

- (e) correctly use the Sanyo trade mark;
- (f) meet minimum purchasing requirements;
- (g) provide post-sales service;
- (h) meet range-stocking expectations (of Sanyo's and competing suppliers' brands);
- (i) have commitment to the promotion of the Sanyo brand;
- (j) meet reasonable requirements for the advertising and promotion of Sanyo's products;
- (k) resell Sanyo's products only to authorized dealers, or consumers; and
- (l) continue to comply with Sanyo's approval criteria.

Sanyo said it required, too, that a dealer 'must not sell any Sanyo product as a loss leader, or otherwise at such a low price that it is not consistent with the brand and market positioning for Sanyo products'. Sanyo does not supply PriceCostco nor any wholesalers. Sanyo also said that the catalogues of mail order companies and catalogue stores should use full colour pictures and full descriptions of the Sanyo reference brown goods they sell. Sanyo told us (paragraph 12.148) that, provided these points were satisfied, the catalogue:

has substantially the same function and serves substantially the same purpose as the display and demonstration by trained staff. It may be that the information imparted is sometimes slightly less extensive than that available, for example, from an independent dealer and the customer, therefore, will not have an opportunity for having his or her question answered. That however is a matter for the personal choice of the consumer in selecting to purchase by mail order/catalogue.

Denon

4.182. Denon had 2.1 per cent of the UK hi-fi system market in 1995. The information it gave us about its distribution policy implied that it operates a selective distribution system.

Samsung

4.183. Samsung had 2.1 per cent of the UK hi-fi system market in 1995. From the information it gave us we are satisfied that it does not operate a selective distribution system.

General

4.184. Sharp had only 1.8 per cent of the UK hi-fi system market in 1995 and so does not appear in the preceding section (which is limited to suppliers with shares of 2 per cent or more). However, we are satisfied from the information we received that Sharp does not operate a selective distribution system.

4.185. Some suppliers, particularly Sony, argued that they had invested heavily in raising consumer awareness of their brand and the quality it connoted. It was essential to maintain the brand's image and position in the market and not allow it to be devalued. Those suppliers which used adequate pre-sales advice as a selective distribution criterion similarly justified it in terms of protecting the reputation of their brands in the eyes of the consumer. JVC, Kenwood, Sanyo and B&O were among the suppliers that told us 'commitment to the brand' on the part of potential dealers was an important criterion. We had defined it as 'a qualitative requirement that the retailer identifies his interests with the supplier's advancement' (see Appendix 12.1, paragraph 18). JVC said that it interpreted the criterion to mean that the retailer should not do anything that would bring the brand into disrepute. Sanyo said it required that the retailers' actions should be consistent with the position of the Sanyo brands in the market.

4.186. In summary, we found that all the larger suppliers established a dealer's creditworthiness before agreeing to supply it. No other criterion was cited by all of them, although minimum turnover was common. Otherwise the criteria most frequently cited were the suitability of the retailer's premises, his display and demonstration facilities, and the availability of pre- and post-sales service. Several suppliers thought that these requirements did not amount to a formal selective distribution system. Some suppliers' criteria were imprecise: we think they would not necessarily be understood by a retailer.

4.187. CIH supplies only members of its local groups. It told us that it had no control over the membership of these groups but it did recommend to them that retailers admitted for membership should have a minimum turnover of around £75,000 a year, should be financially sound and should be bona fide electrical retailers. It insisted that audited accounts covering three years' trading should be obtained from prospective members.

4.188. We asked the local groups what criteria they used for admitting new members and we received a range of answers. All groups mentioned creditworthiness and the submission of accounts for a period of three years. Some also required a minimum turnover, suitable premises, or acceptability to existing members.

Extent of withholding of supply

4.189. We investigated the extent to which the supply of hi-fi systems had been withheld from dealers. The evidence from multiple retailers suggested that they had little difficulty with hi-fi system supply. Those chiefly affected were the warehouse clubs, and particularly PriceCostco. (Indeed, we know of only three suppliers (Aiwa, Sharp and Philips) that directly supply hi-fi systems to PriceCostco.) Wholesalers were affected (see paragraphs 12.107 to 12.114) because three hi-fi system suppliers (JVC, Sanyo and Pioneer) do not supply any wholesalers in the UK. Panasonic does not supply hi-fi systems to outlets whose primary business is wholesaling, except in Northern Ireland (where it supplies only one). The only observations we had from a hi-fi system wholesaler (PACT) related to Aiwa in Northern Ireland and Scotland, and LG in Northern Ireland (see paragraph 4.191, cases (ii) and (xv)). Our survey of small retailers produced 18 cases of refusal to supply hi-fi systems (see paragraph 4.192(a)), usually on the grounds that the locality was already supplied.

Observations on suppliers' behaviour

4.190. We received a total of 120 observations by dealers on the question of withholding supply of hi-fi systems. We judged that 74 of these lacked sufficient detailed evidence for us to pursue them further, in particular because many retailers were unwilling to be specific about suppliers or because the observations were about matters outside our terms of reference. The remaining observations (with two exceptions), and suppliers' comments on them, are set out in Appendix 12.2. (The exceptions are set out in paragraphs 12.132, 12.138 and 12.139.) In three cases the retailer making the observation asked for the name of the business not to be divulged to the supplier. We carefully considered each retailer's request for anonymity, mindful of the potential risk that disclosure of that retailer's identity could adversely affect his relationship with suppliers and thereby damage his business. Initially, we put the substance of the observations made by retailers wishing to remain anonymous to the suppliers named by those retailers for their comments. However, in each of these cases, the named supplier declined to comment without knowing the full facts including the identity of the particular retailer. We decided in each of these cases to preserve the anonymity of the person who had sought it, since we accepted that there was a risk that the disclosure of his identity could harm his business. To complete our record of the evidence we received, we have included two of these anonymous observations in Appendix 12.2 together with 11 other cases which we were unable to substantiate owing to an irreconcilable conflict of evidence between retailer and supplier. We have not relied on those cases in reaching our conclusions. However, in one case we decided that the supplier had in effect accepted the substance of what the retailer had said.

4.191. In reaching our conclusions, we have relied on the following 33 cases where we accepted the dealer's account, either because the supplier has effectively conceded the substance of the dealer's observations, or we find that the supplier's comments are unconvincing. The cases are presented briefly in alphabetic order, by supplier:

Aiwa

- (i) Brighton Audio and TV (BAT), Brighton, Sussex, told us that it had been refused supply of Aiwa hi-fi systems during 1993 on the grounds that the locality was already supplied.
- (ii) PACT told us that Aiwa had asked it to refrain from canvassing business from dealers in Northern Ireland and Scotland.

B&O

- (iii) JLP told us that it had wished to sell some models of B&O's hi-fi systems in a few branches but was unable to do so because B&O had stipulated that it should stock a minimum range, presented in a way that did not suit it.
- (iv) Sevenoaks Hi-Fi & Video told us that B&O had terminated its dealer agreement when its Tunbridge Wells branch moved 100 yards down the road to larger premises on the grounds that the agreement was specific to the original site.

Hitachi

- (v) PriceCostco told us that, as at 21 July 1995, Hitachi would not discuss supply of hi-fi systems with it.

JVC

- (vi) PriceCostco told us that in a letter of 1 November 1994 JVC stated, not for the first time, that it would not supply PriceCostco with hi-fi systems.
- (vii) BAT, Brighton, Sussex, told us that it had been refused supply of JVC hi-fi systems during 1993 on the grounds that the locality was already supplied.
- (viii) N&P told us that JVC had refused to supply Cargo Club with hi-fi systems.

Kenwood

- (ix) Lisnasure Interiors, Dromore, Co Down, said that it had been refused supply of Kenwood hi-fi systems in 1993/94 because the locality was already supplied.
- (x) Mannering & Sons Ltd, Harrow, said that Kenwood had refused to supply it with hi-fi systems in 1993 because the locality was already supplied.
- (xi) Charlesworth of Crewe Ltd, Hightown, Crewe, said that it had been refused supply of Kenwood hi-fi systems in 1993 on the grounds that the locality was already supplied.
- (xii) Ancrum Electronics, Dundee, said that it had been refused supply of Kenwood hi-fi systems around July 1994 on the grounds that the locality was already supplied.
- (xiii) S & R Electric Ltd, Belfast, said that it had been refused supply of Kenwood hi-fi systems on more than one occasion on the grounds that the locality was already supplied. The Kenwood representative had said that it could be considered for supply if another Kenwood retailer in the area were to cease trading.
- (xiv) Anglian Home Entertainment, Ipswich, Suffolk, said that it had been refused supply of Kenwood hi-fi systems in March 1993 on the grounds that Kenwood was not seeking any additional outlets locally at that time.

LG

- (xv) PACT told us that the agreement it had with LG excluded the right to distribute hi-fi systems to dealers in Northern Ireland.

Panasonic

- (xvi) A One Services, Sutton, Surrey, said that it had been refused supply of Panasonic hi-fi systems in January 1994 on the grounds that the locality was already supplied.
- (xvii) PriceCostco said that on 12 June 1995 it had asked Panasonic to supply hi-fi systems but it had been refused, not for the first time. Panasonic had offered only non-reference goods and had not responded to PriceCostco's request for Panasonic's premier range products.
- (xviii) N&P told us that Panasonic had refused to supply Cargo Club with hi-fi systems.
- (xix) Freemans told us that Panasonic had refused to supply it with Technics hi-fi systems on the grounds that the image given in Freemans' mail order catalogue was unacceptable.
- (xx) Makro told us that it had been involved in discussions with Panasonic for 15 months before it secured supply of hi-fi systems (see paragraphs 12.138 and 12.139). Even then Panasonic would not supply its Technics brand.

Pioneer

- (xxi) S & R Electric Ltd, Belfast, said that it had obtained Pioneer hi-fi systems from a local distributor, but when (following a reorganization) Pioneer ceased to supply that distributor, Pioneer had refused him direct supply of those goods on the grounds that the locality was already supplied.

Samsung

- (xxii) Alphavision, Eastbourne, told us that Samsung's refusal to supply it with hi-fi systems was common practice in the trade and might reflect pressure on suppliers from large retailers telling them not to supply smaller competitors.

Sanyo

- (xxiii) PriceCostco told us that Sanyo would not supply it with hi-fi systems.
- (xxiv) Makro told us that Sanyo had withdrawn supply of hi-fi systems with effect from 1995.

Sony

- (xxv) Magnet Discount Warehouses, London, N18, told us that it had been refused supply of Sony hi-fi systems in 1994/95 on the grounds that the locality was already supplied.
- (xxvi) Lisnasure Interiors, Dromore, Co Down, said that it had been refused supply of Sony hi-fi systems in 1993/94 because the locality was already supplied.
- (xxvii) Shadoos, Wilmslow Road, Rusholme, Manchester, said that Sony had refused to supply it with hi-fi systems in earlier years, but that (following its representations to the Area Manager) it had signed an agreement with Sony in April 1995. Shortly afterwards the Area Manager had changed, and his successor had halted the opening of the account, questioning whether the retailer met Sony's criteria.
- (xxviii) PriceCostco told us that Sony would not supply it with hi-fi systems.
- (xxix) Broadbent Television told us that it was unable to obtain supply of Sony hi-fi systems until April 1995, having applied in 1993 and 1994.
- (xxx) Colins (Electrical Warehouse) Ltd of Kingstanding, Birmingham, told us that it was unable to obtain supply of Sony hi-fi systems.
- (xxxi) Mr Whistance, of Hereford, told us that he had been refused supply of Sony hi-fi systems in 1993 on the grounds that the locality was already supplied.
- (xxxii) Sony told us that it had refused to supply Cargo Club with hi-fi systems (see paragraph 12.132).
- (xxxiii) SRS 110. This retailer told us that he had been refused supply by Sony in 1993 because the locality was already supplied.

4.192. In assessing the significance of these cases we have borne the following points in mind:

- (a) Eighteen of the cases identified in the preceding paragraph were derived from our survey of small retailers; this covered a random sample of about 12 per cent of such retailers in the UK; had all of them been asked for their observations it is reasonable to suppose that the number of such cases would have been substantially larger.
- (b) As we have observed (see paragraph 4.162(a)), small retailers were commonly reluctant to come forward in the course of our survey with observations that suppliers could construe as critical of them; this concern is reflected in the wish of three of the 18 who made observations to remain anonymous.
- (c) Fifteen of the observations come from multiple retailers, wholesalers and warehouse clubs, thus indicating that the practices referred to are not solely about the relationship between suppliers and small retailers.

The monopoly situations

4.193. Our terms of reference (see Appendix 6.1) require us first to investigate and report whether a monopoly situation exists in relation to the supply in the UK otherwise than by retail sale or hire of hi-fi systems, and if so:

- (a) by virtue of which provisions of sections 6 to 8 of the FTA that monopoly situation is to be taken to exist; and
- (b) in whose favour the situation exists.

4.194. Section 6 of the FTA deals with monopoly situations in the supply of goods and is therefore the relevant section for our inquiry. (Section 7 deals with services and section 8 with exports.) In effect section 6 identifies four different kinds of monopoly situation, of which three are relevant for our purposes. Two of these are commonly described as 'scale' monopoly situations, and the third is what the FTA calls a 'complex monopoly situation'.

Findings on a scale monopoly situation

Suppliers

4.195. A scale monopoly situation is taken to exist under section 6(1)(a) of the FTA in relation to the supply in the UK (otherwise than by retail sale or hire) of hi-fi systems when at least one-quarter of all hi-fi systems which are so supplied are supplied by one and the same person; or, under section 6(1)(b), where at least one-quarter of hi-fi systems which are so supplied are supplied by members of one and the same group of interconnected bodies corporate.

4.196. Table 4.1 shows that Sony Corporation had a 33.1 per cent share of the market by value in 1995, and 29.7 per cent in 1994. In February 1996 we informed Sony of our provisional finding that a scale monopoly situation existed in that Sony Corporation supplied at least one-quarter by value of hi-fi systems supplied in the UK. We invited Sony to inform Sony Corporation to this effect and we understand it did so. Sony Corporation did not question this provisional finding.

4.197. We conclude that a monopoly situation exists by virtue of section 6(1)(b) of the FTA (a scale monopoly situation) in that Sony Corporation supplies (otherwise than by retail sale or hire) at least one-quarter by value of the hi-fi systems which are supplied (otherwise than by retail sale or hire) in the UK.

4.198. Our terms of reference also require us to report in whose favour the monopoly situation exists. We informed Sony Corporation (through Sony) of our provisional finding that the scale monopoly situation existing by virtue of its share of the supply of hi-fi systems existed in favour of Sony Corporation, Sony and Aiwa. Sony Corporation did not question the provisional finding; the views of Sony and Aiwa are set out in paragraphs 13.68 and 13.116 to 13.119 respectively.

4.199. We conclude that the scale monopoly situation we have identified, and which is taken to exist by virtue of section 6(1)(b) of the FTA, exists in favour of Sony Corporation, Sony and Aiwa.

Acquisition of goods by retailers

4.200. Our terms of reference exclude supply by retail sale or hire. However, a scale monopoly situation under the FTA is taken to exist in relation to the supply in the UK (otherwise than by retail sale or hire) of hi-fi systems, when at least one-quarter of all the hi-fi systems which are so supplied in the UK are supplied to one and the same person (section 6(1)(a)), or to members of one and the same group of interconnected bodies corporate (section 6(1)(b)). In other words, the FTA provides for a scale monopoly situation in relation to the acquisition of goods. We have no direct measure of the share of hi-fi systems acquired by each retailer but we believe that retailers' shares of sales to consumers will be a good proxy

measure. In 1995 no retailer of hi-fi systems had a share of the UK market exceeding 22.6 per cent. This was insufficient to give rise to a scale monopoly situation.

Findings on complex monopoly situations

4.201. Under section 6(1)(c) and (2) and section 11 of the FTA a complex monopoly situation is taken to exist in relation to the supply in the UK (otherwise than by retail sale or hire) of hi-fi systems, when at least one-quarter of all hi-fi systems which are so supplied are supplied by or to members of one and the same group consisting of two or more persons (not being a group of interconnected bodies corporate) who, whether voluntarily or not and whether by agreement or not, so conduct their respective affairs as in any way to prevent, restrict or distort competition in connection with the production or supply of hi-fi systems, whether or not they themselves are affected by the competition and whether the competition is between persons interested as producers or suppliers or between persons interested as customers of producers or suppliers.

4.202. In February and March 1996 we informed all suppliers and retailers of hi-fi systems whom we could identify of our provisional findings that two complex monopoly situations existed, by virtue of section 6(1)(c) and (2) of the FTA, in respect of the supply (otherwise than by retail sale or hire) of hi-fi systems in the UK.

4.203. We set out our full provisional findings in the issues letters that we sent to the larger suppliers and larger multiple retailers of hi-fi systems (see Appendix 6.1). In the interests of minimizing the demands on the trade, we sent only a summary of our provisional findings to the smaller suppliers and smaller multiple retailers. We also wrote briefly to some 4,000 small retailers of hi-fi systems. The full provisional findings were sent to any supplier, retailer or third party who requested them.

4.204. In considering whether any complex monopoly situation existed in relation to the supply of hi-fi systems in the UK (otherwise than by retail sale or hire), we had to consider the limitations on our jurisdiction arising from the application of the RTPA. Section 10(2) of the FTA stipulates that in determining the existence of a monopoly situation, the MMC shall take no account of the provisions of any agreement in so far as they are provisions by virtue of which it is an agreement to which the RTPA applies.¹ This matter was relevant to our investigation with regard to the activities of CIH and its local groups. Those organizations fall within the definition (in section 43(1) of the RTPA) of a trade association as they exist for the purpose of furthering the trade interests of their members or of persons represented by their members. Section 8(2) of the RTPA applies to specific recommendations made by a trade association to its members or to any class of its members, as to the action to be taken by them in relation to any particular class of goods, in respect of any matters mentioned in section 6(1) of the RTPA. Those matters include restrictions as to the prices to be charged (or to be recommended or suggested as the prices to be charged) for goods and the persons or classes of persons to whom goods are to be supplied. Section 8(3) of the RTPA deems the constitution of the trade association to contain a term by which each member and any person represented on the association by any such member agrees to comply with the association's recommendations. In order to conclude that CIH and the local groups are part of a group for the purpose of establishing the existence of any complex monopoly situation, we needed to show that they were conducting their respective affairs as in any way to prevent, restrict or distort competition in connection with the supply of hi-fi systems (otherwise than by retail sale or hire).

4.205. It was our provisional view that the making of various recommendations by CIH and the local groups to retailers and compliance by retailers with those recommendations could amount to a prevention, restriction or distortion of competition. This included any of the following actions which we had found were taken by CIH and the local groups:

- (a) in relation to hi-fi systems which CIH (or any other supplier through CIH) supplies to individual retailers, any recommendations by CIH as to the retail prices which those retailers should charge

¹Section 54(5) of the FTA also states that we should exclude from our consideration the question whether the provisions of such an agreement operate or may be expected to operate against the public interest.

for such goods; this would include passing on those RRP's recommended or suggested by other suppliers;

- (b) any similar recommendations made by the local groups in respect of hi-fi systems which they supply otherwise than by retail sale or hire to individual retailers;
- (c) any recommendations made by CIH to individual retailers against the resale, to dealers who are not members of the local groups, of hi-fi systems purchased from or through CIH;
- (d) any similar recommendations made by the local groups to their individual retailer members; and
- (e) any recommendations made by CIH as to the criteria to be adopted by local groups in admitting individual retailers to their membership, thereby making those retailers eligible to receive supply from or through CIH.

4.206. The question then was whether such recommendations, and retailers' compliance with them, were provisions of agreements to which the RTPA applied, in which case we would not have been able to take account of those matters in analysing the position of CIH and the local groups with regard to their possible inclusion in any complex monopoly group.

4.207. CIH told us that it intended to change its membership arrangements so that membership of CIH would be open to individual retailers. However, at the date of our report the new membership policy had not been brought into effect and the members of CIH continued to be the local groups (whose own membership consisted of individual retailers who satisfied the particular local group's criteria for admission as members). In the light of this we concluded that:

- (a) in recommending or suggesting retail prices to retailers, CIH would not be making any specific recommendations to which the RTPA applied since those retailers were not members of CIH itself; accordingly we were able to take account of those recommendations and subsequent compliance on the part of retailers in considering the existence of any complex monopoly situation;
- (b) in recommending or suggesting retail prices to their retailer members, the local groups would be making specific recommendations to which the RTPA applied; accordingly we were not able to consider the effect of those recommendations and subsequent compliance on the part of retailers in considering the existence of any complex monopoly situation;
- (c) on the same basis as set out in (a) above, we were able to take account of CIH's recommendations as to resale of hi-fi systems supplied by or through it, and subsequent compliance by retailers;
- (d) on the same basis as set out in (b) above, we were not able to take account of recommendations concerning resale of hi-fi systems made by the local groups to their individual retailer members; and
- (e) in making recommendations as to the criteria to be adopted by local groups in admitting individual retailers to their membership, CIH would not be making recommendations as to the persons or classes of persons to whom goods are to be supplied or any of the other matters mentioned in section 6(1) of the RTPA; accordingly we were able to take account of the recommended criteria and their use by the local groups in considering the existence of any complex monopoly situation.

4.208. We also concluded that we could take account of the use of various criteria adopted by the local groups (without any recommendation by CIH) in admitting individual retailers to their membership. This was on the basis that this, too, could amount to a prevention, restriction or distortion of competition, and, since the adoption of such criteria involved no restriction being accepted by existing members with regard to any of the matters mentioned in section 6(1) of the RTPA, it was not likely to give rise to an agreement to which the RTPA applied.

First complex monopoly situation

4.209. We provisionally found a complex monopoly situation ('the first complex monopoly situation') to exist in relation to the supply in the UK otherwise than by retail sale or hire of hi-fi systems as a result of a group of persons, comprising both suppliers (which together supplied more than one-quarter of the hi-fi systems supplied in the UK other than by retail sale or hire) and retailers of hi-fi systems, which appeared so to conduct their affairs as to prevent, restrict or distort competition by engaging in the following practices:

- (a) suppliers within the group recommend or suggest retail prices, or both, for hi-fi systems that they supply to their retailers, or take part in discussions with retailers which influence the recommended or suggested retail prices that the suppliers then set, or both; and
- (b) retailers within the group take account of suppliers' recommended or suggested retail prices, or both, in setting advertised and displayed prices for the hi-fi systems that they sell, or take part in discussions with suppliers which influence the retail prices recommended or suggested by those suppliers, or both.

4.210. We provisionally identified the following as members of the group described in paragraph 4.209:

- (a) suppliers of hi-fi systems that conducted their respective affairs as described above; these suppliers included Aiwa, Sony, JVC, Panasonic, Kenwood,¹ Philips, Pioneer, Sanyo and Sharp; and
- (b) retailers of hi-fi systems that conducted their respective affairs as described above.

At a later stage in our inquiries we provisionally identified as members of this group Alba, CIH and each of the retailers who are members of its local groups.

4.211. We provisionally found that the first complex monopoly situation existed in favour of the suppliers and retailers mentioned in paragraph 4.210.

Views of parties on the first complex monopoly situation

4.212. We invited the suppliers and retailers concerned to comment on our provisional findings and on the supporting evidence in the issues letters which included the results of analyses we had undertaken of:

- (a) data from GfK to establish the distribution of hi-fi retail prices and their relationship to RRP's;
- (b) our survey of small retailers; and
- (c) responses to a questionnaire we sent to multiple retailers.

The material also reflected points made in exploratory hearings that we had in 1995 with 12 of the larger multiple retailers and two of the warehouse clubs. Some of the information included in the issues letters, particularly that relating to price distributions, was subsequently amended. We sent amended price distribution data to all recipients of the provisional data.

(a) Suppliers

4.213. Suppliers' views on their inclusion in the first complex monopoly situation are set out in full in Chapter 13. With few exceptions, of which Aiwa was the largest (see paragraph 4.217), suppliers of hi-fi systems agreed that they recommended retail prices to retailers. In general suppliers thought, however, that

¹Referred to in the issues letters as Trio-Kenwood Limited.

the practice could not be held to prevent, restrict or distort competition as retail transaction prices for hi-fi systems were determined in the market-place by competition between suppliers and between retailers.

4.214. The larger suppliers (with the exception of Sony) also agreed that they discussed with the larger retailers the price positioning (see paragraph 4.102(iv), footnote) of new models and the selling prices of existing models in the market. They argued that this was natural since retailers were closer to the market and, because of their access to information from a range of suppliers, had a more extensive understanding of the competitiveness of individual models. In the suppliers' view such discussions did not constitute conclusive evidence that the suggested selling prices that might emerge in any way inhibited price competition between retailers. Suppliers also noted that the survey of small retailers showed that over 92 per cent of respondents selling hi-fi systems had charged prices lower than RRP's and 44 per cent had advertised prices below RRP's. Suppliers thought it scarcely surprising that almost all small retailers 'took into account' RRP's since, they argued, an RRP provided useful information on the positioning of a model relative to competing offers in the market-place. However, the survey showed that small retailers were constrained by the RRP in deciding at what price to conclude a transaction with a consumer.

4.215. Sanyo said that our terms of reference related only to 'steps taken ... to influence the prices at which dealers resell hi-fi systems' and that in consequence there was an insufficient direct causal connection between any protection of all or part of a retailer's margin on the one hand and the ability by any such action to influence the prices at which that dealer resells the reference goods that it has purchased on the other. Sanyo argued that we did not have jurisdiction under our terms of reference either to report or to make any recommendation on margin support or a supplier's protection of its retailers' margins.

4.216. Sony said it did not consider that suppliers' policies concerning POA advertising came within our terms of reference; Sony was not aware of any evidence that such policies were intended to influence the prices at which dealers resold products.

4.217. Aiwa told us that with effect from 1 April 1997 it had ceased to recommend retail prices.

(b) CIH

4.218. CIH did not dispute our conclusions on our jurisdiction (see paragraphs 4.204 to 4.208) and it accepted that it was technically a supplier in our terms, in that it took title to the hi-fi systems it purchased on behalf of retailers which were members of its local groups. However, it argued that for the purposes of any recommendations we might make we should not treat it in the same way as suppliers which were manufacturers or importers.

(c) Retailers

4.219. Retailers' views on their inclusion in the first complex monopoly situation are set out in full in Chapter 14.

4.220. Comet argued that our provisional finding did not conform with the terms of section 6(1)(c) of the FTA. More particularly, it thought this section did not provide for a single group comprising both members supplying and members being supplied with the relevant goods. Comet told us that it 'does not consider it can be included in a complex monopoly group consisting of the suppliers from whom it purchased its products and with whom it has to negotiate its buying prices and terms of trade'.

4.221. With regard to our terms of reference, Comet argued that they were 'specific in applying to the supply in the UK, otherwise than by retail sale or hire, of the reference goods'. In Comet's view, the terms of reference expressly excluded supply at the retail level of the market. In other words, they did not extend to Comet (or, indeed, any other retailer). Accordingly, in Comet's view any attempt at inclusion of retailers in a complex monopoly group otherwise consisting of suppliers would be outside our terms of reference.

4.222. Dixons said that in this case, the relevant group was defined by reference to a specific level of supply, namely 'supply in the UK otherwise than by retail sale or hire' in accordance with the terms of

reference. Dixons said that as the level of supply at which it operated was expressly excluded from the terms of reference, necessarily it could not form part of the group since it does not supply otherwise than by retail. In Dixons' view, the approach taken by us in our provisional findings disregarded what Dixons saw as an important qualification imported by the terms of reference and also disregarded the fact that the two matters specified in the terms of reference for the purposes of section 49(2)(c) of the FTA are confined to steps taken by suppliers rather than steps taken by retailers.

4.223. Dixons stated that its prices had no regard to RRP; that its discussions with suppliers were similarly without regard to RRP; and hence that it could not be included within this complex monopoly. When asked at a hearing, Dixons told us that its prices often coincided with RRP.

4.224. Dixons agreed that it discussed the product positioning and relative competitiveness of new models with suppliers before the models were launched. It was also in continual contact with suppliers about the market prices being achieved by models already in the market-place since these prices were relevant both to the numbers that Dixons was committed to buy and to the profitability of the line. It agreed that suppliers might be influenced by such discussions in reaching their decisions on what retail prices to recommend.

4.225. However, Dixons itself made no reference to suppliers' RRP in its promotional material and was not constrained by them. It set its own retail prices independently of the supplier's views, basing its judgment on its expectation of what the product would fetch in the market-place, taking account of the wide choice of competing models from other suppliers and of other retailers' competitive strategies. The market price resulted from consumers' views of the value of a particular product and not from suppliers' or retailers' views of the price that ought to be obtainable. In Dixons' view therefore, there was no basis for the provisional finding that conduct by suppliers or retailers affected competition.

Conclusions on first complex monopoly situation

4.226. In reaching our conclusions on the existence of the first complex monopoly situation we have taken account of the suppliers' and retailers' views set out in full in Chapters 13 and 14 respectively, and as summarized above.

4.227. We have carefully considered but do not accept the view put forward by Comet that retailers cannot, in law, be included in the same complex monopoly group as suppliers. As stated in paragraph 4.220, Comet primarily relies for this view on the wording of section 6(1)(c) as indicating that the complex monopoly group must wholly consist of either the suppliers of the relevant goods or the recipients of those goods.

4.228. Comet acknowledged that in past reports¹ the MMC had included both suppliers and other parties in the group for the purpose of establishing the existence of a complex monopoly situation, and we note that on several occasions² the MMC's approach in this regard has been endorsed by the Court.

4.229. However, Comet relied on the proposition that the previous cases involved complex monopoly group members who were '... either actual suppliers of the reference goods or other parties at the same level of the market who contribute to such supply'. Comet thought that the present case was very different in that suppliers and retailers operated at different levels of the market. In Comet's view, retailers had no structural links with suppliers and, following arm's length negotiations with those suppliers, were at the receiving end of supply. Whilst noting that section 6(2) makes clear that the effects of a complex monopoly group's conduct may be at any level of the market, Comet thought that this section should be read as leading from what it saw as the premise in section 6(1)(c) that the group could consist of those persons supplying and those being supplied. Comet also said that to its knowledge no previous MMC report had included in the complex monopoly group both suppliers and persons being supplied.

¹For example, see the MMC's reports on: *Greyhound Racing*, Cmnd 9834, July 1986, paragraph 8.7; *Credit Card Services*, Cm 718, August 1989, paragraph 7.24; *Electrical Contracting at Exhibition Halls in London*, Cm 995, April 1990, paragraph 6.9. All published by HMSO.

²See *R v Monopolies and Mergers Commission ex parte Visa* (1990)-affirmed by the Court of Appeal (1991); *R v Monopolies and Mergers Commission ex parte Ecando Systems* (1991)-upheld by the Court of Appeal (1992).

4.230. What is important in establishing the existence of a complex monopoly situation is the identification of a group of 'two or more persons ... who, whether voluntarily or not and whether by agreement or not, so conduct their respective affairs, as in any way to prevent, restrict, or distort competition in connection with the production or supply of [the] goods ...'.¹ Once such a group of persons is identified, then all section 6(1)(c) requires is that those who supply at least one-quarter of the total supply of the goods shall be members of the group.

4.231. This leaves the possibility that there may be others who do not themselves supply the goods but are through their conduct to be regarded as being in the same group as those who do supply the goods. (This does not require that the group should be 'homogeneous' in the sense that the ways in which the members of the group conduct their affairs in relation to the supply of goods need to be identical or even very similar.) As our provisional findings in paragraph 4.201 indicate, we regard both suppliers and retailers through the conduct of their respective affairs to be involved in the setting and dissemination of RRP's in respect of hi-fi systems. Among the points to emerge from the evidence relating to prices, set out in paragraphs 4.99 to 4.162, with respect to the conduct of retailers, are the following:

- (a) retailers are involved in discussions with suppliers concerning the setting of initial RRP's which are typically the starting point for negotiations on the size of the retailers' gross margins;
- (b) the majority of retailers take account of RRP's in setting their own prices and, in those cases where those prices are at the same level as RRP's, effectively derive their gross margins from those RRP's; and
- (c) retailers often urge suppliers to put pressure on their competitors to adhere to RRP's or to compensate them by, for example, offering margin support.

4.232. We also do not accept Comet's view that we are constrained, as it suggests, in our application of section 6(2). In our view section 6(2) applies even if members of the group operate at different levels of the market, provided those members that are not suppliers are conducting their respective affairs as in any way to prevent, restrict or distort competition in connection with the supply of the goods. This would not be the first case in which persons operating at different levels of a market were included in the same complex monopoly group. In the MMC report on the supply of films² both distributors and exhibitors were identified as being in the same group.

4.233. We do not accept Comet's view with regard to our terms of reference. Whilst we are required to determine whether a monopoly situation exists in relation to the supply of hi-fi systems in the UK, otherwise than by retail sale or hire, our terms of reference do not exclude retailers being included in the group for the purpose of establishing a complex monopoly situation in relation to such supply if, as we provisionally concluded in paragraph 4.201, they satisfy section 6(2) by being members of a group which conducts its respective affairs so as to prevent, restrict or distort competition in connection with the supply of such goods.

4.234. Likewise we do not accept Dixons' similar argument that, in this case, the complex monopoly group is defined by reference to the specific level of supply set out in our terms of reference. As already explained, we do not consider that the complex monopoly group need consist only of suppliers. Our terms of reference require us to investigate and report on whether a monopoly situation exists in relation to the supply of hi-fi systems in the UK, otherwise than by retail sale or hire. As indicated above, we do not consider that our terms of reference prevent us from including retailers within the group of persons who conduct their respective affairs so as to prevent, restrict or distort competition, provided that the group also includes persons who supply at least one-quarter of hi-fi systems in the UK otherwise than by retail sale or hire. Furthermore we do not agree with Dixons that the two matters specified in our terms of reference (influence on dealers' resale prices and withholding supplies from dealers), with regard to our investigation of the effects on the public interest, preclude us from identifying retailers as being members of a complex

¹Section 6(2) FTA.

²*Films: a report on the supply of films for exhibition in cinemas in the UK*, HMSO, Cm 2673, October 1994.

monopoly group existing in relation to the supply of hi-fi systems in the UK (otherwise than by retail sale or hire).

4.235. We considered whether a party with a modest market share should not be included in the group which carries on the practices referred to in paragraph 4.209, on the grounds that it cannot individually affect competition.¹ It is the fact that the relevant practices are so widespread, and accepted by the brown goods industry, that restricts or distorts competition. It is quite common for the MMC when investigating such widespread practices to include numerous persons in the complex monopoly group even though many, and perhaps all, may have very small market shares,² and such practices are condoned by the industry at large.

4.236. Having considered objections to our provisional findings, we now turn to our conclusions, addressing first whether a complex monopoly situation exists by virtue of section 6(1)(c) and (2) of the FTA. In doing so, we rely upon the evidence relating to prices set out in paragraphs 4.100 to 4.162.

4.237. All the suppliers named in paragraph 4.210 (except Aiwa, since 1 April 1997) recommend or suggest retail prices for hi-fi systems. Most other suppliers with a smaller market share do likewise. A full list of those suppliers of which we are aware that recommend or suggest retail prices is set out in Appendix 4.1.

4.238. The larger multiple retailers, in particular Dixons and Comet, take part in discussions with suppliers about the prospective RRP of their products. Several suppliers told us that they took account of retailers' views when setting RRP. 93 per cent of respondents to the survey of small retailers (see paragraph 4.155) and 49 per cent of multiple retailers, weighted by sales (see paragraph 4.157), took account of or were influenced by RRP when setting their own retail prices. As our knowledge of this practice comes mainly from survey material, we cannot name all the retailers who engage in it.

4.239. The suppliers (other than Aiwa and CIH) named in paragraph 4.210 have a combined market share of about 50 per cent of the supply of hi-fi systems in the UK, otherwise than by retail sale or hire (see Table 4.1). Thus these suppliers, together with all other suppliers which recommend or suggest retail prices for hi-fi systems, have a combined share of more than one-quarter of the supply of hi-fi systems in the UK (otherwise than by retail sale or hire).

4.240. The next issue which arises is whether the practices referred to in paragraph 4.209 restrict or distort competition. One of the conclusions of the 1969 MMC report on RRP³ was that the recommendation of resale prices in conjunction with factors such as restriction of outlets and monopoly in the supply industry might prevent price competition in retailing, and that in such cases prices were likely to be higher than they would otherwise be. The report found that the effect of the practice differed in different trades and that the balance of the effect on the public interest differed accordingly.

4.241. In our view the effect of the setting of RRP for hi-fi systems by suppliers (often after consultation with retailers) is to influence dealers' pricing decisions and thereby restrict or distort competition in the supply of hi-fi systems in the UK. The price distribution analysis in paragraphs 11.94 to 11.107 points to a clustering of transaction prices within 5 per cent of the RRP for most of the best-selling models examined. We think this clustering is a result of the influence of RRP on transaction prices (see paragraph 4.266 for a more detailed discussion).

4.242. The evidence suggests to us that the setting of RRP by suppliers, and retailers' actions in taking account of RRP, constitute conduct which has the effect of restricting or distorting competition in the supply of hi-fi systems in the UK.

¹A similar argument was rejected in the MMC's report on *Credit Card Services*, HMSO, Cm 718, August 1989, paragraph 7.26.

²For example, see *Private medical services*, HMSO, Cm 2452, February 1994 and *The supply of residential mortgage valuations*, HMSO, Cm 2542, April 1994.

³*Recommended Resale Prices: a report on the general effect on the public interest of the practices of recommending or otherwise suggesting prices to be charged on the resale of goods*, HMSO, HC 100, February 1969.

4.243. We conclude that a complex monopoly situation exists by virtue of section 6(1)(c) and (2) of the FTA. The members of the group who conduct their affairs so as to restrict or distort competition in the supply of hi-fi systems are all those suppliers of hi-fi systems that suggest or recommend RRP, and all retailers of hi-fi systems who take account of RRP in setting their own retail prices or take part in discussions with suppliers which influence the RRP suggested by those suppliers, or both.

4.244. The next question we must address is in whose favour this first complex monopoly situation exists. The effect of retailers largely adhering to RRP is to reduce price competition between them. This operates in their favour in that it reduces the pressure on them to cut the prices that they charge to consumers. It also operates in favour of those suppliers suggesting or recommending RRP as we believe that if retailers were forced to compete more on their selling price they in turn would put greater pressure on suppliers to improve the terms on which they sold to retailers. We conclude that the first complex monopoly situation exists in favour of all the members of the group identified in paragraph 4.210, except Aiwa.

Second complex monopoly situation

4.245. We provisionally found a complex monopoly situation ('the second complex monopoly situation'), relating to the withholding of supply, to exist in that a group of suppliers (supplying more than one-quarter of the hi-fi systems supplied in the UK other than by retail sale or hire) appeared so to conduct their affairs as to prevent, restrict or distort competition by engaging in the practice of selecting dealers to be supplied with hi-fi systems by taking into account one or more of the following:

- (a) the number, type or location of its existing dealerships;
- (b) the nature of the dealer's business, for example that the dealer's premises are open to all members of the public, that he is a recognized retailer of the reference product, or the appearance of the premises;
- (c) the conduct of the business, including the nature and appearance of the premises, the level and type of pre- or post-sales service to be provided by the dealer, for example with regard to staff calibre and training, stockholding, display, demonstration, delivery, installation or repair facilities;
- (d) the acceptance by the dealer of restrictions on how the supplier's goods are to be advertised or promoted, for example by requiring the dealer to submit advertising material for approval or to use material provided by the supplier;
- (e) the acceptance by the dealer of restrictions on onward sale of the supplier's goods to unauthorized dealers;
- (f) the dealer's pricing policies;

and refusing to supply hi-fi systems to retailers who are not so selected.

4.246. We provisionally identified as members of this group the suppliers who conducted their affairs as described in paragraph 4.245. These suppliers included Aiwa, Sony, JVC, Panasonic, Kenwood, Philips, Pioneer and Sanyo. At a later stage in our inquiries we provisionally identified CIH, and those of its local groups which are suppliers, as members of this group.

4.247. We provisionally found that this complex monopoly situation existed in favour of the suppliers specified in paragraph 4.246, and of those retailers in the UK selected to receive supplies of hi-fi systems from these suppliers.

Views of parties on second complex monopoly situation

4.248. We invited the suppliers and dealers concerned to comment on our provisional findings.

(a) Suppliers

4.249. Suppliers' criteria for selecting dealers are set out in paragraphs 4.169 to 4.190; suppliers' views on those criteria are set out in full in Chapter 13 and suppliers' distribution policies are described in Chapter 12. All the suppliers denied that they had withheld supply from dealers because they had charged, or were expected to charge, prices below RRP. Sanyo told us, however (see paragraph 12.106), that if it were to supply cut-price retailers who did not meet [its] present standards for service, and its other selection criteria, this could be expected to induce some of its existing approved dealers to stop buying Sanyo products and, instead, to concentrate on products of [its] competitors which are not supplied to free riders' (see paragraph 4.377).

(b) Retailers

4.250. Dixons argued that the grounds on which we had provisionally based our findings did not justify the conclusion that the second complex monopoly existed. Items (a) to (c) of paragraph 4.245 were qualitative criteria which did not restrict or distort competition and which existed in selective distribution systems throughout the EU, with the approval of the European Commission. In its view, any supplier which used these criteria with objective justification could not be held to be preventing, restricting or distorting competition. Dixons said that objectively justified selection criteria of this kind are not normally regarded as anti-competitive and in the present case should not themselves form the basis for concluding that suppliers so conduct their affairs as to prevent, restrict or distort competition. Dixons had not experienced the imposition of the requirements set out in items (d) to (f) of paragraph 4.245, and its competitive behaviour had not been influenced by them. It said that the findings of our survey of small retailers confirmed its own experience.

4.251. Dixons submitted that we had erred in holding that Dixons was a person in whose favour the second complex monopoly situation existed. It had not been identified as a member of the group for the purpose of establishing the second complex monopoly situation and no detailed reasoning and evidence had been submitted in support of our provisional conclusion that it was a person who benefited from the second complex monopoly. In Dixons' view no such evidence existed. In response we said that our provisional conclusion had been derived from our assessment of the totality of the evidence and our judgment that the obvious effect of suppliers' use of selective distribution would be to reduce competitive pressure on those dealers selected by suppliers. Dixons said that it regarded this as wholly untenable and unsupported by any evidence of which it was aware. In order to respond, Dixons said that it needed to see the evidence on which our judgment had been based. As examples of the matters which Dixons thought should have been put to it, Dixons asked what evidence existed as to whether the number of retailers not selected by suppliers was sufficient to have the effect contended; whether the situation varied as between suppliers or products or type of products; and whether the pressure on retailers selected to receive supplies was reduced.

Conclusions on second complex monopoly situation

4.252. In reaching our conclusion on the existence of a second complex monopoly situation, based on the selection of dealers, we have taken account of the views summarized above, and those set out in Chapters 13 and 14.

4.253. We considered whether a supplier with only a small market share should not be included in the group whose members conduct their affairs so as to create the second complex monopoly situation, on the grounds that it cannot individually affect competition. As with the first complex monopoly situation, it is the fact that the relevant practices are widespread that restricts or distorts competition.

4.254. We have carefully considered Dixons' views set out in paragraph 4.250 concerning the European Commission's approach to selective distribution criteria. We agree that the adoption of some

non-discriminatory qualitative criteria¹ has been found by the European Commission and the ECJ in several cases not to bring certain selective distribution systems within Article 85(1). However, the European Commission told us that no inviolable rule in this regard has been established. In particular, the European Commission will consider whether Article 85(1) does or does not apply in any case only in the light of an assessment of the specific features of the relevant market and whether effective competition exists in that market. The European Commission still regards Article 85(1) as continuing to prohibit a selective distribution system based on criteria that cannot be justified by the nature of the goods and the market in question, or are too restrictive in the limitations placed upon dealers. Moreover, we do not accept Dixons' view that the criteria set out in item (a) of paragraph 4.245 are all necessarily qualitative.

4.255. We also do not agree with Dixons' view that it cannot be considered to be a person in whose favour the second complex monopoly situation exists. That it is such a person appears to us to be a reasonable judgment for us to make in the light of all the evidence we have received during our inquiry with regard to the existence and operation of selective distribution systems. That evidence shows that selective distribution systems are used by suppliers of hi-fi systems to channel supplies of their products to those dealers which satisfy the criteria laid down by those suppliers. Such dealers are likely to benefit from a reduced level of competition: in particular, if distribution were non-selective, outlets selling on a large scale or with a different trading philosophy might be expected to be in a position to sell the goods more cheaply, which would lead to a reduction in the sales of presently-selected dealers. In the circumstances of this inquiry it would have been impossible, in practical terms, for us to carry out a full analysis of the number of dealers not selected by suppliers and of the effect of such non-selection. In any event such an investigation would not have provided meaningful data since the mere existence of a selective distribution system may discourage many dealers from applying for selection if they think they are unlikely to satisfy the criteria.

4.256. Having examined the objections to our provisional findings, we turn to our conclusions, considering first the question of whether a second complex monopoly situation exists by virtue of section 6(1)(c) and (2) of the FTA.

4.257. From paragraphs 4.163 to 4.190 of our evidence relating to withholding supply, it appears to us that all the suppliers named in paragraph 4.246 engage in selective distribution using one or more of the criteria specified in paragraph 4.245. Other suppliers with a smaller market share engage in the same practice. Suppliers' policies and practices with regard to selective distribution are set out in greater detail in Chapter 12. A full list of suppliers of which we are aware that carry out this practice is set out in Appendix 4.2. The suppliers named in paragraph 4.246 other than CIH and its local groups have a combined market share of about 70 per cent. Thus these suppliers, together with all other suppliers which engage in this practice, have a combined share of more than one-quarter of the supply of hi-fi systems in the UK (otherwise than by retail sale or hire).

4.258. Our assessment of the evidence we have set out in paragraphs 4.163 to 4.192 and in Chapter 12 is that the practice has the effect of protecting suppliers' networks of dealers from unrestricted intra-brand competition by selecting prospective new entrants and monitoring those already in the network for conformity with the suppliers' marketing style and objectives. The degree of control sought varies between suppliers; some may lay emphasis on gaining more outlets, but it is significant that several leading hi-fi system suppliers have withheld supply from PriceCostco. In our view the practice restricts or distorts intra-brand competition for hi-fi systems by excluding non-conforming dealers from the distribution networks of the suppliers concerned.

4.259. We conclude, therefore, that a complex monopoly situation exists by virtue of section 6(1)(c) and (2) of the FTA. The members of the group who conduct their affairs so as to create this second complex monopoly situation are all those suppliers identified in paragraph 4.246.

4.260. This second complex monopoly situation exists in favour of suppliers by inhibiting intra-brand competition and hence reduces the pressure on suppliers to improve the terms on which they sell to dealers. The situation also benefits dealers who have been selected to receive supply by limiting the number or type

¹By which we understand those criteria which focus upon the technical requirements for handling the goods (particularly high-technology products), for example the dealer's qualifications, expertise and product knowledge, and the suitability of his premises and staff.

of other dealers with whom they have to compete, thus reducing the pressure on them to attract customers by reducing prices or other means of promotion.

4.261. We conclude that the second complex monopoly situation exists in favour of the suppliers identified in paragraph 4.246, and of the dealers in the UK selected to receive supply from these suppliers.

Public interest issues

4.262. In paragraphs 4.243 and 4.259 we concluded that two complex monopoly situations existed in relation to the supply of hi-fi systems in the UK (otherwise than by retail sale or hire). We further concluded in paragraph 4.244 that the first complex monopoly situation (in respect of RRPs) existed in favour of suppliers who suggest or recommend RRPs and retailers who take account of them in setting their own prices, or who take part in discussions with suppliers which influence the RRPs that those suppliers set, or both. In paragraph 4.261 we concluded that the second complex monopoly situation (with respect to the withholding of supplies) operated in favour of those suppliers using one or more of the criteria specified in paragraph 4.245 and those dealers who are selected to receive supply. Our terms of reference (see Appendix 6.1) require us to consider whether any action or omission on the part of the persons in whose favour we have found the complex monopoly situations to exist operates or may be expected to operate against the public interest. In this regard, we are limited to investigating and reporting on the following two matters:

- (a) steps taken, by recommending or suggesting prices to be charged by dealers, or otherwise, to influence the prices at which dealers resell hi-fi systems; and
- (b) withholding supplies of hi-fi systems from dealers.

We now deal with each matter separately.

Effects of the practices in relation to prices

4.263. In paragraphs 4.103 to 4.159 we examined the evidence on the pricing practices of suppliers and retailers in the hi-fi system market. In the following paragraphs we consider in closer detail whether the effect of these practices is to influence the prices at which dealers resell hi-fi systems and, if so, whether these practices operate or may be expected to operate against the public interest.

Variation in retail prices

4.264. If suppliers, through the setting of RRPs, influenced the prices at which dealers sold hi-fi systems, we would expect to see a clustering of prices around the RRPs. We have referred already (see paragraphs 4.149 and 4.150) to the results of our investigation of the prices of 12 best-selling models of hi-fi systems. We regard these results as indicative of a clustered distribution of prices. In our view this is prima facie evidence of an association between RRPs and the prices charged to consumers for hi-fi systems.

4.265. We received numerous comments on our pricing analysis. These comments fell into two broad categories:

- (a) claims that the data did not establish an association between transaction prices and RRPs; and
- (b) arguments that, to the extent that there was an association, it did not arise from the influence of RRPs on transaction prices.

We deal with each of these in turn.

Association between RRP's and transaction prices

4.266. Some of those who commented asserted that the data were not sufficiently reliable to provide a basis for any conclusions. We are well aware of the problems of the data; they are discussed in Chapter 11. It was important for us to use data relating to a period before this inquiry was announced (since the inquiry might have changed pricing behaviour). This meant that we had to rely on existing sources. However, the source we used, GfK's price-monitoring data, is what the industry itself uses; we have taken great care to ensure that the data are as accurate and relevant as possible; and we are satisfied that there is no better information available.

4.267. It has been argued that there are reasons to suspect that in some cases the data might overstate the extent to which prices are at or close to RRP's: the weekly averaging of EPOS price data and our use of £5 bands were cited in particular. Weekly averaging is undoubtedly a disadvantage but not one we could do anything about given the source of our data. We looked carefully at the consequences for our data and concluded that weekly averaging was more likely to understate the extent to which prices are at RRP's than to overstate it, though at the same time its effect was likely to have been a modest reduction in the dispersion of prices (see paragraph 11.30). We have also identified other factors which will lead to an understating of the incidence of prices at RRP's (see paragraphs 11.28 to 11.30). Overall, we are satisfied that the data we used were not systematically biased towards exaggerating the extent to which transaction prices were at or close to RRP's. It seems to us to be entirely reasonable to take account of our pricing data, notwithstanding their limitations, along with all the other evidence that we have collected.

4.268. Sony and Sanyo sent us a copy of a report produced on their behalf by Lexecon which commented on our pricing analysis. Several of the points made by Lexecon were also raised by other parties and are discussed later in this section. We deal here with Lexecon's claim that our pricing data did not support the hypothesis that RRP's were associated with price clustering.

4.269. Lexecon's case was based on analysis of the aggregated data for all four of the reference brown goods. It thus ignored the fact that we had received four separate references, and that in reaching conclusions on any one of them we are obliged to assure ourselves that the evidence on which we rely is relevant to the reference good in question. We decided, nonetheless, that we should deal with Lexecon's case in a substantive way.

4.270. Lexecon said that, to the extent that there was clustering of retail prices, there was no evidence that it was caused by the use of RRP's. Instead, Lexecon argued that the low level of search costs relative to product price meant that consumers had a stronger incentive to shop around for hi-fi systems than was the case when buying items costing only a few pounds each, and that retailers had a stronger interest in ensuring that their prices matched those of their competitors.

4.271. Lexecon tested the hypothesis that RRP's were associated with price clustering by an econometric analysis. To put it in ordinary language, this analysis examined whether higher proportions of sales within 5 per cent of the RRP's tended to be associated with lower degrees of price variability, and vice versa, and concluded that they did not.

4.272. More technically, Lexecon used two econometric models,¹ based on a limited number of secondary statistics derived from the basic GfK data on price observations, to test whether levels of covars of these observations could be explained by regression analysis. The independent variables used in the models were the logarithm of units sold, the logarithm of average price, the four-firm concentration ratio for each product category, the percentage of sales within 5 per cent of RRP's, dummy variables for four of the major manufacturers (Mitsubishi, Panasonic, Sony and Toshiba), and a dummy variable for products where there were promotional prices.

4.273. Lexecon found that with either model the 'within 5 per cent' coefficient was not statistically different from zero since the t-value² was less than the 1.96 threshold for significance at the 95 per cent

¹One was a standard ordinary least squares (OLS) model, the other a weighted least squares (WLS) model with data points weighted by volumes of sales for each product.

²The t-value is obtained by dividing the regression coefficient for a given independent variable by the associated standard error, thus providing a measure of the statistical significance of the coefficient being examined.

level. Lexecon argued that, if RRPs were believed to influence price variability, a higher proportion of sales at or close to RRP should reduce price variability, and said that its models found no evidence of this relationship.

4.274. We have considered Lexecon's arguments carefully. For the economic and technical reasons set out below, we were not convinced by Lexecon's econometric analysis. In particular, we think that Lexecon's conclusions have been substantially influenced by its choice of variables, several of which we think are questionable. It is noteworthy that when a model with fewer variables was used, there was an association between closeness of prices to the RRP and lower price variability.

4.275. Our detailed comments are as follows:

- (a) In terms of its underlying economic analysis, we find the Lexecon approach to be unconvincing. In particular, by specifying the four-firm supplier concentration ratio as an independent variable, Lexecon ignored the implications of the practice of setting RRPs being part of a complex monopoly situation, ie the fact that the use of RRPs is widespread among suppliers, large and small, in each of the markets for reference goods. Lexecon's own results, from a separate analysis, appeared to show that supplier concentration levels did not affect price dispersion.
- (b) We are not convinced that the lack of significance of the t-values for the 'within 5 per cent' variable in Lexecon's two models can be taken as refutation of the general proposition that there is an association between RRPs and clustering of prices close to RRPs. Lexecon's models were based on a set of secondary statistics which include a small number of cases of products where high degrees of clustering of prices were found with modal prices significantly different from the RRP. (In certain cases these were end-of-line products, and therefore likely to exhibit atypical pricing patterns, especially if associated with major marketing activity.) To test this we used a stepwise multiple regression (OLS) model. We found that a model using three independent variables alone (the 'within 5 per cent' variable, a dummy variable for Panasonic products, and a dummy variable for products for which the two major retailers accounted for more than 50 per cent of sales) explained a greater degree of variability in the dependent variable (the covar, defined-see paragraph 4.150-as the standard deviation from the mean divided by the mean value, expressed as a percentage) with r-squared (adjusted) at 0.31. (The r-squared in Lexecon's OLS model, which did not include any variables for retailer market share influences, was 0.205.) The t-value for the 'within 5 per cent' variable in our model was 2.7, thus appearing as significant (on Lexecon's terms) against a threshold of 1.96. The difference in significance of the t-value for the 'within 5 per cent variable', when certain other variables are omitted from the regression, reflects a significant level of collinearity between this variable and some of the dropped independent variables.
- (c) We do not think econometric models of the type used by Lexecon are appropriate for this type of analysis. First, the covar used as the dependent variable in Lexecon's model is a ratio type of variable. There are technical arguments against the use of ratio type variables as dependent variables in regression modelling (though we recognize that there is more than one opinion in this matter). Second, account should be taken of the nature of the standard deviation from which the covar is derived. The standard deviation is calculated by taking the square root of the summation of squared deviations from the mean divided by the number of observations. In such a calculation the further away observations are from the mean, the greater the weight contributed to the final result. The consequence of this is that covars do not vary on a linear basis with average divergences from the mean, and linear models of the types used by Lexecon are unlikely to be appropriate.
- (d) We recognize that some of the covars which we found to be low (whether or not end-of-line products are included) were associated with low proportions of sales within 5 per cent of RRP. But we do not accept that this invalidated the findings for those which did have relatively high proportions of sales volumes close to RRPs. An alternative analysis that we undertook (see paragraph 4.276) supports our view.
- (e) In considering the Lexecon analysis, we were also conscious of a more general point. To carry out an econometric analysis it is necessary to select the independent variables, but the choice of both the number and the identity of those variables is to some extent arbitrary (as noted in (a) above, we explained the variability of the covar using fewer independent variables than Lexecon). This leads

us to ask how far it is appropriate to apply econometric techniques to the data, quite apart from the more technical comments set out above.

4.276. As an alternative analysis (based, like Lexecon's, on all four reference brown goods) we divided the brown goods models into two groups—those with 60 per cent or more of their sales within 5 per cent of RRP (27 products) and the remainder (20 products). The average covar for the former group was 6.2 and for the latter group 7.3, which suggests an association between RRPs and price clustering. We repeated the analysis by dividing the models between those with 70 per cent or more of their sales within 5 per cent of RRPs (17 products) and the remainder (30); and between those with 80 per cent or more of their sales within 5 per cent of RRPs (6 products) and the remainder (41). In both cases we found that the difference between the average covar for the first group was below that for the second.

4.277. In the later stages of the inquiry, Sony and Lexecon submitted further GfK-based evidence relating to three Bush products: two televisions and one VCR. Lexecon said that the pricing data on the models selected exhibited covars that were not statistically different from those in our pricing analysis and that, since Bush did not set RRPs, this showed that RRPs are not the main factor determining the dispersion of prices. However, since Alba (which owns Bush) has told us that Bush does set RRPs we drew the opposite conclusion from Lexecon's argument. We refer to this matter here since the argument is of general application to the four brown reference goods (which was the basis for Lexecon's analysis—see paragraph 4.269).

4.278. For these reasons we decided that we could not accept the conclusions of Lexecon's econometric analysis on the lack of an association between RRPs and price clustering.

4.279. In a letter dated 26 March 1997 Panasonic suggested that in our analysis of prices we should have made use of the standard deviation of the differences between transaction prices and the RRPs, divided by the RRPs (and expressed as percentages), rather than the covar. Panasonic argued that its measure ('P covar') would be more appropriate because it would assess the spread of observations around the RRP. Panasonic added that it believed the values for its measure P covar would have been higher than those we calculated for the covar. At an earlier stage of our examination of the pricing data we had considered whether to use a composite measure such as the P covar which would combine information both on variability of pricing (which the covar provides) and relative proximity to the RRPs (that is, differences between mean prices and RRPs). We had decided against it, because we thought that our approach which separately provides an assessment of the proximity of prices to the RRP (as represented by the 'within 5 per cent' measure) as well as relying on the covar (which indicates the degree of clustering around the average market price) would permit a more clear-cut way of analysing the price data, especially in the case of models predominantly sold at prices away from the RRP. Moreover, we note that another Panasonic criticism—that there is no standard against which our covar can be assessed—applies just as much to the P covar which Panasonic urged us to use.

4.280. It was put to us that whilst the price distribution charts for 12 hi-fi system models illustrated some convergence on a modal price, they also revealed the extent of short-term tactical price cuts below the modal price. Retailers would avoid sustained price cuts that damaged their margins, but they would initiate or respond to tactical price promotions, before a 'going price' re-established itself. It was for that reason that the charts showed significant amounts of selling below the modal price. The argument was also advanced that the parameters within which retail prices moved were set by suppliers' and retailers' margin requirements. If the going rate did not accommodate their respective needs the product would not be displayed and actively sold by retailers. These margin requirements also tended to diminish the variability of retail prices. In our view this argument, and the point in the previous paragraph, are fully compatible with the hypothesis that there is an association between RRPs and the prices charged to consumers. A further argument put to us was that, even if advertised or displayed prices were close to the RRPs, transaction prices were likely to be lower, as a result of retailers offering price reductions to close a sale. We were referred to the finding of the survey of small retailers that 92 per cent of respondents who sold hi-fi systems had answered 'yes' in reply to the question 'Do you ever charge prices lower than either RRPs or suppliers' suggested (or promotion) prices?' A GfK survey, commissioned by Sony (see paragraph 4.69), of consumers' attitudes to RRPs for the reference brown goods reported that nearly three-quarters of the respondents to the survey said that they would normally expect to pay less than the RRP. The survey also asked 'Would you try or have you ever tried to secure additional discount when buying an electrical product?' In response roughly 13 per cent said that they would try, 10 per cent said that they had tried, but

had been unsuccessful, 44 per cent stated that they had tried and had been successful, and 34 per cent said that they would not try or had not tried.

4.281. As explained in paragraph 4.155(c) respondents to the survey of small retailers were asked whether prices below RRP were 'ever' charged: the answers therefore give us no indication of the frequency of, or reason for, price-cutting. They must also be interpreted in context: 93 per cent of respondents who sold hi-fi systems also told us that they took account of RRP in setting their prices and 34 per cent told us that they did not meet local competition by cutting prices.

4.282. As to the Sony survey reporting that 75 per cent of respondents expected to pay less than the RRP, we noted that respondents were not asked whether they thought they would see the RRP on the ticket, for example 'RRP £649.99, our price £599.99' (which would not be possible in retail outlets accounting for perhaps two-thirds of hi-fi system sales-see paragraph 4.395). Nor did the survey ask whether respondents thought the expectation of paying a lower price than the RRP would be met by an offered reduction of this sort.

4.283. As stated in paragraph 4.280, the Sony survey also reported that 44 per cent of respondents said that they had tried successfully to secure additional discount when buying 'an electrical product'. Setting aside that 'an electrical product' does not necessarily refer to a reference good, let alone a hi-fi system, this result is hard to square with the other evidence that we have had about the extent of bargaining. When we asked multiple retailers about the extent of in-store price bargaining (which could result in transaction prices being lower than displayed prices), we were generally told that the value of all forms of price reduction amounted to only about 1 or 2 per cent of turnover. These forms included reduced prices for damaged and shop-soiled goods, for staff discounts, for price-matching and for consumer-negotiated discounts. Some large retailers (such as JLP and Argos) said that sales staff were not permitted to enter into any kind of bargaining. The evidence from our survey of small retailers is not conclusive: 92 per cent of respondents selling hi-fi systems said that they were prepared to bargain or price-match below ticket prices (Appendix 9.1, Table 29), and 83 per cent of these said that they would go between 3 and 10 per cent below ticket prices. However, it is not clear how far these answers related to bargaining as opposed to price-matching; in addition, we do not know the frequency of price-cutting for these reasons. Hearings involving small retailers did not provide clear evidence about their attitudes to bargaining. The Consumers' Association was sceptical about claims that price bargaining was widespread, and Verdict stated that it was largely irrelevant. Our overall interpretation of the evidence is that bargaining by consumers to obtain hi-fi systems at prices below those advertised or displayed is not significant.

4.284. We also decided to carry out a sensitivity analysis by dividing our pricing data into two groups, one covering the figures from Dixons, Comet and the RECs, all of which use EPOS systems and hence record transaction prices, the other including the information from all other retailers in the sample, many of which do not have EPOS systems, and for which, therefore, displayed prices are recorded. We found that the price observations in the first group were markedly less close to RRP than those for the second group. Given our conclusion about the extent of in-store bargaining, we doubt that this can account for more than a small part of the difference.

4.285. It was put to us that as the 12 models we investigated in our price distribution analysis were all popular, best-selling hi-fi systems, their retail prices would probably be well-known to consumers and hence be unlikely to vary much from retailer to retailer. But the first part of the premise is open to question. The Sony survey (see paragraph 4.69) asked respondents what they would expect to pay for midi and micro hi-fi systems. In both cases not more than one-half of respondents were broadly right. However, even if the premise were well-founded the opposite argument could also be made: if prices are well-known a retailer wishing to compete on price is more likely to attract customers to his store by promoting the more popular and better-known models. We believe that this second argument is more telling, particularly since there are so many models on the market.

4.286. A further criticism of our pricing analysis was that it took no account of non-price offers (such as interest-free credit). As these offers are benefits to the consumer, it was argued, their monetary value should be deducted from the transaction price. However, we note that the price observations on which price indices such as the RPI are based take no account of non-price offers. Moreover, this criticism seems to us to miss the essential point that our terms of reference involve establishing whether or not the practice of setting RRP influences transaction prices. Non-price competition is frequently an alternative to price

competition, and may not be so attractive to consumers; so adjusting prices by the value of non-price benefits (which in any case are difficult to determine) would serve only to obscure the issue.

4.287. Taking account of the points addressed in the previous paragraphs, we remain of the view that our pricing analysis does establish an association between RRPs and transaction prices. We turn now to the question of whether it is RRPs which are influencing transaction prices or whether the association between them has some other cause.

Influence of RRPs on transaction prices

4.288. If we had found that the prices of individual models of hi-fi systems had varied widely from one retailer to another then the proposition that suppliers were influencing dealers' prices, through the setting of RRPs or otherwise, could not have been sustained. Our finding that transaction prices cluster around RRPs is consistent with suppliers' influence over prices. However, as Lexecon pointed out in its commentary on our pricing analysis, price clustering can be symptomatic of a highly competitive market. We do not believe that this is the case in this market for the reasons given later in this section. Suppliers and retailers argued that, while RRPs might have some influence on the prices at which consumers bought hi-fi systems, other factors were more important, and that RRPs followed market prices rather than led them. In a similar vein, Lexecon claimed that, to the extent that RRPs and modal prices coincided, the proposition that this was because RRPs responded to market prices was consistent with the evidence.

4.289. We were told that the intense advertising to which we have drawn attention (see paragraph 4.125) created a high level of price visibility for competing retailers and consumers alike, so that no retailer could afford to stay out of line on prices for more than a few days. A going rate for a model would be established in the market-place and would be influenced by its competitiveness against that of other models. Where a supplier had correctly forecast what the product would fetch at retail, or where the RRP was regularly reviewed in response to market conditions, there would be a coincidence between the RRP and the modal transaction price. But price convergence flowed from price visibility and was indicative of a competitive market in which no retailer could afford to be out of line. We were told that price convergence was not evidence of retail price management by suppliers and retailers in pursuit of an 'orderly market'.

4.290. We were further told that the degree of price convergence was partly explained by retailers' promises to match or beat competitors' prices. These pledges had been initiated to give a competitive edge, but they had been copied so widely that their potency as a differentiator between retailers had been weakened. We asked multiple retailers about the extent of their discounting from displayed prices on an individual basis as a result of their price-matching policies. As mentioned above (see paragraph 4.283) we were told that the value of all forms of individual discounting amounted to between 1 and 2 per cent of turnover.

4.291. We noted earlier (see paragraph 4.108) that suppliers' RRPs are reduced (along with the selling prices to dealers) at the traditional January and summer sales periods. This seemed prima facie to indicate that suppliers could lead shop prices down and back up again when it suited their marketing plans. We were told that the pattern of trade and retail prices during the traditional sales was a matter of custom and practice. No single supplier could lead prices upwards on a sustained basis. The only result would be loss of market share to competing models. And retailers, however important in the market, could not lead prices up since there would always be a retail competitor ready to steal a price advantage and advertise it widely.

4.292. We agree that the relationship between RRPs and retail prices is complex and that there may be occasions when the RRP follows the market rather than leads it. However, in assessing the overall impact of the use of RRPs on the market for hi-fi systems, we have taken account not only of our analysis of price distributions but also of the extensive evidence we received from hearings with suppliers and retailers; of the results of our questionnaires to, or surveys of, suppliers, multiple retailers and small retailers; of observations by dealers on suppliers' practices; of our examination of the trade press; and of our assessment of the extent of competition. Drawing on this information, we believe that RRPs do influence transaction prices for the following reasons:

- (a) The coincidence between modal price bands and RRP's seems to us to be more simply and convincingly explained by the hypothesis that transaction prices are influenced by the RRP which preceded them, rather than by the alternative view that RRP's track transaction prices. RRP's are set before the product reaches the market, usually taking account of retailers' views, and they are the basis for determining retailers' buying prices. For RRP's to follow the market, suppliers would have to monitor transaction prices of their products in some detail, and to have in place ongoing arrangements for reviewing RRP's in the light of the results (and of other relevant factors). No supplier provided any evidence of such arrangements, or indeed of detailed monitoring of transaction prices (and Panasonic explicitly stated that it did not do so). But both the multiple and the small retailers surveys suggest that many suppliers monitor ticket prices.
- (b) It is clear that Sony, JVC and Sanyo, among the larger suppliers, and B&O and Hitachi among the smaller, put pressure on retailers to adhere to RRP's. We also noted the pressure that JVC admitted that its area representatives might put on retailers, and the striking evidence in the case of Sonics Hi-Fi and Pioneer (see paragraph 4.162(c)). We have also noted a statement by Philips that it prefers retailers to sell at RRP's.
- (c) Most retailers also prefer their selling prices to be the appropriate RRP's, as is abundantly shown (see Appendix 9.1, Table 41) by the propensity of other retailers to complain to suppliers about competitors' price discounting. The combination of suppliers' and retailers' preference for the RRP's creates a climate which is favourable to RRP's' influence on both displayed and transaction prices.
- (d) The claim that relatively low price variations reflect the visibility of prices in this market seems to us to be questionable. As we have already mentioned (see paragraph 4.72), the range-stocking policies of retailers, in a market with so many models, in our view make it far from easy for consumers to draw price comparisons.

4.293. Several suppliers drew attention to the number of price observations that were more than 5 per cent below the RRP. Suppliers argued that retailers' net margins were rarely as much as 5 per cent and, in consequence, price reductions of more than 5 per cent represented vigorous price competition.

4.294. Before it abandoned RRP's Aiwa (see paragraph 13.100) thought our studies indicating a correlation between transaction prices and RRP's were unconvincing and put to us its own analysis of GfK data on average transaction prices of seven models in the period April/May 1996. Aiwa said that the results were very different from ours: they suggested that 'a significant number of retail transactions take place away from the RRP's' and that 'there is no uniformity between models in the average transaction prices as a proportion of the RRP'.

4.295. We do not accept these arguments. The results of the analysis of our price study relating to current deals do not suggest that the number of price observations that are more than 5 per cent below the RRP is substantial and it is likely that many of them are attributable to special factors, such as those discussed in paragraphs 11.21 to 11.30. Moreover, occasional retailer-funded price reductions to levels well below the RRP's are quite compatible with a general policy of adhering to RRP's. The Aiwa data (see paragraph 11.107) refer to a time of peak model change (as well as a period 12 months into our inquiry), and we therefore think that it would not be appropriate to give any weight to them.

4.296. Our view is that the high degree of price convergence in this market results from the strength of the relationships between suppliers and retailers. The essential elements of those relationships are the recommendation of RRP's and the means suppliers use to encourage adherence to them. The setting of, and adherence to, RRP's is a deliberate strategy on the part of both suppliers and retailers in pursuit of an 'orderly market'. Most members of both groups see adherence to RRP's as the norm.

Influence of RRP's on displayed prices

4.297. Our discussion so far has been in terms of transaction prices. We did not collect data about displayed prices on a systematic basis. However, some suppliers which commented on our pricing analysis accepted that displayed prices tended to be clustered at the RRP's, but argued that this was because the RRP's were tracking the market. We have already given our reasons (see paragraphs 4.292 to 4.296) for

being sceptical about the idea that RRP's follow the market and for concluding that RRP's influence the level of transaction prices. These arguments apply *a fortiori* to displayed prices.

4.298. We doubt that overall there is widespread bargaining about the prices at which hi-fi systems are bought at retail. But even if in-store price bargaining (and hence variation in transaction prices) were as common as the Sony survey suggests, the influence of RRP's on displayed prices would still restrict or distort competition because displayed prices are what consumers see when they are considering which hi-fi system to buy. An impression of widespread price uniformity will discourage shopping around and oblige the consumer to choose between stores on the basis of non-price factors which are less easy to value and to compare.

Influence of the larger retailers on RRP's

4.299. The larger suppliers have confirmed that, as part of the decision-making process leading to the recommendation or suggestion of a retail price, they seek the views of retailers and are influenced by them. Dixons said that it makes no reference to RRP's when setting its own prices, but we believe its market share, and to a lesser extent that of Comet, give these two companies great influence on the recommended prices of the models they include in their ranges. Furthermore, Dixons and Comet agreed that their own prices often coincided with RRP's. As most small retailers and many multiple retailers say that they take account of RRP's when setting their own prices, the influence of major retailers on the RRP's that suppliers set will amount to an influence over the prices at which other dealers resell hi-fi systems.

Non-price competition

4.300. We considered why there is so much non-price competition at retail level. We were told by suppliers and retailers that a retailer seeking a competitive advantage from price-cutting might succeed for a few days with a tactical promotion but that invariably his prices would soon be matched by those of competitors. Non-price promotions are normally harder to match quickly and can provide a more enduring means of differentiation and competitive advantage. Techniques such as deferred payment may also tie the customer into the store in a way that a once-and-for-all cash purchase could not.

4.301. We explored whether customers would not be better served by a retailer adopting a straightforward transparent price policy for hi-fi system sales without the need to evaluate the various ancillary non-price promotions which customers might not want. On this approach, accessories which cost extra, such as headphones, would be charged for separately so that customers who did not want them would not have to bear a share of the cost, as they do now. There would always be an interest charge for deferred payment.

4.302. We were told that there were sound marketing reasons for adopting these different forms of promotion, particularly 'buy now, pay later' and interest-free credit. Consumers were not all alike and different promotions addressed their different needs. When we asked retailers which customers made most use of interest-free credit, we were told that they were usually the relatively affluent.

4.303. We were also told that consumers have come to expect non-price promotions. Any supplier or retailer who gave them up in favour of straightforward price reductions would be at a competitive disadvantage, since the price reduction would be promptly matched by competitors which would still have their non-price offers as additional inducements to purchase. This argument, if true, would contradict what we have been told about the tightness of margins.

Retailers' and suppliers' margins

4.304. We have described the negotiation of retailers' terms. Effectively they are about the size of the retailer's gross margins, starting from the RRP's. We believe that this top-down approach to the determination of retailers' net buying prices, together with the various types of discount that contribute to

retailers' profits and suppliers' undertakings about the agreed margins, have marked effects on retailer behaviour. In particular, retailers will be influenced to charge prices at or close to RRP's.

4.305. The provision of a discretionary advertising and promotion allowance inevitably gives the supplier influence over the content of the retailers' advertisements. Until it was withdrawn in June 1996 Sony's Dealer Agreement prohibited POA advertising. More generally we believe that retailers are unwilling to jeopardize the continuation of their advertising and promotion allowances at the next annual negotiation by advertising prices significantly below the supplier's recommendation. The absence of any substantial evidence of advertising and promotion allowances being withheld suggests only that retailers conform.

4.306. The payment of volume-related retrospective discounts may be contractual rather than discretionary. Nonetheless, they often succeed in their purpose of making retailers concentrate their sales efforts on best-selling brands, particularly towards the end of the relevant period when the volume target is within reach. The discounts offered on lesser-known brands appear to be of much the same size as those available from the market leaders (see Table 10.9). Thus the supplier of a lesser-known, and particularly a new entrant, brand may find it more difficult to provide the same cash sum to a retailer, by way of retrospective discount, than will the supplier of an established brand with higher market share. Such discounts therefore serve to support existing relationships and to make market entry more difficult. They also give retailers an incentive to continue with their existing suppliers, to avoid the risk of delayed payment that might occur if they took their business elsewhere.

4.307. The suppliers' practice of maintaining the retailers' percentage gross margins when products fail to sell at the planned prices, and have to be repositioned, shifts back to suppliers much of the risk of retailers' decisions to include models in their ranges. The practice also acts as a disincentive to a retailer to initiate his own campaign to shift slow-moving stock since he knows that, if he waits, the supplier may in due course finance a promotion at no cost to the retailer's percentage margin. The supplier leads most price reductions and achieves its own marketing strategy, with its bias in favour of 'orderliness', and the absence of heavy price discounting by retailers.

4.308. The management and protection of retailers' margins have not prevented extensive retail closures. We were told that this reduction of the retailer base is a matter of concern to suppliers. For many of them, the preservation of a substantial body of small retailers is a strategic objective, sought to counterbalance the strength of the largest multiples.

4.309. Retailers' frequent complaints about competitors' tactical price cuts put pressure on suppliers to bring price-cutters back into line. Retailers' requests for compensation in the form of some *ad hoc* margin support are sometimes successful, and serve to remind suppliers which condone price-cutting that their failure to maintain discipline in terms of an 'orderly market' carries a cost penalty for themselves. Suppliers may be able to afford to ignore small retailers, but not major customers. Dixons' clause 13 (see paragraph 4.119) epitomizes this attitude.

4.310. We explored whether suppliers discouraged retail price competition to protect their own selling prices, and hence their margins, from shrinking under retailers' pressure. Suppliers argued that, even if this had been their strategy, it had been unsuccessful since retailers had managed to depress the prices at which they bought from suppliers. Suppliers also conceded that if a major retailer failed to achieve its desired retail price, and hence profitability for a model, it would inevitably seek to recover some of its lost margin by pressing the supplier for better terms. Most retailers' complaints were on these lines. If such improved terms were not forthcoming, the retailer had the freedom to pursue its own profitability objectives by selecting other products to display which would provide the required margin.

4.311. We do not think that a reduction in suppliers' selling prices, to the extent that it has occurred, answers our point. If there were more retail price competition, there would be more pressure on suppliers' selling prices than there is now. By encouraging retailers to adhere to RRP's, suppliers are protecting their own position.

Misleading consumers

4.312. We believe that consumers are given a false impression during sales and promotion periods, when prices for hi-fi systems are promoted by individual retailers as if they were bargain offers initiated by them. In practice, as the price histories in paragraphs 11.108 to 11.116 indicate, sales-out and cash-back promotions (see paragraph 4.137), and occasional reductions in RRP's of hi-fi systems at these times, are typically supplier-initiated, and feed through as lower buying prices for retailers, thus preserving their percentage gross margins (though cash margins will be proportionately reduced). It was put to us that the consumer is interested only in the net cost of a hi-fi system to him or her and is indifferent as to who or what has contributed to it. Nonetheless, we believe that consumers will get the impression that there is more price competition at retail level than is the case and will be inclined to believe they have found special bargains (particularly if they are energetic enough to redeem cash-back vouchers), when in reality they are paying effective RRP's which have been reduced across the entire market.

Innovation in retailing

4.313. The arrangements we have described tend to bind suppliers and retailers together in the pursuit of what they believe to be an 'orderly market' and limited price competition. This objective is underpinned by an apparent preference for retail prices at the RRP levels and by the small number of major retailers. By the same token these two factors generally discourage innovative retailers and those who wish to offer consumers lower prices rather than services or other non-price benefits.

Pricing practices of CIH and its local groups

4.314. We noted in paragraph 4.207 that CIH makes suggestions or recommendations to individual retailers about the retail prices of goods it supplies to them. Often such price recommendations take the form of passing on to the individual retailers details of RRP's which have been recommended or suggested to CIH by those suppliers from which it has obtained goods. CIH also organizes national promotion campaigns which publicize the RRP's of some of the hi-fi systems it supplies.

4.315. Since CIH is a trade association within the meaning of section 43(1) of the RTPA (see paragraph 4.204), we noted (although it is not within our terms of reference) that the European Commission examined the status of price recommendations made by trade associations in its recent decision concerning the practices of a Dutch trade association, FENEX, which represented forwarding agents operating in the Netherlands.¹

4.316. As part of its activities FENEX compiled, and circulated to its members, recommended tariffs for their services. The European Commission reiterated the view of the ECJ² that the fixing of a price, even one which merely constitutes a target, is anti-competitive within the meaning of Article 85(1). The European Commission further stated that the habitual drawing up and circulation of recommended tariffs by a trade association could likewise be caught by Article 85(1) since it was likely to prompt the trade association's members to align their tariffs irrespective of their cost prices. The European Commission pointed out that 'such a method dissuades undertakings whose cost prices are lower from lowering their prices, and this creates an artificial advantage for undertakings which have the least control over their production costs'.

4.317. This comment accords with our views concerning CIH's practice of issuing RRP's and their use generally in the hi-fi system market.

4.318. We received evidence suggesting that some of the CIH local groups sought to co-ordinate or control the retail prices of their retailer members. As this is a matter which, if true, would fall within the

¹*European Commission v Nederlandse Organisatie Voor Expeditie En Logistiek (FENEX)* [1996] 5 CMLR 332.

²*Vereeniging Van Cementhandlaren v European Commission* [1972] ECR 977.

scope of the RTPA, we are precluded by the FTA from making public interest findings about it. However, we have passed to the OFT the evidence we have obtained.

Public interest findings on influence on dealers' selling prices

4.319. We find that the setting of RRPs, and action by the suppliers in whose favour the first complex monopoly exists to encourage dealers to adhere to RRPs, are steps taken to influence the prices at which dealers resell hi-fi systems. We have to determine whether those actions operate or may be expected to operate against the public interest.

4.320. It has been put to us by many suppliers that RRPs in principle can provide useful information to retailers about the positioning of a model relative to others and provide consumers with a bench-mark against which to compare prices. It has also been suggested that the use of RRPs reduces average prices by establishing a maximum market price. It is true that we have not found many examples of hi-fi systems sold above the RRPs but that would be indicative of lower average prices only if the RRPs themselves did not increase average prices. For the reasons given below, we do not believe the latter to be the case.

4.321. We have examined the argument that setting RRPs encourages price competition by giving retailers clear bench-marks against which to discount. We accept that this might be true of some markets but we do not think it true here. The clustering of prices we have observed, the aggrieved reaction by many retailers to price discounters, the fact that the two largest and some smaller retail chains, together with some department stores and other outlets, do not refer to RRPs in their price displays, and the emphasis on non-price competition, do not suggest to us that RRPs encourage price competition in the hi-fi system market.

4.322. We have also considered whether the findings of previous MMC inquiries which examined the use of RRPs in other markets have any implications for our conclusions. The inquiry with the most relevance to our findings in this report appears to be that on contact lens solutions.¹ The MMC found in that inquiry that the setting of RRPs by suppliers was not a practice which, in the contact lens solution market, operated against the public interest. However, they also found that the observance of RRPs by a substantial majority of retailers operated against the public interest, because it caused retail prices of contact lens solutions to be higher than they otherwise would be.

4.323. The MMC did not find evidence of suppliers of contact lens solutions attempting to influence retailers to sell at the RRPs. The main reason for the absence of such influence was that a substantial proportion of suppliers' sales of contact lens solutions was through wholesalers. The close relationship between supplier and retailer that we have found in the hi-fi system market was therefore absent. Other relevant differences between the two markets were that contact lens solutions, unlike hi-fi systems, are low-cost, frequent purchases by a minority of consumers. Moreover, contact lens solutions were sold by opticians and pharmacists: for opticians the sales were a minor by-product of their main business; for pharmacists they represented a tiny fraction of their total turnover. In these circumstances it was likely to be hard for suppliers of contact lens solutions to put pressure on retailers.

4.324. We do not think that conclusions about the practices of contact lens solution suppliers towards RRPs have implications for our conclusions about hi-fi system suppliers.

4.325. RRPs have become part of the mechanism for the trade's customary calculation of the prices at which suppliers sell hi-fi systems to retailers. The top-down approach to the determination of these prices is itself, in our view, a major influence on the way retailers set their own selling prices. We think that suppliers have structured their terms to retailers around the RRPs in such a way that most retailers lack incentives to form their own independent views on prices, and are strongly encouraged to conform to the suppliers' marketing strategies.

¹*Contact lens solutions: a report on the supply within the United Kingdom of contact lens solutions*, HMSO, Cm 2242, May 1993.

4.326. The practice of recommending a retail price, when combined with the structure of suppliers' discounts to retailers, creates a stronger adherence to RRP than would otherwise be the case. It leads to the discouragement of innovative forms of retailing which would give consumers a wider choice of retail prices and style. The effectiveness of these arrangements is underpinned by an apparent preference on the part of many suppliers and retailers for price levels which do not vary from the RRP, and by the importance of the two leading retailers. We also think that the use of retrospective and discretionary allowances increases suppliers' influence over retail prices by making retailers more apprehensive about the consequences of pricing at levels not sanctioned by suppliers.

4.327. We received limited evidence on suppliers' profitability (see paragraphs 4.81 to 4.83).

4.328. We noted the view that retailers' profitability has not been unduly high, though the contribution from hi-fi system sales is difficult to determine and profits on sales from extended warranties or breakdown insurance obscure the picture. Overall, we take the view that the level of profit of suppliers and retailers does not bear to a material extent on the matters referred to us, since steps taken by persons in whose favour the first complex monopoly situation exists to influence prices at which dealers resell hi-fi systems could have effects adverse to the public interest whether suppliers and retailers were earning high or low profits (see paragraph 4.87).

4.329. We were not persuaded by the argument that consumers are protected by the strength of inter-brand competition and the visibility of competing offers in this market. The exposure of consumers to inter- and intra-brand competition is diminished by retailers' range-stocking strategies. Their price-matching pledges mean that they have a strong interest in selecting a distinctive range with as little overlap as possible with their competitors.

4.330. As we have already noted (see paragraph 4.77), it is also difficult for consumers to compare the purchase costs of different models when retailers couple non-price inducements with the selling price. Assessing the package which offers the best value for money in the consumer's circumstances is not straightforward, and transparency is limited, despite the amount of advertising.

4.331. The critical question is whether adherence to RRP by retailers, against a background of somewhat more muted competition than at first appears to be the case, has any effect on the average level of transaction prices. We were told that low margins prevented prices from being any lower than they are now. We think this is questionable. We noted that expenditure on non-price offers, particularly interest-free credit, is substantial and also has the effect of reducing margins. The practice of some suppliers of stating RRP in point-of-sale material is in effect a statement that this is the amount the consumer will be expected to pay, and the dealer to charge. We think that in the absence of RRP, and the practices which encourage retailers to adhere to them, there would be less emphasis on non-price promotions and more on price reductions as a means of securing sales. Some expenditure by suppliers and retailers would be shifted away from financing non-price offers and would be used instead to reduce prices. In addition there would be a greater chance of low-margin retailers entering the market and of innovative methods of retailing (for example, electronic shopping) being developed.

4.332. It is possible that on average the resulting price reductions would be relatively small. Nevertheless, in our judgment the effect of setting RRP, and of other actions by suppliers and retailers which influence the prices at which dealers resell hi-fi systems, in the context of the willingness of most retailers to adhere to RRP, is to cause many prices to be higher than they would otherwise be.

4.333. We believe that, in the absence of RRP and the other practices which influence dealers' selling prices, there would be an increase in price competition accompanied by less emphasis on non-price competition. This in turn would be likely to encourage the development of a wider range of retail offerings, thus increasing the choice available to consumers, with positive effects on their economic well-being. If the product were to be offered separately from accompanying services (for example, cheap credit or free delivery) it would be possible for more consumers to purchase what they want: some will not want the related services, will place little value on them and will therefore prefer to purchase the product by itself at a lower price. Similarly, some consumers will not place much value on free gifts and will prefer the option of lower prices without them.

4.334. We conclude that, in the context of:

- (a) the limits to competition we have found;
- (b) the preference of both suppliers and retailers for 'orderly markets';
- (c) the pervasive use of RRPs to determine dealers' buying prices;
- (d) the payment of discretionary and retrospective discounts to dealers; and
- (e) the steps, listed in paragraph 4.335, taken by at least some suppliers;

the actions of suppliers (in whose favour the first complex monopoly exists) in setting RRPs are steps taken to influence the prices at which dealers resell hi-fi systems which operates or may be expected to operate against the public interest.

4.335. We also conclude that the following actions are steps taken by suppliers (in whose favour the first complex monopoly exists) to influence the prices at which dealers resell hi-fi systems, which in each case operate or may be expected to operate against the public interest:

- (a) reducing or threatening to reduce discounts to dealers who advertise or display prices below the RRP;
- (b) making support for dealers' advertising costs conditional upon advertisements not quoting prices below those approved by the suppliers;
- (c) contacting dealers who advertise prices considered by the suppliers, or other dealers, or both, to be too low, even if only to ask them if they have made a mistake;
- (d) providing point-of-sale material that includes the display of RRPs, thereby reinforcing the impression that these are the prices retailers are expected to charge and consumers are expected to pay; and
- (e) not permitting POA advertising.

4.336. We find that the following actions by individual suppliers or retailers (each of whom is a person in whose favour the first complex monopoly exists) are steps taken to influence the prices at which dealers resell hi-fi systems which operate or may be expected to operate against the public interest:

- (a) the inclusion of a clause (now deleted) in Dixons' terms and conditions for suppliers giving Dixons the right to renegotiate terms if the supplier permitted a 'disorderly market' to develop; we interpret this practice as putting pressure on suppliers to prevent other retailers from discounting prices by more than Dixons thought appropriate; and
- (b) the former inclusion in Sony's terms and conditions of a provision forbidding POA advertising; we interpret this practice as putting pressure on retailers not to discount prices to a greater extent than Sony thought acceptable.

4.337. We acknowledge that Dixons has told us that it does not now engage in the practice about which we have made an individual finding. However, it ceased to engage in it only during the course of our inquiry and the commercial pressures which led it to introduce the practice in the first place are likely to remain. We cannot therefore be confident that Dixons will not reintroduce the practice. In our view we are not precluded by the FTA from making findings about action that has ceased during the currency of our inquiry. This applies equally to our findings on Sony's actions (see paragraph 4.336(b)).

4.338. The adverse effects of setting RRPs (see paragraph 4.334) and of the steps listed in paragraphs 4.335 and 4.336 are: higher prices to consumers than would otherwise be the case; reduced choice for the consumer between lower prices with fewer non-price benefits on the one hand, and higher prices with more non-price benefits on the other; and hence a reduction in consumer well-being and the discouragement of

innovation in retailing and of the development of retailers who choose price discounting as a strategy, which also leads to less consumer choice.

4.339. We noted in paragraph 4.144 that most suppliers in whose favour the first complex monopoly exists (although not Panasonic, and not Aiwa since 1 April 1997) suggest MORPs for hi-fi systems that are higher than the RRP's for the same models. We also found (paragraph 4.146) that mail order companies generally charged the same prices for the models that they offered in common and that 86 per cent by value of sales of hi-fi systems by mail order companies were at prices equal to the MORPs (see paragraph 4.145). Sony suggested (see paragraph 10.101) that price discounts and a range of non-price offers introduced competition between the mail order companies.

4.340. We are aware that mail order companies sometimes reduce the catalogue prices of hi-fi systems (principally by including them in special promotions), but the evidence which we received from them (see paragraph 10.89) suggests that this practice is not extensive. As to non-price offers accompanying hi-fi systems sold through mail order, we do not regard these as equivalent to price reductions, any more than we would if they were sold through high street outlets. Overall, we think that our findings regarding mail order pricing are another illustration of the suppliers' aim, shared by retailers including the mail order companies, to maintain an 'orderly market' in hi-fi systems.

4.341. We conclude that the use of MORPs by persons in whose favour the first complex monopoly situation exists (except Panasonic and, since 1 April 1997, Aiwa) is a step taken to influence the prices at which mail order companies resell hi-fi systems, which operates or may be expected to operate against the public interest by causing these prices to be higher than they otherwise would be.

4.342. Notwithstanding what Empire has told us about its practice of asking suppliers about its competitors' hi-fi system prices (see paragraph 4.148), we find that this practice provides Empire with the opportunity of adjusting at least some of its prices in the light of advance knowledge about what its competitors are doing and reduces the need for it to price competitively in order to secure adequate sales. We conclude that the practice operates or may be expected to operate against the public interest by causing some of the prices of hi-fi systems in Empire's catalogue to be higher than they otherwise would be.

Effects of the practices relating to withholding of supplies

4.343. In paragraphs 4.163 to 4.192 we examined evidence regarding the practices of suppliers relating to the withholding of supply. In the following paragraphs we consider the effects of these practices.

4.344. We have found that most hi-fi system suppliers (weighted by market share) select the dealers whom they supply by taking into account such criteria as they deem appropriate. We consider next the extent to which this has led to the withholding of supply.

Multiple retailers

4.345. The evidence we have seen suggests that multiple retailers have not experienced much difficulty from the withholding of supply of hi-fi systems. We know of only three cases: JLP was unable to reach agreement with B&O on questions of display; Sevenoaks Hi-Fi had difficulties with B&O in respect of supply to one of its outlets following a change of premises; and Asda expressed concern in general terms about problems of negotiating with suppliers. The observations of the multiple retailers concerned, and suppliers' comments on them, are set out in Appendix 12.2.

Small retailers

4.346. The evidence suggests that the withholding of hi-fi system supply from small retailers has been a common event. Of the 454 respondents to our survey of small retailers who sold hi-fi systems (see paragraph 4.154), 104 alleged refusal to supply (see Appendix 9.1, Table 20(f)).

4.347. Since our survey of small retailers covered a random sample of about 10 per cent of all small retailers of the reference brown and white goods, it would be reasonable to infer that there was a large number of cases in which small retailers would allege that they had been refused supply of hi-fi systems. The analysis of the survey of small retailers presents technical difficulties (explained in the notes to Tables 19, 20(a), 20(e) and 21 in Appendix 9.1) but 'direct supply obtained' (see Table 21) was a notably infrequent outcome: only one such case was reported.

4.348. We found 18 cases substantiated by the evidence: see paragraph 4.192(a). The most common grounds that the respondents cited for being refused supply of hi-fi systems (see paragraph 4.191) were 'locality already supplied' (14 cases). The summary of the cases of alleged refusal to supply which gave the grounds cited (see Appendix 9.1, Table 20(e)) indicates that 'turnover insufficient' ranked second to 'location already supplied' and that other reasons were much less important.

Wholesalers

4.349. JVC, B&O and Sanyo do not supply any wholesalers. Panasonic will supply no firms engaged exclusively in wholesaling, except in Northern Ireland, although it will supply major retailers who have a wholesale element in their business. Sony and Panasonic require wholesalers to supply only authorized dealers.

Retailer buying groups

4.350. JVC used to supply CIH with hi-fi systems for JVC authorized dealers, then ceased to do so at CIH's request, but has now started again. Panasonic refuses to supply CIH: it believes it supplies two-thirds of the CIH retailers directly, and that to supply them through CIH would not be to their financial advantage. Sony supplied CIH's central stock only for a trial period in 1995.

Warehouse clubs

4.351. We noted earlier (see paragraph 4.4) that the then DGFT decided to make this reference in part as a result of refusal to supply retail outlets such as warehouse clubs. Their advent in the UK domestic electrical goods retail trade was controversial and many retailers had been and continue to be hostile to them.

4.352. In September 1993, at the annual dinner for Dixons' suppliers, Dixons' Chairman made a speech which was extensively reported in the trade press. In the course of this speech he said:

You will face the dilemma of whether or not you supply the warehouse clubs. Some here may succumb and try and ride two horses simultaneously—a fairly dangerous exercise. Others will try and fudge by supplying them only with special merchandise. There will be those who will claim colour blindness when confronted with grey shipments; those who suffer from cholesterol will at least have the advantage of knowing which side of the bread has the butter. But the far-sighted suppliers should be sensibly resolute. I believe there is a fundamental conflict with parallel distribution and you will have to consider which offers the most attractive option—cut-price or value-added retailers.

4.353. Dixons told us that this was not an implicit invitation to refuse supply. But we noted that an electrical goods supplier who was in the audience had precisely the opposite impression (see paragraphs 12.155 to 12.162).

4.354. N&P's subsidiary, Cargo Club, closed in March 1995. However, during its 18 months of operation it was refused supply of hi-fi systems by Sony, Panasonic and JVC. Sony and Panasonic refused supply because Cargo Club did not meet its normal criteria for retailers; and JVC because Cargo Club did not formally apply for supply.

4.355. Makro told us that Sanyo withdrew supply of hi-fi systems in 1994 when Sanyo adopted its policy of not supplying wholesalers. Panasonic had begun to supply late in 1996, after negotiations lasting 15 months-a delay which we regarded as tantamount to refusal to supply.

4.356. PriceCostco told us that it had had great difficulty in obtaining direct supplies of hi-fi systems from most of the larger suppliers (Aiwa, the market leader, is a notable exception). In consequence it relied, and continued to rely, heavily on diverters. In September 1996 Sony, JVC, Panasonic, Sanyo and Grundig were still refusing to supply it. Sony said that it was willing to consider supplying warehouse clubs if they could meet its criteria for service and premises; JVC said that it had rejected PriceCostco's application because PriceCostco had not met its dealership criteria and had not been willing to provide information requested; Panasonic said that warehouse clubs did not meet its normal criteria for retailers; Sanyo said that it did not supply wholesalers and that PriceCostco had reduced levels of point-of-sale and after-sales service; and Grundig said that it supplied only those retailers that met its selective distribution requirements. Aiwa supplies all creditworthy warehouse clubs.

4.357. We asked the suppliers which did not supply warehouse clubs whether this was because they wished to discourage discounting. Most respondents denied any association between the two; the common argument was that consumers needed pre-sales advice, and that warehouse clubs did not provide it adequately.

Sales through mail order

4.358. All the major suppliers that have refused to deal with warehouse clubs supply one or more of the five mail order companies, which collectively accounted for 12.9 per cent of sales of hi-fi systems in 1995.

4.359. We put to suppliers the proposition that refusal to supply PriceCostco on the grounds that it did not provide suitable premises or adequate pre-sales advice was inconsistent with supply to the mail order companies, which had no retail premises and arguably provided no advice. The suppliers' responses are set out in paragraphs 12.143 to 12.150. We noted in particular Sanyo's view (see paragraph 4.181) that a suitable catalogue served substantially the same purpose as trained sales staff.

Sales promotion incentive voucher schemes

4.360. One of the techniques most major suppliers use from time to time to provide incentives to retailers to sell particular models of hi-fi systems is to reward the retailers' individual sales staff through 'sales promotion incentive voucher schemes', known colloquially in the industry as 'SPIVS'. We examine SPIVS here because of their relevance to arguments about pre-sales service as a criterion for selecting dealers.

4.361. SPIVS commonly take the form of gift vouchers, but other incentive schemes are based on retailers' staff collecting points towards the cost of foreign travel, or of goods. We were told that major retailers were increasingly reluctant to tolerate SPIVS because they could cut across their own priorities for moving stock. Some retailers do not permit them at all.

4.362. Suppliers generally regarded them as a nuisance, but we were told that, since nearly every supplier uses them occasionally, none could afford to put itself at a disadvantage by stopping the practice unilaterally.

4.363. Undisclosed incentives to sales staff to push sales of particular models are likely to result, at least in some cases, in partial advice to consumers who might reasonably expect to be given unbiased assistance on how to satisfy their particular requirements. We have considered suppliers' arguments, in the context of selective distribution, about the need for informed pre-sales service by competent staff to avoid customers making the wrong choice, with lasting damage to the brand. We believe that suppliers' provision of SPIVS is inconsistent with their defence of their distribution policies.

4.364. Our terms of reference do not permit us to reach public interest findings on the use of SPIVS, and our main reason for considering them is to assess arguments about pre-sales service. We believe,

however, that the practice is of itself harmful to the consumer. Consumers who go to retailers which stock more than one brand have a right to expect at least a degree of impartiality by the retailer's staff between the various brands on offer. We recognize that retailers will have their own reasons for urging the purchase of one model rather than another but consumers can deal with that by visiting more than one retailer. It is much more difficult for consumers to discount the effects of SPIVS, not least because they will have no idea which suppliers are running them and which retailers have permitted their staff to participate. In our view SPIVS should be abandoned by the industry.

CIH and its local groups

4.365. CIH supplies only those retailers who are members of one of its local groups. All these groups (on CIH's recommendation) require applicants for membership to submit audited accounts for three years. Some of them only admit new members who are acceptable to existing members. We saw evidence suggesting that some retailers had been refused membership of a local group on grounds other than financial risk. In our view the denial by local groups of membership to certain retailers, hence preventing them from taking advantage of CIH's purchasing power, will have the effect of restricting competition to the benefit of other retailers including existing members of CIH local groups.

4.366. In April 1994 CIH reminded all the retailers it supplied that they should sell goods bought from CIH only to the general public or to other retailers supplied by CIH. We were told by CIH that, in consultation with the OFT, it had subsequently abolished the restriction on whom the retailers it supplied could sell to.

Public interest findings on withholding supply

4.367. The selective distribution criteria that we found to be used in the UK hi-fi system market are listed in Appendix 12.1. In paragraphs 4.164 to 4.167 we discussed the definition we adopted for selective distribution. We said that we excluded creditworthiness as a criterion, because it seemed to us to be no more than commercial prudence for a supplier to establish it. We also excluded minimum turnover because it seemed to us to be reasonable commercial practice for a supplier to refuse to supply a retailer with uneconomically small amounts of goods. We noted, however (see paragraph 4.384), that insufficient turnover was the second most important reason cited by respondents to the survey of small retailers in alleging refusal to supply hi-fi systems. And, whatever criteria are used to select dealers to receive supply, it is clear to us that they are likely to have anti-competitive effects if they are applied in a discriminatory manner.

4.368. We were told by several suppliers that their brands were valuable assets and that they were anxious to protect their products from being sold to consumers in circumstances that would damage the brand name. We accept that suppliers have a legitimate interest in protecting the image of their brands, and that some retailers might take action which could harm it, for example by selling damaged goods without indicating that there was anything wrong with them, or by making misleading claims about the product. We have had no evidence to suggest that this is more than an occasional problem, but we accept that the withholding of supply from such retailers would not necessarily be an anti-competitive action.

4.369. More generally, we are aware that the European Commission has accepted that certain selective distribution systems are not caught by Article 85(1) of the EC Treaty or are suitable for exemption under Article 85(3). The selective distribution criteria that we found to be used to varying degrees by suppliers in the UK hi-fi system market are listed in Appendix 12.1. Whilst it could be questioned whether some of these criteria, for example minimum stock requirements, are compatible with Article 85(1) or are suitable for exemption under Article 85(3), we have no evidence to indicate that these criteria have in practice been used to restrict entry to the UK hi-fi system retail market to any significant extent.

4.370. We accept that individual selective distribution arrangements may not of themselves operate against the public interest provided that they do not have an adverse effect on competition. But we have noted already (see paragraph 4.169) that hi-fi system suppliers' selection criteria are imprecise. It is apparent from the response to our survey of small retailers that these criteria may not always be understood. We think that when selection criteria are obscure or ambiguous, it is easier for suppliers to apply

them in a way which discriminates against particular dealers by withholding supply from them even though their ability to meet the selection criteria is not significantly different from that of other dealers who are supplied. In our view such discrimination is almost certain to be anti-competitive.

4.371. The clearest examples of discrimination we have found are in respect of warehouse clubs, and we deal with them first. We then state our public interest findings in relation to small retailers (who have also been substantially affected by the withholding of supply, including supply by CIH and its local groups). Multiple retailers have not been affected to an extent that warrants further action from us.

Warehouse clubs

4.372. Warehouse clubs are well known to be price discounters, so we put it to the suppliers which had withheld supply from them that they had done so because they wanted to discourage price discounting by retailers. The suppliers concerned denied that this was their motive. They told us that their reason for not supplying warehouse clubs was that consumers needed advice and information at the point of sale for products like hi-fi systems; that hi-fi systems would need after-sales service; and that the provision of such advice and service by warehouse clubs was inadequate or non-existent.

4.373. We inferred from this that the quality of retailers' staff, and their competence in after-sales servicing, would be of close concern to suppliers. But the analysis of the survey of small retailers (see Appendix 9.1, Table 17) supported that inference only to a limited degree. In the survey retailers had been asked whether suppliers imposed conditions relating to the quality of retailers' staff, the knowledge they possessed, and their competence in after-sales servicing. Only 31 per cent of the respondent retailers of hi-fi systems said that their suppliers imposed conditions on the quality or knowledge of the staff; but 60 per cent said that suppliers imposed conditions relating to after-sales service.

4.374. Since virtually all suppliers that refused to supply warehouse clubs are willing to supply mail order companies and catalogue stores we examined the pre-sales service those companies offered. We noted Sanyo's view (see paragraph 4.181) that a suitable catalogue served substantially the same purpose as demonstration by trained staff. We looked at catalogue entries and found that they described the main features of the models. But the entries did not say in what way the sound, as heard by the ordinary listener without technical user knowledge, would be different from one model to another, or whether the system would be easier to use. Nor did the catalogues say that one model would be more durable than another, or be more reliable, or be easier or less costly to repair or easier to set up. Mail order companies also provide customer helplines but we were told by GUS that the staff who answered these helplines had no expertise about hi-fi systems. The staff could pass on customer queries for specialist advice, but in 80 per cent of cases the customer's question was answered by helpline staff merely by reading from the catalogue.

4.375. This evidence does not indicate to us that pre-sales advice plays a critical role in the purchase of hi-fi systems. On the contrary, it suggests that this selection criterion is being applied by suppliers in a discriminatory way as between mail order companies and catalogue stores, on the one hand, and warehouse clubs on the other.

4.376. We took two further considerations into account. First, the widespread use of SPIVS means that it will be a matter of chance whether the consumer is advised by staff who are impartial as between the brands they are selling or by those who have a financial incentive to push a particular brand or model. In our view biased advice is likely to be worse than no advice (see paragraphs 4.360 to 4.364). Second, we have seen a survey by the Consumers' Association¹ which suggests that the quality of advice received from staff about domestic electrical goods in conventional retail outlets is of very mixed quality.

4.377. It has been put to us by Dixons that outlets such as warehouse clubs which provide minimal pre-sales information are 'free riding' on the service provided by other retailers who offer a high level of competent pre-sales advice and incur costs accordingly. Customers have the opportunity to obtain expert advice about hi-fi systems from these retailers and then purchase from the cheaper warehouse clubs on the basis of this advice. We do not believe that the free rider argument has much force in the hi-fi system

¹Which?, June 1996, page 22.

market. Those consumers who want advice can obtain it from other sources, such as consumer magazines. Moreover, many consumers make their decisions on the basis of brand or their own experience. We were told that customers of the mail order companies frequently went to ordinary retailers to familiarize themselves with products they had seen in a catalogue. But the free rider argument does not appear to have been used about mail order retailers. We think this is because mail order prices are generally well above RRP's and thus do not threaten an 'orderly market' for hi-fi systems.

4.378. In our view consumers should be able to choose how much pre-sales information they look for and, if they opt to go to a retailer where such information may be limited, that is up to them. (Sanyo's comment in paragraph 4.181 implies support for this view.) We do not believe that this constitutes a serious threat to the brands sold in these outlets. In PriceCostco, for example, if a consumer buys a hi-fi system, it can be exchanged for another model or returned for a refund if the consumer changes his or her mind. And if, within three years of purchase, the purchased system is defective in any way, it will be repaired free of charge. It is not obvious to us that this recourse would necessarily be any less satisfactory than that which could be secured in the same circumstances from a conventional retailer whose staff had given advice that led to the purchase.

4.379. We were strengthened in this view more generally by evidence from Philips (which supplies PriceCostco with hi-fi systems). Philips told us that it had tested PriceCostco's guarantee of product exchange or cash back if not satisfied, and had been treated 'very fairly'. Philips thought PriceCostco gave its hi-fi systems 'a reasonable display area' and provided 'an accurate product description to the consumer'. It was aware of no complaints by purchasers of its hi-fi systems from PriceCostco.

4.380. So far as we are aware, too, the availability at PriceCostco of goods, supplied by diverters, of leading brands such as Sony and Panasonic has not had an observable adverse effect on the brands' images.

4.381. We know that at present warehouse clubs have only a small share of the hi-fi system market. Nevertheless, we conclude that the withholding of supply from them by suppliers in whose favour the second complex monopoly exists represents a discriminatory application of the criteria they use to select dealers for supply (and specifically of the pre-sales service criterion), and operates or may be expected to operate against the public interest with the following adverse effects. First, it restricts entry to the market. Second, it directly deprives consumers of choice, for unless supplies can be secured from a diverter, which is uncertain, a warehouse club (and particularly PriceCostco) will be unable to offer its customers anything more than a chance opportunity of purchasing most leading brands of hi-fi systems at a discounted price. Third, as a consequence, the average retail prices for these hi-fi systems will be somewhat higher than they otherwise would be. And fourth, it discourages retail innovation by signalling to potential entrants to the retail market who have a non-standard approach that they may have difficulty in securing supply.

Small retailers

4.382. We noted (see paragraph 4.348) that the most common ground that respondents to the survey of small retailers cited for being refused supply of hi-fi systems was that the locality was already supplied, ie that the supplier was already supplying one or more retailers in the applicant's area and was unwilling to supply another. A brief summary of the cases in which we found against the suppliers concerned is in paragraph 4.191 (together with cases relating to multiple retailers); the retailers' observations and the suppliers' responses are set out in full in Appendix 12.2 (see the relevant asterisked entries). In particular, Sony said that until the introduction of its PEDAs it had selected retailers *inter alia* on the basis of geographic location, but it had now ceased this practice and was offering supply to retailers it had previously refused but which met its revised criteria.

4.383. We conclude that the refusal on the part of suppliers (in whose favour the second complex monopoly situation exists) to supply hi-fi systems to dealers on the grounds that the locality is already supplied operates, or may be expected to operate, against the public interest because consumer choice of outlet is restricted, competition is reduced and prices are higher than they would be otherwise.

4.384. The second most common ground that small retailers cited for being refused supply of hi-fi systems was insufficient turnover. We have said that, in principle, this seems to us an acceptable com-

mercial practice for a supplier to adopt, and we have not found evidence to indicate that it has had adverse effects.

4.385. Appendix 9.1, Table 17, sets out the hi-fi systems suppliers' conditions that small retailers said they were subject to, but these responses must be taken in conjunction with Table 12.1, which shows, on a weighted basis, the criteria that we believe these suppliers adopt. The retailers report 'competence in after-sales and servicing' as much the most important suppliers' condition. But (in respect of applications for supply) the suppliers rank 'suitable premises' as the most important criterion, with 'minimum turnover' next, and then 'pre-sales service', 'post-sales service', 'demonstration facilities', 'display ambience', 'calibre of staff' and 'product knowledge', all at the same level but far lower. The retailers, on the other hand, rank all these well below 'after-sales and servicing'. It is not clear to us why there should be this difference in appraisals by the two sides. The suppliers' appraisal, however, is consistent with that which the majority of them adopt towards the warehouse clubs.

CIH and its local groups

4.386. The practice of CIH local groups (upon CIH's recommendation) of requiring applicants for membership to establish their financial soundness by submitting audited accounts for three years may be expected to restrict entry into hi-fi system retailing. A new entrant retailer, however financially sound, cannot meet this criterion when he is just starting his business. Its use as the only acceptable test of the credit risk of applicants could therefore prevent creditworthy retailers from taking advantage of CIH's purchasing power. In the context of this practice by CIH local groups, we conclude that the consequential withholding of supply by CIH (being a person in whose favour the second complex monopoly exists) to non-members of local groups operates or may be expected to operate against the public interest by restricting entry into hi-fi system retailing, thereby reducing consumer choice, and by causing the terms on which consumers can buy hi-fi systems to be worse than they otherwise would be.

4.387. The practice of some of the CIH local groups of refusing to admit new members on grounds other than their lack of financial soundness, and in particular of making acceptability to existing members a criterion of membership, will also prevent some retailers from being able to take advantage of CIH's purchasing power. In the context of this practice, we conclude that the withholding of supply by CIH to non-members of local groups operates or may be expected to operate against the public interest for the reasons given in paragraph 4.386.

4.388. We also conclude that recommendations by CIH to the retailers it supplies that they should not resell goods to dealers who are not members of CIH local groups will restrict the supply of hi-fi systems bought with the benefit of CIH's purchasing power and hence operate against the public interest for the reasons stated in paragraph 4.386.

Public interest findings on scale monopoly situation

4.389. We have found that a scale monopoly situation exists in favour of Sony Corporation, Sony and Aiwa (paragraph 4.199). Sony and Aiwa are two of the suppliers in whose favour both the first and second complex monopoly situations exist. We have dealt with the effects on the public interest, in respect of the two matters referred to us, of actions and omissions by persons in whose favour each of the two complex monopoly situations exist. So far as the scale monopoly situation is concerned, we conclude that there are no further actions or omissions on the part of Sony Corporation, Sony and Aiwa that operate or may be expected to operate against the public interest in respect of either of the two matters specified in paragraph 3 of our terms of reference.

Summary of findings

4.390. We have concluded that the following actions on the part of persons in whose favour the first complex monopoly exists are steps taken, by recommending or suggesting RRP's or otherwise, to influence prices at which dealers resell hi-fi systems, which operate or may be expected to operate against the public interest, with the adverse effects which we have specified in paragraphs 4.338, 4.341 and 4.342:

- (a) the setting of RRP by suppliers (paragraph 4.334);
- (b) the actions listed in paragraph 4.335 by which suppliers influence the prices at which dealers resell hi-fi systems;
- (c) the provision, formerly included in Sony's terms and conditions for retailers, prohibiting POA advertisements (paragraph 4.336(b));
- (d) the clause, formerly included in Dixons' terms and conditions for suppliers, which referred to the renegotiation of terms if the supplier permitted a 'disorderly market' to develop (paragraph 4.336(a));
- (e) the suggestion or recommendation by suppliers of MORPs (paragraph 4.341); and
- (f) Empire's request for information about its competitors' prices (paragraph 4.342).

4.391. We have concluded that the following actions on the part of persons in whose favour the second complex monopoly exists are steps taken to withhold supplies of hi-fi systems from dealers which operate or may be expected to operate against the public interest with the adverse effects which we have specified in paragraphs 4.381, 4.383 and 4.386:

- (a) the discriminatory withholding of supply from warehouse clubs (paragraph 4.381);
- (b) the withholding of supply from hi-fi system retailers on the grounds that the locality is already supplied (paragraph 4.383);
- (c) in the context of the requirement by CIH local groups that applicants for membership should submit audited accounts for three years, the consequential withholding of supply by CIH to non-members of local groups (paragraph 4.386);
- (d) in the context of the use by some CIH local groups of acceptability to existing members as a criterion for the admission of new members (paragraph 4.387) the consequential withholding of supply by CIH to non-members of local groups; and
- (e) recommendations by CIH to the retailers it supplies that they should not resell goods bought from CIH to dealers who are not members of the local groups (paragraph 4.388).

Recommendations

Influence on dealers' selling prices

4.392. In view of our conclusion that the recommendation or suggestion of retail prices by suppliers, together with other practices which encourage retailers to adhere to the suggested prices, operate against the public interest, we have considered whether suppliers should be prohibited from setting RRPs. This remedy would be the most direct way to address the adverse affects that we have found. In the absence of RRPs we would expect more price competition among retailers leading to somewhat lower average prices.

4.393. We formulated a range of proposed recommendations about pricing practices and put them, when they were still hypothetical, to suppliers, dealers and other parties for comment. Respondents were widely critical of our proposal to prohibit RRPs (see Chapters 13, 14 and 15). We have considered their objections in paragraphs 4.439 to 4.443.

4.394. As stated earlier, it was put to us that RRPs have benefits both for consumers and for the small retailer. More particularly, it was suggested that consumers can use the RRP as a bench-mark against which to compare shop prices, that it gives them an idea of the sort of price they might have to pay without

the need to engage in much search activity, and that it provides a target that they can try to beat. RRPs are also bench-marks for small retailers, it was argued, and help them to set their initial prices for new products without a great deal of research, even if they subsequently had to change them to meet local competition.

4.395. We have reservations about these arguments. Several hi-fi system suppliers (see paragraph 10.17) told us that it was common for consumers to ask them about their RRPs. Sony told us that it had received 5,500 enquiries in 1994 about prices or products. Panasonic said that it had received 330 price enquiries about RRPs in March 1996. On the other hand we noted, from the GfK survey commissioned by Sony (see paragraph 4.69), that 64 per cent of respondents said that they would not consider contacting the manufacturer to find the RRPs of its models, and that less than 1 per cent had actually done so before purchasing. The same survey reported that 93 per cent of respondents expected the manufacturers' RRPs to be on the price tickets. But over half these respondents said that they would visit Dixons and Comet, apparently unaware that these and other large multiples, probably accounting for two-thirds of hi-fi system sales in the UK, do not refer to RRPs either in their advertisements or on their point-of-sale material. It is therefore quite likely that many consumers do not know what the RRP is for a given model of hi-fi system and could not use it as a bench-mark.

4.396. Where RRPs are quoted to consumers, we are concerned that this information might give them the impression that they know more about the prices they should be aiming for than they really do. We believe that, in the absence of RRPs, price discounters would be both more common and bolder in promoting their offers, so that consumers would be better informed about prices.

4.397. As for small retailers, we think that they can and should set their own prices without recourse to suggestions from their suppliers. The willingness, even eagerness, of many retailers to follow suppliers' suggestions about retail prices is, in our view, a serious restriction on intra-brand competition in this market. It was put to us that in the absence of RRPs small retailers would simply follow the prices of the large multiples. We think that their ability to do so would be limited by the multiplicity of hi-fi systems and by the fact that different retailers stock different ranges. We also believe that, in the absence of suppliers' guidance, retailers would pursue a more independent approach to pricing.

4.398. Two conflicting justifications for RRPs were put to us. On the one hand it was argued that RRPs effectively establish maximum prices and hence help to keep average prices down. On the other hand, many small retailers expressed the fear that the absence of RRPs would benefit those retailers who tried to compete mainly on price to the detriment of those who sought to offer a better service to the consumer. The consequence of this, it was argued, would be that many in the latter group would go out of business to the long-term disadvantage of consumers who would find it more difficult to get advice and assistance and who would suffer the inconvenience of losing their local high street store.

4.399. We reject the first of these arguments as in our view retail prices on average would be somewhat lower in the absence of RRPs. We noted that the second argument implicitly concedes this conclusion. As regards the fears of many small retailers, if consumers prefer lower prices and less service, they should not be denied the opportunity of making this choice by practices, such as the adherence to RRPs, which keep prices artificially high. We think it likely that many consumers do want the services and the convenience provided by a local store and that, in the absence of RRPs, there will continue to be a place in the market for retailers offering these benefits.

4.400. It was suggested to us that prohibiting RRPs would reduce inter-brand competition by preventing suppliers from promoting their products to consumers on price. We were not convinced that an inability to quote RRPs would seriously restrict suppliers' promotional activity. Suppliers would not be prevented in any way from promoting their products by reference to quality, performance, features and other non-price benefits. Nor would they be prevented from quoting actual retail prices provided that they were prices established by retailers without any prior suggestion or recommendation by a supplier.

4.401. A further objection put to us was that it would be illogical to treat hi-fi systems differently from other goods not referred, such as hi-fi separates, by prohibiting RRPs for the former but not for the latter. We cannot accept that argument. The FTA requires us to consider what action (if any) should be taken for the purpose of preventing or remedying the effects adverse to the public interest which we have specified, and empowers us to include in our report, if we think fit, recommendations as to such action. We have

identified the adverse effects we believe exist and the remedial action we think desirable in relation to the two matters concerning the supply of the reference goods. That meets our statutory obligations. We cannot investigate, or make recommendations about, goods that have not been referred to us.

4.402. CIH argued that it should not be treated in the same way as suppliers which are manufacturers or importers for the purposes of any prohibition on the use of RRP's. Unlike these other suppliers, it did not exist to make profits from the supply of hi-fi systems. Its purpose was to increase the purchasing power of small retailers. This meant that it was in practice more like a buying department of a large multiple retailer than a supplier proper. It told us that its practice of suggesting an RRP for some of the products it purchased, and in particular the promotion of this RRP through national advertising campaigns, had the effect of increasing competition by enabling the retailer members of local groups to compete more effectively with the large multiples. If it were prevented from publicly promoting the RRP's on its goods, this would make it more difficult for the small retailers it supplied to compete.

4.403. Although we recognize that CIH performs a different function from most suppliers, we do not think that this difference justifies the continued use of RRP's by CIH. The retailers CIH supplies are in competition with each other. If CIH continues to issue RRP's and to promote them, retailers will be less likely to compete with each other on price.

4.404. In our view nothing short of the prohibition of RRP's would deal effectively with the adverse effects that we have found. The use of RRP's is entrenched in the way that business is conducted in the UK hi-fi system market. To tackle only the associated practices, such as the ways in which pressure is put on dealers to adhere to RRP's, would have only limited benefits. For as long as the structure of an RRP-centred market is in place, new ways of encouraging adherence to RRP's will always be found to get round any specific prohibitions. We believe that the benefits of ending the market's current dependence on RRP's, namely the elimination or reduction of the adverse effects we have identified, will exceed such disadvantages as the absence of RRP's may entail.

4.405. We therefore recommend that:

suppliers should be prohibited from publishing, or otherwise notifying to dealers, the prices that suppliers recommend or suggest that dealers advertise, display or charge when they seek to resell hi-fi systems.

We have deliberately framed this recommendation in general terms so that it applies to MORP's as well as RRP's. We recognize that this recommendation, if implemented, would prevent suppliers recommending maximum retail prices for their hi-fi systems. We believe this to be necessary because any exception to a complete prohibition of RRP's could be used to undermine our recommendations by giving suppliers grounds to maintain a close interest in retailers' prices.

4.406. It appears from evidence we received that sales representatives sometimes put pressure on small retailers to adhere to RRP's even when this is not in accordance with official company policy. We therefore think there should be prohibitions on all practices which could be used to put pressure on retailers to follow informal price suggestions by suppliers and that suppliers should take steps to ensure that their staff comply with these prohibitions.

4.407. We recommend that:

- (a) suppliers should be prohibited from taking any action to compel or influence dealers to resell hi-fi systems at prices higher than those decided on by the dealer;
- (b) dealers should be prohibited from taking steps to persuade suppliers to:
 - (i) suggest or recommend prices at which dealers should resell hi-fi systems; and
 - (ii) encourage or influence other dealers to resell at prices different from those at which those other dealers themselves wish to resell;

- (c) suppliers should be prohibited from providing point-of-sale material which includes prices;
- (d) suppliers should be prohibited from reducing or threatening to reduce discounts to dealers who advertise or display hi-fi system prices below levels considered appropriate by the supplier;
- (e) suppliers should be prohibited from making support for dealers' advertising costs conditional upon those advertisements not quoting prices below levels considered appropriate by the supplier;
- (f) suppliers should be prohibited from including in any agreement with dealers a requirement that the dealer should not refer to POA in advertisements;
- (g) suppliers should be required to include in their terms and conditions of sale to dealers an unqualified written term stating that dealers are entirely free to resell hi-fi systems at a price of their own choosing; this term should be sent to the OFT on request; and
- (h) suppliers should be required to send to the OFT, within a period to be determined by the DGFT, a statement of their arrangements for ensuring that their staff comply with the requirement not to seek to influence the hi-fi system dealers' selling prices and should be required to make this statement available to dealers on request.

In implementing recommendation (h) above, the OFT may wish to specify a threshold, in terms of turnover or market share, below which it would not be necessary for suppliers to send compliance statements to the OFT. However, our other recommendations should apply to all suppliers or dealers as appropriate, regardless of size.

4.408. In line with these general recommendations, we further recommend that:

- (a) Dixons should be asked to provide an undertaking that it will not reintroduce into its terms and conditions of purchase a clause to the effect that it reserves the right to renegotiate prices if 'disorderly market forces' are allowed by the supplier to prevail; and
- (b) Empire should be asked to provide an undertaking that it will cease to seek from suppliers information about the prices to be charged for hi-fi systems by its competitors.

4.409. In view of the recommendation in paragraph 4.407 (h) it is unnecessary for us to recommend that Sony should be asked to provide an undertaking that it will not reintroduce into its terms and conditions of purchase a clause prohibiting POA advertisements. It is similarly unnecessary for us specifically to recommend against CIH sending lists of resale prices for hi-fi systems to the retailers it supplies: the practice is covered by the recommendation in paragraph 4.405. (But see also paragraphs 4.314 to 4.318.)

4.410. In addition to the recommendations set out in paragraphs 4.404 to 4.408 we put forward another provisional recommendation, to prohibit suppliers from providing margin support to dealers who cut their prices in response to competitors who charge prices below levels considered appropriate by the suppliers. This drew much adverse comment. Respondents argued that margin support of this kind was to the benefit of consumers as it reduced prices. We have dropped this provisional recommendation because we came to the conclusion that the problem it was designed to address would be adequately dealt with by our other recommendations.

4.411. The remaining recommendations about prices were the subject of less adverse comment although many respondents considered that the recommendations were unnecessary either because the market was working well or because they were already covered by existing legislation, in particular the RPA. We have already explained in our public interest findings the problems we have identified with the working of this market. We indicate in paragraphs 4.412 to 4.414 why the RPA has proved inadequate to deal with the adverse effects we have found.

Resale Prices Act

4.412. Some of the suppliers' practices with which our recommendations aim to deal, for example reducing discounts or limiting supplies to retailers who price at levels not approved by the suppliers, appear to be tantamount to attempts by the suppliers to impose minimum price levels and might reasonably be supposed to be covered by the RPA.

4.413. In the course of our inquiries we were told by the OFT of the practical and evidential problems it had experienced in applying the RPA in cases where it suspected that a form of RPM might be in operation (see Appendix 6.2). The main problems identified by the OFT are set out below:

- (a) The DGFT had no information-gathering powers under the RPA.
- (b) Evidence normally had to come from a retailer who had been refused supply or threatened with a withdrawal of supply; when the retailer did not want to offend the supplier, he or she would be unwilling to provide evidence.
- (c) Price uniformity on its own was not sufficient evidence of a breach of the RPA, as it could result from causes that had nothing to do with RPM.
- (d) Evidence to support the DGFT's seeking an injunction (or an interdict in Scotland) had to be admissible in law and sufficient to persuade the Court. Even retailers who were willing to give evidence might be unable to produce anything other than unsupported accounts of conversations.
- (e) The evidence had to establish, among other things, that there had been an attempt to enforce a particular, ascertainable resale price. A supplier could get away with refusing to supply on the grounds of the general low level of a retailer's selling prices.
- (f) It was not clear how far the RPA extended to include advertising and display of low prices.
- (g) The supplier might plead other reasons, for example a selective distribution policy, which would also lead to a withholding of supply. If the supplier had grounds to refuse supply which on their own justified that course, it would not be in breach of the RPA, even if RPM was one of its reasons.

4.414. In our recommendations we have sought to overcome some of these problems of applying the RPA to the hi-fi system market. But we regard it as unsatisfactory to have to deal with the limitations of the RPA on a piecemeal, product-by-product, basis.

Withholding supply

4.415. We have found that the criteria used by suppliers to select dealers to receive supply of hi-fi systems have been applied in a discriminatory way, in particular the application of the pre-sales and post-sales service criteria to warehouse clubs. Accordingly we recommend that:

suppliers of hi-fi systems should be prohibited from applying the criteria they use to select dealers to receive supply in a manner which discriminates against particular dealers or categories of dealers.

4.416. We doubt whether this prohibition would be sufficient on its own, even though most of the larger hi-fi system suppliers have formal selective distribution systems and discrimination within such systems is a breach of Article 85(1). But given the imprecision of suppliers' selection criteria it would be relatively easy for a supplier to avoid the prohibition of discrimination by introducing *ad hoc* criteria designed to exclude particular dealers from supply or by giving an oral refusal couched in such ambiguous terms that the dealer concerned would be unclear as to which selection criteria he was held not to have met.

We believe the criteria should be transparent, objective and consistent. We therefore make two further recommendations:

- (a) suppliers of hi-fi systems should be required to notify would-be dealers in writing of the criteria they use to select dealers to receive supply; and
- (b) a dealer who is refused supply of hi-fi systems should be given a written statement of the reasons for refusal by the supplier concerned; provision should be made for a copy of this statement to be sent to the OFT.

4.417. Even with these further safeguards, a supplier determined to withhold supply from warehouse clubs could still do so by formulating selection criteria specifically designed to exclude this type of dealer. For example, a supplier might say that it would supply only those retailers who were open to all members of the public or dealers who sold entirely by wholesale. To prevent this or similar moves designed to withhold supplies from warehouse clubs without breaking the prohibition on discrimination, we further recommend that:

suppliers should be required to supply all creditworthy warehouse clubs which request supply, on terms which are not significantly less favourable than those on which other dealers in similar circumstances are supplied, unless the supplier concerned can satisfy the DGFT that the criteria used to refuse supply do not have as their object or effect the prevention, restriction or distortion of competition, and that these criteria have been applied in a non-discriminatory manner.

4.418. We recognize that this recommendation raises the problem of defining a warehouse club. We have in mind the definition we adopted in paragraph 4.39, namely dealers which sell only to their members but which do not restrict membership to retailers. Thus cash-and-carry outlets or other discount stores which have these features will be covered by our recommendation, whether or not they call themselves warehouse clubs.

4.419. The objection to a remedy affecting only warehouse clubs is that it might offer no protection to future innovative retailing formats which could be refused supply without breaching the prohibition on discrimination but which did not fit the warehouse club definition. However, the importance of the signal given to suppliers by even a limited remedy should not be underestimated. If the withholding of supply from one particular variety of outlet and, more particularly, of one type of price discounter were prohibited, the DGFT would be in a stronger position to deal with analogous refusals to supply.

4.420. We must also address the withholding of supply from retailers on the grounds that the locality is already supplied. Accordingly, we recommend that

suppliers should be prohibited from withholding supply from retailers of hi-fi systems on the grounds that the locations of any of their retail outlets are in areas already supplied by these suppliers.

4.421. In addition to our general recommendations about withholding supply we also have two recommendations specifically related to the practices of CIH and its local groups:

- (a) each CIH local group should be prohibited from refusing membership to any retailer who applies for it and who can demonstrate ability to pay for any goods he may order from or through CIH or its local groups; and
- (b) CIH should be asked to give an undertaking that it would not in future make any recommendations restricting the resale of hi-fi systems purchased from it.

4.422. We have noted already (see paragraph 4.207) that CIH has plans to change its membership arrangements to admit retailers as direct members. As the requirement for membership applicants to submit accounts for three years is one that CIH recommends to its local groups, it is likely that CIH will itself engage in this practice when its membership arrangements change. We therefore recommend that CIH

should also be prohibited from refusing membership to any retailer who applies for it and who can demonstrate ability to pay for any goods he may order from or through CIH.

Effects of EC law on selective distribution

4.423. It has been put to us that in several cases:

- (a) the European Commission and the ECJ had accepted that certain selective distribution systems for consumer electronic products (which would include hi-fi systems) were not caught by Article 85(1);
- (b) where the European Commission had decided that a particular selective distribution system was caught by Article 85(1), it had granted an individual exemption under Article 85(3); and
- (c) where no formal decision had been taken, the European Commission had issued a comfort letter indicating that, in the light of the information it had seen, the particular selective distribution system fell outside Article 85(1) or merited an individual exemption under Article 85(3).

It was argued by those parties who drew our attention to these points that we should not make recommendations which would restrict the ability of suppliers to operate selective distribution systems, the terms of which accorded with those cases where the approaches in (a) to (c) above had been taken at the EC level. We therefore sought advice from the European Commission (DGIV) on the effects of EC law on selective distribution.

4.424. The European Commission told us that it will consider whether Article 85(1) does or does not apply in any case notified to it only in the light of an assessment of the specific features of the relevant market and of the effectiveness of competition in that market.

4.425. The European Commission also said that in EC law there is no general presumption in favour of selective distribution, and, if Article 85(1) applies, selective distribution is such a restrictive system of distribution that it needs to be specifically justified under Article 85(3), in the light of the specific circumstances of each case. If a given selective distribution system does not fall under Article 85(1) it may still be prohibited under national law. The European Commission has never accepted under Article 85(3) any clause enabling a supplier operating a selective distribution system to fix or otherwise influence dealers' prices or to discriminate against dealers who satisfy the conditions for supply and who want to be supplied. The European Commission told us that there was therefore no general objection, of the kind suggested or at all, to our making the recommendations we propose.

4.426. The European Commission examined the market for consumer electronic products when considering the application by Grundig AG for an extension of the exemption for its selective distribution system. In its decision of 21 December 1993¹ approving the extension of Grundig AG's individual exemption until 1999, the European Commission noted the following features of the market for consumer electronic products and of the operation of Grundig AG's distribution system:

- (a) the market was keenly competitive;
- (b) Grundig AG's dealers were free to set their own prices;
- (c) there was a sufficient number of comparable competitive products from other manufacturers being distributed via different distribution channels, in particular discount stores and cash-and-carry outlets, to ensure that consumers had sufficient choice between more service- and more price-oriented ways of distribution; and
- (d) Grundig AG's selection criteria were applied in a non-discriminatory fashion.

¹ *Official Journal*, No L20, 25 January 1994, page 15.

4.427. In making this assessment we understand that the European Commission paid particular attention to the national markets in which Grundig AG has a large market share, such as Germany, Italy and Portugal. We understand that it did not look closely at the UK market where Grundig AG is a minor supplier of consumer electronic products. Furthermore, the European Commission's comments on the operation of Grundig AG's selective distribution system cannot be taken to apply to the selective distribution systems of other suppliers (which may differ in their application of selection criteria, as well as in the contractual obligations imposed, the number of dealers appointed, and the extent of the services provided by the suppliers to dealers and by dealers to customers). We note that the decision on Grundig AG was based in part on the existence of competition from discount stores.

4.428. We also understand that other factors, whether favourable or not, might be relevant in other cases. For example, the existence of substantial price differences between dealers in each member state and between different member states, and the absence of parallel imports, would be arguments against concluding that a selective distribution system complied with the conditions required by Article 85(3). Maintaining a rigid separation between wholesalers and retailers is not always appropriate. Apparently qualitative dealer selection criteria or obligations may have quantitative effects. The cumulative effect of all the restrictive clauses in dealership agreements must always be looked at. In general, the European Commission finds that it is essential to look at what happens in practice in each member state, and not to look merely at what clauses in dealership agreements say. Since selective distribution makes entry into the market difficult for new suppliers and retailers, the question whether there is a sufficiently large number and diversity of retail outlets is also important.

4.429. As we have already indicated, our assessment of the UK hi-fi system market, and of the operation of the selective distribution systems of the main suppliers in that market, differs in the following important respects from the findings of the European Commission in respect of Grundig AG:

- (a) we consider that there are limits to the extent of competition in the UK hi-fi system market and, in particular, that the setting of RRP's by suppliers has the effect of restricting or distorting competition;
- (b) although dealers in the UK are nominally free to set their own prices, in practice we consider that this freedom is constrained by the role played by RRP's and the preference of both suppliers and retailers for 'orderly markets';
- (c) there are not sufficient suppliers in the UK willing to supply discount stores such as warehouse clubs to ensure that the consumer has sufficient choice between more service- and more price-oriented ways of distribution; and
- (d) we consider that selective distribution criteria have been applied in a discriminatory fashion; in particular we believe that, in the context of the UK market, the refusal to supply warehouse clubs while supplying mail order companies is discriminatory.

4.430. In the light of these assessments, we see no reason to consider that the European Commission's conclusions in the Grundig AG case, and in those other cases in which it has written comfort letters, are applicable to, and are now necessarily valid in, the UK for other suppliers. We note that the UK is hardly mentioned in the European Commission's decision on Grundig AG. We also note that the European Commission's assessment concerns the agreements notified and the background information provided to it, and could not be expected to deal with the subsequent behaviour of the notifying parties, let alone other suppliers.

4.431. Sony notified its PEDAs (see paragraph 4.172) to the European Commission and, having made modifications requested by DGIV, received a comfort letter in July 1995 to the effect that there were no further grounds for action by the European Commission in respect of the PEDAs. Sony has put it to us that, in view of this letter, we should not make recommendations which would prevent Sony from fully implementing its PEDAs.

4.432. We put Sony's point to the European Commission. It told us that it did not believe that a comfort letter or decision by the European Commission had the effect of preventing the UK competition

authorities from pursuing their investigation in a related matter under national law. However, it would wish to be informed before any action was taken on the basis of any recommendations which we might wish to make (see paragraph 12.176).

4.433. The European Commission did not undertake a detailed examination of the markets in which Sony is a major supplier of hi-fi systems, including the UK. The European Commission's assessment of Sony's PEDAs was based mainly on information submitted by Sony in response to questions by the European Commission. We have a different view from Sony of the UK hi-fi system market, particularly in relation to the features identified in paragraph 4.172. For example:

- (a) Sony told the European Commission that intra-brand competition was assured by the complete freedom of each dealer to set its own resale prices; Sony has made the same claim to us but, as noted above, we believe that this freedom is limited in the UK market; and
- (b) Sony told the European Commission that the PEDAs would not function so as systematically to exclude certain types of outlets; it is true that Makro has been supplied under the PEDAs, but only following a Europe-wide agreement between Sony Japan and SHV Holdings, and after Makro had begun to modify its method of selling hi-fi systems to one more like that of a conventional hi-fi system retailer; thus we believe that the PEDAs do in practice effectively exclude a warehouse club style of operation.

4.434. In these circumstances we think that (having first reached relevant public interest findings) we are not inhibited from making recommendations which would affect the operation of Sony's PEDAs in the UK (having first reached relevant public interest findings).

4.435. The European Commission has confirmed to us that we are free to make such recommendations. In particular it has made it clear that even a comfort letter saying that the conditions of Article 85(3) appear to be fulfilled might not apply, and would certainly have to be reconsidered, if at any time the notifying companies were engaged in any anti-competitive practices likely to restrict or discourage price competition and those processes had not been brought expressly and fully to the European Commission's notice in the notification.

4.436. Sanyo told us (see paragraph 4.181) that it had notified the European Commission on 31 May 1995 of its selective distribution system with a view to obtaining negative clearance or exemption under Article 85(3). The European Commission was still considering Sanyo's case when we completed our report.

4.437. We have considered each of our general recommendations on withholding supply taking account of the points on EC law in paragraphs 4.423 to 4.436. Our comments are as follows:

- (a) the requirement that suppliers should notify would-be dealers in writing of the criteria they use to select dealers for supply appears to us to be in line with the practice of suppliers which operate selective distribution systems that are allowed under EC law;
- (b) the requirement for suppliers not to discriminate in the application of their selective distribution criteria is already an essential feature of distribution systems allowed by the European Commission;
- (c) the requirement for a written statement of reasons for refusal to supply is consistent with what is required from selective distribution systems allowed under EC law, though it is not necessarily a formal part of such systems: it is needed in the UK market to support the prohibition on discrimination;
- (d) the requirement to supply warehouse clubs is specifically related to the problems of the UK market and is therefore to be differentiated from the European Commission's approach to selective distribution; and
- (e) the prohibition on withholding supply on the grounds that a locality is already adequately supplied accords with the European Commission's views on selective distribution criteria which may not be

compatible with Article 85: that a locality is already supplied is a quantitative criterion and in most cases is unlikely to be acceptable under EC law.

4.438. We see no reason, therefore, why our recommendations should not apply to all suppliers in the UK, including those that have exemptions under Article 85(3) or comfort letters from the European Commission.

Suppliers' and dealers' views on remedies

4.439. We consulted suppliers and dealers about our proposed recommendations on withholding supply, when they were still hypothetical. The recommendation which drew most criticism was the proposed requirement for suppliers to supply warehouse clubs. Many of the small retailers who commented apparently feared that this would increase price competition. Since we think that an increase in price competition is desirable we do not accept this as an argument against our proposed remedy.

4.440. Some respondents argued that it was inconsistent to have one recommendation which prohibited discrimination and another which in effect required suppliers to discriminate in favour of a particular group of dealers. We have already explained why we think it is necessary to give special protection to warehouse clubs. But we recognize that, although we have found the reasons given by suppliers for withholding supply unconvincing, they may in future have grounds that are neither anti-competitive nor discriminatory for refusing to supply a particular warehouse club. To meet this possibility we have reformulated our original hypothetical remedy to give suppliers the opportunity for making a case for non-supply to the DGFT.

4.441. CIH argued that it should not be treated as a supplier for the purposes of the recommendation concerning warehouse clubs. It said that, as the retailer members of its local groups were competing with warehouse clubs, it was not appropriate that the latter should have the benefit of CIH's services. We think that to be viable warehouse clubs will need to make their own purchasing arrangements direct with manufacturers or importers of hi-fi systems and would therefore have no interest in becoming members of CIH local groups. However, were they to do so, we do not believe that CIH, any more than any other supplier, should be permitted to discriminate against them.

4.442. Our other proposed recommendations on withholding supply drew less adverse comment. However, many respondents misunderstood what we intended by the proposed prohibition on discrimination and apparently concluded that we were recommending a requirement to supply all dealers who requested it. We did indeed consider that possibility, but it is not the remedy we are proposing. We have reservations about selective distribution arrangements because of their potential for abuse but we accept that there can be criteria for selecting dealers to receive supply which do not operate in an anti-competitive manner. Our concern is that such criteria should not be applied in a discriminatory way. As we have already made clear (see paragraph 4.381) we think it is discriminatory to refuse supply to warehouse clubs on the grounds that their pre-sales and post-sales service facilities are inadequate, when mail order companies, whose facilities are not significantly different, are supplied.

4.443. The hypothetical remedies about which we consulted suppliers and dealers included a right of appeal against refusal to supply and the requirement for suppliers to set up an independent appeals mechanism for dealing with such cases. Many respondents suggested that a formal appeals mechanism would be a costly and bureaucratic arrangement. We have come to the conclusion that, in addition to these objections, a special industry-based appeals mechanism is unlikely to be effective in removing abuses of refusal to supply. Dealers who believe that supply has been unreasonably withheld from them can put their case to the DGFT.

Overview of recommendations

4.444. We see our various recommendations on suppliers' influence on dealers' selling prices and on the withholding of hi-fi system supplies as complementing each other. We believe that reducing the influence of suppliers on dealers' prices will encourage price discounters to enter the market, together with other retailers taking a non-standard approach to pricing. For such entry to be successful, it is clear that the new entrants must not be denied supplies. Similarly, we consider that supplying warehouse clubs will reinforce action against RRPs by bringing into the market more retailers who are keen to compete on price and therefore not interested in pricing their goods at or close to prices indicated or preferred by suppliers.

H H LIESNER (*Chairman*)

R H F CROFT

S EILON

N H FINNEY

D B HAMMOND

J F PICKERING

E C TRITTON

P A BOYS (*Secretary*)

30 April 1997