Domestic electrical goods: II

A report on the supply in the UK of washing machines, tumble driers, dishwashers and cold food storage equipment

Volume I: Summary and Conclusions

MONOPOLIES AND MERGERS COMMISSION

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Members of the Monopolies and Mergers Commission as at 30 April 1997

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[1]These members formed the Group which was responsible for this report under the chairmanship of Mr H H Liesner.

Note by the Department of Trade and Industry

In accordance with section 83(3) and (3A) of the Fair Trading Act 1973, the Secretary of State has excluded from the copies of the report, as laid before Parliament and as published, certain matters, publication of which appears to the Secretary of State to be against the public interest, or which she considers would not be in the public interest to disclose and which, in her opinion, would seriously and prejudicially affect certain interests. The omissions are indicated by a note in the text.

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1 Summary

1.1. On 27 April 1995 the Director General of Fair Trading (DGFT) asked us to investigate whether a monopoly situation exists in the UK in relation to the supply (other than by retail sale or hire) of washing machines and, if so, to determine whether practices relating to 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 washing machines, and

(b) withholding supplies of washing machines from dealers;

operate or may be expected to operate against the public interest. In addition the DGFT referred to us, in similar terms, the supply of three other `white' goods, tumble driers, dishwashers and cold food storage (CFS) equipment (the `reference white goods'), which are also the subject of this report; and four `brown' goods which are the subject of a separate, concurrent report. The full terms of reference for the four white goods are at Appendix 6.1.

1.2. Our separate conclusions on each of the four reference white goods are set out in Chapters 2 to 5. This summary deals with all four, noting any relevant and significant differences between them.

The markets

1.3. Relevant statistics about the markets for each of the reference white goods are given in Table 1.1.

TABLE 1.1 **Markets for reference white goods in 1995**

	Washing machines (including washer-driers)	*Tumble driers*	*Dishwashers*	*CFS equipment (fridges, freezers and fridge-freezers)*
Total value of UK retail sales (£m)	627	93	145	627
Average unit value (to nearest £10)	360	170	350	250
Percentage of households with these goods, 1995/96	90	51	20	99
Number of suppliers with market share of 1% or over	8	7	8	12
				per cent
Market share of GDA	31.8	44.1	21.6	22.1
Market share of Emaco	20.7	16.2	27.6	21.4
Aggregate market share of top four suppliers	80.5	85.6	78	60.6
Retail market share of Dixons	18.4	19.7	18.4	16.7
Retail market share of Comet	10.3	10.9	10.2	12.8
Retail market share of RECs*	27.1	25.1	17.5	21.9

Source: MMC, based on data from GfK Marketing Services Ltd (GfK), suppliers, multiple retailers and Office for National Statistics (ONS).

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*For convenience we use the acronym `RECs' to refer collectively to electrical goods retailing operations which were owned, for most of our inquiry, by one or more of the regional electricity companies of England and Wales, the two Scottish electricity companies and Northern Ireland Electricity, and to Powerhouse, Powerstore and Homepower which bought retailing businesses from regional electricity companies.

1.4. In 1995 the two leading suppliers of washing machines, dishwashers and CFS equipment were General Domestic Appliances Limited (GDA) which supplies the Hotpoint and Creda brands, and Emaco Limited (Emaco) which supplies the Zanussi, AEG, Tricity Bendix and Electrolux brands. GDA was the leading supplier of tumble driers in 1995, Crosslee plc (Crosslee), which supplies the White Knight brand, was second and Emaco third.

1.5. The most important retail channels for each of the reference white goods in 1995 were Dixons Group plc (Dixons), Comet Group plc (Comet) and the RECs. Wholesalers do not play a major part in any of these markets. The only important retailer buying group is Combined Independents (Holdings) Ltd (CIH).

1.6. It was put to us that each of the markets for the reference white goods is very competitive at both the supply and the retail levels. In support of this claim it was argued that prices for these products were highly visible and consumers shopped around; there were no substantial barriers to entry; the profitability of suppliers and retailers was low; there was continuing downward pressure on prices which had fallen in real terms in recent years; and prices for the reference white goods in the UK were below those in other European countries.

1.7. We have reservations about these arguments. We saw evidence to suggest that many consumers did not engage in substantial search activity, and that brand loyalty was strong. The transparency of the market for consumers is limited by different retailers stocking different models from the extensive product ranges of the main suppliers; by the difficulty of establishing objectively the relative performance and reliability of different models; and by the widespread use of non-price offers which are hard to evaluate.

1.8. The brand strength of incumbent major suppliers constrains the ability of a new entrant supplier to achieve a substantial market share. On the retail side, small retailers may be held back by problems of procuring the reference white goods as cheaply as larger, better-established competitors.

1.9. We received limited evidence about profitability and that which we did examine was inconclusive. Moreover we decided that the level of profit of suppliers and retailers did not bear to a material extent on the matters referred to us.

1.10. We accept that the real price of each of the reference white goods has declined in recent years, but we think this reflects improvements in manufacturing efficiency generally rather than a highly competitive market in the UK. We thought for several detailed reasons that the evidence about international price comparisons was inconclusive and of little relevance to the matters we have investigated.

Evidence on prices

1.11. We obtained evidence about pricing practices from a range of sources including suppliers and retailers, large and small. We carried out an analysis of retail prices. For all the reference white goods we found that:

(a) a number of suppliers sought the views of major retailers about the retail prices that their products were likely to fetch;

(b) virtually every supplier of the reference white goods informed dealers of a recommended or suggested retail price (RRP). Many set two RRPs: a higher one, apparently intended primarily as a marketing device, and a lower one which the supplier considered to be a realistic selling price;

(c) most retailers took account of RRPs in setting their own prices; of those which said that they did not do so, for example Dixons, most agreed that their prices often coincided with RRPs;

(d) retailers frequently complained to suppliers about price-cutting by their competitors;

(e) suppliers sometimes contacted dealers who sold at discounted prices; suppliers denied that their intention was to influence retail prices but we identified a number of cases where, in our view, suppliers had discouraged discounting;

(f) most suppliers started from the RRP when negotiating a dealer's net buying price, and this established the dealer's gross margin when the good was resold at the RRP; if the supplier subsequently reduced the RRP, it normally also reduced the dealer's net buying price so that the agreed margin was broadly maintained;

(g) some of the discounts offered by suppliers (for example, advertising and promotional allowances) were paid at the discretion of the supplier or retrospectively or both, giving the supplier the means of influencing retailer behaviour;

(h) retail prices for the reference white goods tended to be at or close to the RRPs; and

(i) most suppliers provided mail order companies with suggested catalogue prices that are higher than RRPs; over 80 per cent by value of mail order sales of each of the reference white goods were at these suggested prices in 1995.

Evidence on withholding supply

1.12. We defined a selective distribution system as one under which a supplier selects dealers to be supplied by taking account of criteria that it deems appropriate. Suppliers of the reference white goods generally denied that they had formal selective distribution systems; nevertheless many of them did have criteria which they took into account when considering whether to supply a dealer. These criteria, which frequently included the provision of pre-sales service, were used by some suppliers as grounds for refusing to supply warehouse clubs.

1.13. CIH supplied only those retailers who were members of its local groups. Local groups would only admit prospective members who could submit audited accounts for a period of three years. Some required new members to be acceptable to existing members.

Monopoly situations

1.14. We find that there are two complex monopoly situations for each reference white good. The first involves all suppliers which suggest or recommend retail prices; for each of the reference goods, the suppliers concerned supply more than one-quarter by value of those goods supplied in the UK. It also involves all retailers who take account of RRPs in setting their own retail prices, or take part in discussions with suppliers which influence the RRPs suggested by those suppliers, or both. Such conduct and the influence that, in our view, RRPs have on transaction prices have the effect of restricting or distorting competition in the supply of each of the reference white goods in the UK. For each reference white good this complex monopoly situation exists in favour of the suppliers and retailers referred to in this paragraph.

1.15. The second complex monopoly situation involves all suppliers which select dealers to be supplied with the reference goods on the basis of certain criteria and refuse to supply dealers who are not selected; for each of the reference goods, the suppliers concerned supply more than one-quarter by value of those goods supplied in the UK. For each reference white good this second complex monopoly situation exists in favour of the suppliers referred to in this paragraph and of dealers selected to receive supply from those suppliers.

1.16. In 1995 GDA's share of the UK washing machine and tumble drier markets and Emaco's share of the UK dishwasher market each exceeded one-quarter. Accordingly there are also two scale monopoly situations which exist in favour of GDA and one which exists in favour of Emaco.

Public interest finding on prices

1.17. Many suppliers and retailers argued that the clustering of transaction prices we observed was not associated with the use of RRPs and that to the extent that transaction prices and RRPs coincided, it was because RRPs followed transaction prices. We are not persuaded by these arguments. Our analysis indicates that there is an association between RRPs and transaction prices. Given the evidence we received about suppliers' and retailers' practices, we believe that the most convincing explanation of this association is that transaction prices are influenced by RRPs.

1.18. The influence of RRPs on retail prices results from the strength of the relationship between suppliers and retailers. Aspects of this relationship include a shared antipathy to unrestrained price competition (often expressed as a preference for `orderly markets'), an antipathy associated with an emphasis on non-price offers and reinforced by the steps taken by some suppliers to encourage adherence to RRPs; and the pervasive use by suppliers of RRPs to determine dealers' buying prices, coupled with discretionary and retrospective discounts.

1.19. We conclude that the following actions are steps taken by suppliers to influence the prices at which dealers resell each of the reference white goods which operate or may be expected to operate against the public interest:

(a) the setting of RRPs;

(b) limiting or threatening to limit supplies to dealers who advertise or display prices below the RRPs;

(c) reducing or threatening to reduce discounts to dealers who advertise or display prices below the RRPs;

(d) making support for dealer advertising costs conditional upon the advertisement not quoting prices below those approved by the supplier;

(e) contacting dealers who advertise prices considered by the supplier or other dealers to be too low;

(f) providing point-of-sale material that includes the display of RRPs;

(g) setting two RRPs, one of them above the expected market price; and

(h) suggesting catalogue prices to mail order companies.

1.20. In addition we found that certain actions undertaken by two suppliers, GDA and Emaco, and two retailers, Dixons and Empire Stores Group plc (Empire), operate or may be expected to operate against the public interest.

1.21. The adverse effects of the actions set out in paragraph 1.19 are to cause retail prices to be higher than they otherwise would be; to reduce the choice for consumers between lower prices/fewer non-price benefits on the one hand and higher prices/more non-price benefits on the other; and to discourage innovation in retailing.

Public interest findings on withholding supply

1.22. Suppliers which had refused to supply warehouse clubs generally told us that they were not satisfied with the pre-sales service of those outlets. However, we noted that such suppliers sold the reference white goods to mail order companies whose level of pre-sales service was not significantly different from that of warehouse clubs. Other evidence, such as the payment by suppliers of sales incentives to retailers' staff, also made us doubt the validity of this reason for refusing to supply warehouse clubs. More generally, we believe that consumers should be able to choose how much pre-sales service they obtain.

1.23. We conclude that the withholding of supply of the reference white goods from warehouse clubs by suppliers represents a discriminatory application of the criteria which suppliers use to select dealers for supply, and operates or may be expected to operate against the public interest. The adverse effects are the restriction of entry to the retail market, a loss of choice for consumers, higher retail prices than would otherwise be the case, and the discouragement of retail innovation.

1.24. We also conclude that in the context of the following actions by CIH's local groups, the withholding of supply by CIH from non-members of local groups operates or may be expected to operate against the public interest by preventing some retailers from taking advantage of CIH's purchasing power and thus restricting entry into retailing:

(a) the requirement by local groups that prospective new members must submit audited accounts for three years; and

(b) the requirement by some local groups that new members be acceptable to existing members.

1.25. In addition, recommendations by CIH that retailers should not resell goods bought from CIH to dealers who are not members of CIH's local groups operate or may be expected to operate against the public interest.

Recommendations on prices

1.26. We believe that the use of RRPs is so entrenched in the way business is conducted in the UK reference white goods markets that nothing short of their prohibition would deal effectively with the adverse effects we have found. We therefore recommend that:

(a) 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 the reference white goods;

(b) suppliers should be prohibited from taking any action to compel or influence dealers to resell the reference white goods at prices higher than those decided on by the dealer; and

(c) dealers should be prohibited from taking steps to persuade suppliers to:

(i) suggest or recommend prices at which dealers should resell the reference white goods; and

(ii) encourage or influence other dealers to resell at prices different from those at which the other dealers themselves wish to resell.

1.27. We also recommend the prohibition of certain other practices which influence dealers to adhere to RRPs, and the introduction of a requirement for suppliers to send compliance statements to the DGFT.

1.28. Some of our recommendations cover similar ground to certain provisions of the Resale Prices Act 1976 (RPA) but we were told by the Office of Fair Trading (OFT) that a number of shortcomings in the RPA made it difficult to enforce. Our recommendations would remedy some of these shortcomings in relation to the reference white goods.

Recommendations on withholding supply

1.29. We recommend that suppliers should be prohibited from applying the criteria which they use to select dealers to receive supply in a manner which discriminates against particular dealers or categories of dealers; that suppliers should be required to notify would-be dealers in writing of the criteria which they use to select dealers; and that a dealer who is refused supply should be given a written statement of the reasons for refusal by the supplier concerned.

1.30. These recommendations might not prevent a supplier, determined to withhold supply from warehouse clubs, devising selection criteria specifically designed to exclude this type of dealer. To prevent this, we further recommend that suppliers should be required to supply all creditworthy warehouse clubs which request supply, on terms which are not 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.

1.31. In addition to these general recommendations, we recommend that CIH local groups should be prohibited from refusing membership to any retailer who applies for it and who can demonstrate the ability to pay for any reference white goods he may order; and that CIH should give undertakings that it would not in future make any recommendations restricting the resale of such goods purchased from it.

1.32. We see our recommendations on RRPs and on withholding supply as complementing each other, so that together they reduce suppliers' influence on retail prices.