6 The market

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Introduction

6.1. In the two preceding chapters we have presented evidence of consumer behaviour in relation to grocery shopping, and identified the participants in the reference market. This chapter describes the way in which these demand- and supply-side elements combine to influence the pattern of competition within the multiple grocery retailing market.

6.2. We begin with an analysis of local market structure, the purpose of which was to identify those areas which appear to provide adequate competition and consumer choice, and those areas which give rise to possible concerns (paragraphs 6.5 to 6.38). We then proceed to look at the market dynamics that have shaped the multiple grocery sector over the last decade (paragraphs 6.39 to 6.117). We consider, inter alia, the evolution of the sector in terms of market entry and exit, as well as more recent trends such as diversification into new product areas and store formats. One recent development that is particularly noteworthy is the emergence of electronic commerce and home shopping generally; the implications for the grocery market are assessed in paragraphs 6.101 to 6.112.

6.3. Paragraphs 6.118 to 6.144 deal with various aspects of the competitive behaviour of the main parties—the role of price and non-price competition, and the different ways in which product differentiation may occur. The main parties’ general strategies towards advertising and marketing are also outlined. Evidence on consumer switching behaviour as an indicator of competitive activity is also considered (paragraphs 6.145 to 6.151).

6.4. Paragraphs 6.152 to 6.181 look at the nature of barriers to entry and exit in the market. Some of these potential barriers to entry receive more detailed treatment in later chapters, particularly Chapter 10 on costs and efficiency, and Chapter 12 on land and planning issues.

Local market structure

6.5. In Chapter 4 (market definition), it was shown that in geographic terms, consumer search for groceries is essentially local. Evidence from the parties showed that on average, the great majority of trade or customers for an individual store would normally come from within a 10- to 15-minute drive time. Consequently, an appropriate isochrone around a store can provide an approximation to the store’s catchment area. Local competition will be affected by those competing stores that are sufficiently near that they provide alternative destinations for consumers in the locality. As such, markets will be affected by the distribution of population, transportation links and other local factors. Isochrones may also overlap, such that geographic markets consist of a chain of individual catchment areas. The issue of how isochrones overlap or blur is considered in Appendix 6.1.

6.6. Given that consumers rarely travel more than 15 minutes to a store, some will face a restricted choice of retailers. This means, first, that some consumers may have a limited choice of stores. This may be because of a lack of stores (for example, in rural areas there may be large gaps between towns and so between stores), or because in some areas one or two retailers own all the relevant stores. Different companies offer different retail formats, quality, pricing, supplementary facilities, promotions and so on. The market will serve customers well only so long as they have a choice, so that they can choose an appropriate retail format. Second, if there are many areas where companies face limited competition, then overall competition between companies may also be limited. Thus a company which chooses a national pricing strategy and has a large hinterland of local monopoly stores may price higher than one whose stores have catchment areas that are generally more competitive. Third, companies may take advantage of local market power, for example through selectively raising prices.

6.7. This section looks at the structure of local store distribution; in particular, it seeks to identify how many areas exist where only one or two main parties are represented. However, for reasons to be discussed, isochrones do not necessarily equate to local markets.

Isochrone-based analysis—method

6.8. The purpose of this analysis was to identify, on the basis of a manageable number of explicit and generally applicable criteria, which areas appear to provide adequate competition and consumer choice, and which areas give rise to possible concerns. The method used was to plot an isochrone around every store under consideration, and to count the number of different competing companies operating stores within it.

6.9. The question arises as to how many competitors are required to provide adequate competition and consumer choice. Considering competition, if this was purely local, then in a local duopoly there would be only one pair of companies competing, and there would be only one price coordination issue to resolve to facilitate uncompetitive behaviour. With three parties there are three such price coordination issues, with four parties there are six such issues, and with five, there are ten. If competition was purely local, it appears that whereas concerns about lack of competition may be possible in a duopoly, such concerns are unlikely with four parties due to the number of price coordination issues to be resolved. Lack of competition is therefore unlikely. Bearing in mind the social impact of store development, and hence the planning aspects involved, it is unrealistic to expect that four competitors could be expected within many isochrones, therefore our view is that three competitors are sufficient to ensure adequate competition, provided all are large enough and of a type that together they are effective competitors. On the issue of consumer choice, it is also our judgement that whereas two competitors may not give an adequate range of choice to consumers, three may be expected to do so.

6.10. Therefore, if there are at least three competitors within an isochrone, we assume that there is an adequate choice. If no or only one competitor is represented, then consumer choice and/or competition may be restricted. This analysis does not purport to assess the nature of competition within an isochrone, and later we consider circumstances where, despite these criteria, competition may be adequate in practice.

6.11. Ideally, isochrones should be drawn around customers rather than around a store, as it is the consumer's choice of retailer that is relevant. Sainsbury illustrated this with two examples, analytically equivalent by our methods but which have different competitive implications. Imagine two stores 20 minutes apart. In the first case, a large town, which provides all their custom, lies halfway between them. The distance between the stores is such that on the basis of a 15-minute isochrone drawn around each store, each appears to be a local monopoly,[1] but all consumers have a choice of two stores within 15 minutes. Secondly, imagine that each store serves a potential customer base in one of two towns which, rather than being located between the two stores, are each located on the far side of either store. Consumers from each town are then likely to use only the store closest to that town. Then each store is a genuine local monopoly. Clearly therefore the distribution of consumers can be important. Unfortunately, such a consumer-based analysis is impossible to conduct, given that there are over 22 million households in the UK.[2] We therefore used our store-based analysis, recognizing that local competition may be influenced on a case-by-case basis by the actual distribution of consumers and their shopping habits. In aggregate, this will induce biases that may either mistakenly detect, or fail to detect, restricted choices, rather than consistently lead to a one-way bias.

6.12. Our method of analysis has the advantage that it will identify stores which face no competition ('local monopoly' stores) or only one competitor ('local duopoly' stores) in isolated areas where there are few, if any, competitors locally, and it will also pick up stores in an area where a particular retailer owns all, or all bar one, local stores. It was put to us that Sainsbury and Tesco tend to dominate areas of the South-East, without any alternative stores being available. It has also been suggested that Safeway controls many stores in more widely separated communities in parts of the North of England and southern Scotland. Any such pattern will be detected by this analysis for individual stores, although con-

[1]Throughout this section, references to local monopoly or local duopoly stores reflect only the number of different fascias available to the consumer.

[2]According to the 1991 census, there were 22.4 million households in Great Britain (*Social Trends*, HMSO, 2000).

sideration of regional concentration may show whether consumers can widen their choices by travelling further. Appendix 6.1 considers overlapping isochrones and regional concentration in more detail.

6.13. Clearly the appropriate isochrone does not need to capture 100 per cent of customers, and it was necessary to exercise our judgement as to an appropriate threshold. The evidence from the main parties considered in paragraph 4.119 and Appendix 4.1 led us to conclude that 15 minutes was an appropriate travel time at which to draw an isochrone for the purposes of defining local markets. However, most of the parties disagreed with this conclusion. Safeway argued that in rural areas, trade would be attracted from further afield, and so a larger isochrone would be appropriate. The size and format of store was also relevant—hypermarkets have a larger pulling power from further afield than smaller stores. Tesco told us that local catchments should be defined in terms of customer behaviour and the impact this has on store profitability. Tesco also told us that the area over which its stores attracted customers was larger than the area defined by a 15-minute isochrone (Appendix 4.1 shows that Tesco obtained 81 per cent of its business from within a 15-minute isochrone for rural stores, and 89 per cent for non-rural stores, rising to 89 per cent and 93 per cent at 20 minutes). Consequently it told us that a 20-minute isochrone was more appropriate. This implies raising the catchment area of the store by 78 per cent to increase the customer base by between 4 and 8 per cent. Sainsbury also pointed to significant numbers of customers from beyond a 15-minute drive time. Asda, however, told us that nearly 90 per cent of its revenue was generated by customers living within a 15-minute drive time of its stores, and 76 per cent within 10 minutes. Consequently it agreed that 15 minutes was an appropriate drive time, and suggested that, if anything, a 10-minute drive time was an appropriate alternative.

6.14. Examination of data of consumer travel times showed that they were typically considerably shorter in urban areas (see, for example, Appendix 4.1, Tables 7 and 8). While this may reflect the fact that there is a greater density of stores, it may also mean that congestion imposes a greater variability in travel times making consumers less willing to travel, or that such consumers chose not to seek to explore alternative fascias further away. It has also been put to us that in some cases, people who place a higher value on their time are likely to locate within cities, and so for some individuals the opportunity cost of travelling is higher, and this is more likely to apply in urban areas. We therefore considered it appropriate to plot 10-minute, rather than 15-minute, isochrones around urban stores (that is, stores situated within large conurbations—see Appendix 6.3).

6.15. It was put to us that not all competitors might actually provide an effective alternative one-stop shop. We were told that many consumers had a preference for larger stores that stocked a wider range of lines, to the extent that, all other things being equal, many would drive past a small store to reach a larger store. We therefore took into account the parties' comments on the minimum size of store required for a one-stop shop. We were also told that as most consumers did their one-stop shopping by car (because of the weight and bulk of the purchases), easy access from the store to a car park might be considered essential. Finally, we noted that some of the main parties (the discounters and M&S) offered a relatively restricted range of products, which means that although some shoppers could do the bulk of their shopping there, many consumers might not see them as a one-stop shop destination. This is shown in the section on consumer attitudes to shopping at the discounters, covered in the consumer survey in paragraphs 4.101 to 4.104. Sainsbury argued that most of the shopping in its stores could have been met by the products available in the discounters, and other parties presented evidence to show that many customers at the discounters were undertaking large purchases. Tesco told us that M&S was often seen as a significant competitor, and was especially important in Northern Ireland. However, the range of pack sizes, and variety of types and quality, are not reproduced in a discounter, while many specialized lines are not available at all. We therefore took account of these arguments by constructing conditions to define 'effective competitor' stores.

6.16. Our view is that, as a reasonable threshold, a store has either to have a net sales area of at least 1,394 sq metres (15,000 sq feet), or to be at least 75 per cent of the size of the store under consideration to be an effective competitor against that store in the one-stop shop market (see Appendix 6.3). If the store under consideration had car-parking facilities nearby, we only included as effective competitors those stores that also had them, and we also excluded the discounters and M&S as effective competitors, because of their more limited product range.

6.17. The analysis counts the number of alternative fascias within a store's isochrone, as this provides an appropriate measure of the variety and choice of store formats available to a consumer. Some of the parties argued that this approach was not appropriate. Although Asda described the analyses as providing a useful first cut of stores/areas in which consumers might not be able to benefit from full and open competition, they said that some filter to assess the impact of the local monopoly and duopoly stores should be employed. Asda presented an analysis based on available sales area and population density to reflect the differing sizes of stores to identify whether there was scope for further stores. Safeway suggested that market shares, as measured by spend, were an appropriate measure of power, rather than the number of competing stores within an area, as it reflected actual consumer behaviour. The Safeway and Asda evidence is reviewed at Appendix 6.2. Safeway found that around 12 per cent of all superstores had a local catchment market share of over 40 per cent, and it told us that there was some evidence that such catchments tended to cluster geographically for some operators. Asda reported that 96 stores had market shares (by store floor space) of over 50 per cent in large catchment areas for 15-minute isochrones, and 211 stores for 10-minute isochrones. It also reported geographic clustering, in this case in London and the South-East particularly.

6.18. We accept that market share of expenditure can be a useful measure, particularly if a high share reflects significantly larger stores, or a lack of floor space for smaller but perhaps more efficient stores, which are unable to expand their businesses. We are aware that larger stores have a greater attraction and catchment area than smaller stores, although this effect begins to diminish again for very large stores. However, the size criteria were added to our test of ‘effective competitors’ in recognition of this point. More generally, there may be perfectly adequate variety of choice available to consumers in a locality, even though one multiple has a significant market share, provided enough alternative fascias exist. In addition, revenue measures will in part reflect companies’ success in attracting customers rather than market power.

Analysis

6.19. For reasons given in paragraphs 5.18 to 5.23, we examined every reference store owned by the major parties: Asda, Morrison, Safeway, Sainsbury and Tesco. First, we identified those stores that faced either no competition or competition from only one other reference store within a 10- or 15-minute isochrone. This procedure is described as stage one in Appendix 6.3. This gives an indication of where there is a choice of store, although it says nothing about whether the alternative stores provide effective competition.

6.20. We then followed a two-step procedure to address the concerns raised in paragraphs 6.15 and 6.16, about the effectiveness of particular competitors. First, we examined each store of the five major parties that faced either no competition from another major party, or competition from only one other member of the major parties, within a 15-minute isochrone, or 10 minutes in an urban area. On this basis we provisionally excluded from further analysis all stores of the major parties that face competition from stores of two or more competitors from the major parties. This procedure is described as stage two in Appendix 6.3.

6.21. For the list of stores that were potentially still of concern, we examined all competitors within the relevant isochrone (not just from the major parties) to determine which provided ‘effective competition’, according to the definition in paragraph 6.16. We therefore determined which of the stores identified in stage 2 faced effective competition from more than one competitor out of all the 24 main parties. This process is described as stage 3 in Appendix 6.3.

6.22. Finally, we considered the possibility that stage 2 may have missed instances where a large store faces competition only from two small rivals from the major parties, as Safeway, Sainsbury and Tesco do operate some smaller stores. We therefore looked for cases where only these three were present, and the two competitors within the isochrone only operated stores that were not effective competitor stores as defined earlier. We refer to this as ‘ineffective triopoly’. In the very limited number of such cases, these stores were also examined for other effective competitors in their isochrones, as in stage 3.

Results

6.23. Seventy-eight stores were identified as facing no 'effective' competitors according to the criteria above. Ninety-one stores were identified as facing just one 'effective' competitor, where the competitor is one of the other major parties. Six of these instances resulted from our consideration of triopolies. Forty-six stores were identified as facing one 'effective' competitor reference store, which was not from the major parties.

6.24. Additionally, five stores were identified in urban areas where duopoly concerns arise at the 10-minute isochrone level. The number of stores identified is low. The reason appears to be that there is a sufficient density and choice of stores in urban areas that, in most cases, concerns over lack of choice do not arise. It is also interesting to note that despite the widely held view that Tesco and Sainsbury dominate the South-East, it appears that there are sufficient other fascias such that the number of 'local monopolies' and 'local duopolies' is very low in that region, so consumers do generally have alternative choices there.

6.25. The database used for the analysis was based on company responses to our questionnaire sent in mid-1999, and in a large database such as this, party responses inevitably included a number of errors and omissions. A number of stores have been opened since that date, and some non-reference competitors were excluded. In particular, there are some large stores in Northern Ireland, outside this reference because they were not in a group of ten or more reference stores, but which nonetheless offered substantial competition.

6.26. The major parties were therefore asked to comment on the findings. After allowance for further information, and retaining our original criteria, we found that 45 out of the 220 stores identified above could be excluded. Therefore, we find from the objective application of our criteria that there are 175 stores where there is a potential concern that there may be a lack of consumer choice.

6.27. The list of stores of potential concern identified in the analysis indicates areas where the choice of retailers available to consumers engaged in one-stop shopping may be restricted. However, whether this is in fact the case will depend on local circumstances, which are not factored into the calculation of the total figure of 175 stores. In some cases excluded or non-reference stores might be significant competitors. The distribution of local consumers may also be such that a significant proportion of them have several stores within their own drive-time horizon, even if the stores themselves appear from our isochrone analysis to be too far apart to compete. In some cases, an unusually high proportion of consumers may travel from beyond a 15-minute isochrone. The situation is also dynamic, and will change as stores open, close or change hands, and transport infrastructure develops. Our analysis serves as a snapshot to illustrate the extent of the problem of restricted choice.

6.28. Many areas with limited choice are relatively isolated or have very low populations. In these cases it is unlikely that the catchments could support more than one large store. Nonetheless, consumers in these 'natural monopoly' areas have only a limited choice of retailers for one-stop shopping.

6.29. We considered the possibility that the isochrone times were too low, and that if this was increased, the identified competition between retailers would increase significantly.[1] We addressed this in two ways. First, companies were asked whether they could demonstrate that this applied to any of the 220 stores identified in paragraphs 6.23 and 6.24. This addresses the concern on a case-by-case basis. Secondly, we used the local competition and consumer choice model described in Chapter 7 (and Appendix 7.8) to look at the effect of widening catchment areas. As shown in Appendix 7.8, paragraphs 96 to 103, widening store-centric markets from 5 to 20 miles shows that company market share falls, but not by very much. This suggests that extending isochrones is unlikely to lead to a rapid increase in the diversity of choice to consumers.

[1]This seemed plausible because the area in which a competing store could be located expands at an increasing rate as travel times are increased. For example, assuming a circular isochrone, the area of a circle with a radius of 15 is 2.25 times that of a circle of radius 10.

Major party responses

6.30. We invited the major parties to comment on the analysis. In addition, given that it was not feasible to conduct a detailed analysis of each catchment,[1] we invited them to comment on the particular circumstances of the stores that we had identified, with particular reference to the points on local competition noted above.

6.31. The parties criticized the analyses as not representing the true competitive conditions in local markets. The market share of an identified store may in fact be low, if consumers will travel outside a store's isochrone, or many consumers are located in areas served by competitors. Sainsbury also suggested that local duopoly stores could be part of a continuous chain of substitution (these are the blurred isochrone and overlapping catchment issues discussed in Appendix 6.1). In particular, some companies argued that competition from smaller stores, below the reference threshold, could in some areas be very significant. They also argued that some consumers used M&S and the discounters for main shopping trips. Tesco mentioned non-reference stores (for example, Boots) competing in particular product categories.

6.32. Tesco also presented an analysis it had conducted based on isochrones around enumeration districts, rather than around stores. An enumeration district is the smallest available measure of population for which UK data are available that can be used in a geographic information system. Typically each would cover around 200 households. It had measured the number of reference stores available within 15 minutes of each enumeration district. Tesco told us it found that 92 per cent of UK households had at least three reference retailers operating reference stores within a 15-minute drive time. While we were not able to check this analysis, this does not appear to be inconsistent with our findings for Tesco. First, our own analysis suggested that the very great majority (at least 88 per cent) of Tesco stores faced more than one local 'effective' competitor. Second, Tesco looked at all reference stores, whereas we have applied criteria to limit these to 'effective' competitors. Third, given that a number of local monopolies and local duopolies as defined in our analysis serve small or isolated communities, we would expect the proportion of such stores to be higher than the proportion of shoppers affected.

6.33. Some of the major parties commented that consumers in some areas frequently drove much further than 10 or 15 minutes to a store.[2] However, this may be a consequence of a lack of choice locally rather than despite it. For example, Safeway told us that consumers in remote areas served by small stores might make infrequent trips to a large store further afield.[3] Sainsbury stressed that consumers might have a choice of stores from several starting points—home, the workplace, or the school run, for example—and so their choices could be based on more than one area. In paragraph 4.112, we considered evidence presented by Asda which showed that 84 per cent of its shoppers started their trip from home, 8 per cent from work, and 7 per cent from elsewhere. Asda suggested that the incidence of linked shopping trips was low. Our own survey, in paragraph 4.132, found that 15 per cent of respondents said they sometimes linked trips, 8 per cent usually did so, and a further 3 per cent always linked the main shopping trip with other journeys.

6.34. Asda commented that there was an important qualitative element to competition. Choice of retailer was important where retailers offered distinct strategies, and therefore any such analysis should include a distinction between different groups of retailers, grouped by shared strategies. However attractive this suggestion may be in principle, the fact that retailers compete on several aspects of their offer as well as pricing strategies, and that such strategies change over time, makes this difficult to do in practice.

6.35. Tesco argued that our analysis was limited, and would become increasingly so over time, because it ignored home shopping. Tesco's home delivery services are confined to areas around certain

[1]Also the availability of local choice will change over time.

[2]Several parties provided evidence on the proportion of trade coming from outside a 10- or 15-minute isochrone. For example, 30 per cent of Tesco's Oban store's trade came from beyond a 25-minute isochrone, and 35 per cent of Sainsbury's Oswestry store's trade came from beyond a 15-minute isochrone.

[3]Safeway presented market share evidence for its stores based on surveys of consumers within a 5 and 10 km radius of the stores. These figures could be very low, even below 20 per cent for 'local monopoly' stores. Safeway told us the figures showed that many consumers did travel longer distances to larger stores. Around half of its stores identified as 'local monopolies' had a market share of over 40 per cent, but only 9 over 50 per cent, of which all but one were in remote small towns. Safeway told us that these towns could only support one relatively large store because of the limited number of consumers.

stores, although the coverage of the UK population is growing rapidly. Some delivery services operate over long distances; for example, Iceland offers national delivery. Alternatively, delivery may be from separate distribution centres. The availability of home delivery is very wide; however, the market share of home delivery at present remains low.

6.36. With regard to specific stores, parties pointed out: *(a)* cases where they disagreed on travel times[1] such that further competitors may fall within the isochrone; *(b)* alternative stores that consumers used outside the isochrone or where their actual consumers lived outside the isochrone and had access to alternative stores; and *(c)* cases of competition from non-reference stores, or stores outside our criteria for 'significant' competitors.

6.37. We noted the relevance of these points to the local competition faced by these stores and consumer choice. For example, there were several cases of Waitrose stores just below the minimum size threshold, which because of Waitrose's limited non-reference products offer, actually had a large floor area devoted to reference products, and so appeared to be a significant local competitive factor.[2] Elsewhere, we were told that market shares of some of the stores of concern in question were low, suggesting either that shops below the significance thresholds were sometimes important, or that consumers travelled long distances to other stores. For some stores, there were a wide variety of alternative retailers just outside the isochrone, or the catchment population was distributed such that it would be easy for them to use stores outside the isochrone. As stated above, we were not able to conduct a full assessment of these cases and so our final list does not conclude that all of these stores necessarily have a restricted consumer choice. On the other hand, in some areas, factors such as the distribution of population, or the effectiveness of particular retailers, may mean that areas where apparently there was sufficient choice in fact present a restricted choice for consumers, which the criteria employed will have missed.

6.38. The criteria used by Safeway and Asda for their own analyses generated very different lists of stores, although the numbers of stores that might face limited competition were not dissimilar. Most of the stores they identified faced at least two other significant competitors from the main parties, but were in catchments where one fascia had a high market share.

Market dynamics

The external environment

6.39. We were told that trading conditions faced by multiple grocery retailers had altered significantly during the course of the last decade. On the demand side, a key event appears to have been the recession of the early 1990s. As a result, we were told, consumers had become more discriminating in terms of their spending decisions, with a greater focus on price than hitherto. This increased price consciousness had paved the way for the entry of the limited-range Continental discounters to the UK market in the early 1990s (discussed below), and had also necessitated changes in retail strategy among established players, such as wider use of promotions.

6.40. Wider demographic trends, for example the long-term increase in the female labour-force participation rate, have also affected the nature of demand for groceries in various ways, most notably in terms of the premium attached by consumers to convenience in their shopping habits and purchases. Consumer preferences for greater convenience in the grocery retail offer have been expressed in various ways. The provision of chilled ready-prepared meals and other convenience-type foods by the larger supermarkets is one example.

6.41. A further important change in demand is the emergence of one-stop grocery shopping: consumers save time by concentrating their grocery purchases into a single trip to a store where they can buy all or a substantial part of their grocery requirements, rather than undertaking more frequent visits to

[1]Isochrones are based on average speeds for particular grades of road. In practice, actual travel times on a particular road will vary according to the density of traffic, number of junctions, time of day etc. Therefore there is potential for disagreement over the actual position of the isochrone boundary.

[2]The parties stressed that the proportion of a store's net sales area devoted to 'reference' products could vary markedly.

a variety of different outlets. This has been made possible by the long-term rise in car ownership. In 1961 only three out of ten households in Great Britain had a car, a proportion that had risen to seven out of ten by 1998. The proportion of households with two or more cars has grown from 2 per cent in 1961 to 28 per cent in 1998.[1]

6.42. One important aspect of convenience is the ability to one-stop shop; another is easy access to grocery outlets (for example, having a supermarket within easy reach of home) and, for car-borne shoppers, availability of parking. More flexible opening hours, such as Sunday trading, may also reflect this consumer demand for greater convenience.

6.43. Extra costs have been incurred in meeting demands for convenience, for example the costs of providing flat car parking adjacent to stores, and the fixed costs of refrigeration associated with demand for chilled ready-made meals.

6.44. Overall growth in demand for food is slow, a point emphasized by a number of the main parties in their evidence to us. Until recently, this may not have been a major constraint on growth, as the large chains have been able to benefit from the long-term shift in shopping patterns away from the specialist and independent sector and towards one-stop shopping. Paragraphs 13.42 to 13.48 describe the trends in number of outlets and sales for the specialist and independent grocery sector. Due to the contraction of the independent sector, however, opportunities for sales growth from this source have been reduced. This suggests that growth is increasingly restricted to three sources: gaining market share from other retailers, diversification into new products or markets, or through acquisition or merger. Tesco said that the slow overall growth in demand for food had resulted in intense competition between multiples, and was borne out by the fluctuating fortunes of different grocery retailers over recent years.

6.45. It has been suggested that grocery retailers need to gain greater scale in order to compete against a background of declining real prices for food (see paragraphs 7.7 to 7.12 for a review of the trend in grocery prices in real terms), coupled with perceived cost inflation in inputs. However, retailers do have some scope to limit the impact of falling real prices for food in a number of ways, such as through increased sales of value-added meals and non-food grocery products.

Entry and exit

New entry and transfer of ownership

6.46. In describing the recent history of entry into a sector or industry, it is customary to distinguish between entry involving the creation of new productive capacity. The former will tend to reduce concentration levels. Entry via a transfer of ownership does not, in itself, affect concentration, but may involve the introduction of new elements into the competitive mix, depending on the efficiency levels and strategies pursued by the acquiring firm.

6.47. We first focus on new entry through increases in productive capacity; the following section deals with transfers of ownership through acquisitions and mergers in grocery retailing.

New entry to the supermarket sector

6.48. The 1990s witnessed some new entry to multiple grocery retailing. In April 1990 the first limited line discounter opened—Aldi from Germany. It was quickly followed by Netto (1991), Ed (1993, then owned by Carrefour), Lidl (1994) and Shoprite. Rewe acquired a 21 per cent holding in Budgens in 1993, converting some of its stores to the discount ‘Penny Market’ format. These overseas-based discounters had several characteristics that distinguished them from the existing mainstream multiple grocers, notably a limited product range (around 600 to 950 product lines, as against around 30,000 lines in a typical Tesco store) and a direct focus on price as opposed to other elements of the grocery retail offer.

[1]*ONS, Social Trends 30*, 2000 Edition, p197.

6.49. Many of the early new entrants have since exited the industry, mainly through acquisition by other discounters. Carrefour sold its Ed stores to Netto in 1994, while Lidl acquired the Penny Market stores from Rewe in 1995. Kwik Save purchased the Shoprite discount stores in 1994.

6.50. The performance of the overseas-based discounters was predicated on a business model radically different from that of the existing mainstream grocers. Their offer focuses on meeting demand for low-cost food, primarily among the lowest-income groups for whom food comprises a disproportionately high share of personal spending. The vehicle for offering such discounts is normally through a limited range of exclusive own-label products, rather than price reductions on manufacturer brands (which usually are not stocked).

6.51. The discounter model depends in part on having a corporate structure geared to low-cost operating and selling. Build and fit-out costs are kept to a minimum by having a standardized store format. A narrow but fast-moving product range means that the discounters can avoid the slow-moving items that must be stocked by a broad-range multiple. With a largely standardized store layout and product range across stores, the distribution system can be kept relatively simple and cost effective. Stores do not have the types of extra facilities and services offered by some of the mainstream multiples, for example coffee shops, information desks, or specialized food counters. With a small product range and few additional facilities, stores of the discounters are small and can be put in low-cost sites.

6.52. The existing mainstream grocers reacted to the challenge posed by the discounters in a number of ways. One strategy has been the introduction of ‘value’ or ‘economy’ own-label ranges, aimed to compete directly on price with the limited line discounters. Multi-buy promotions have become more commonplace. Some of the mainstream multiples also tried a foray into discount retailing. Asda experimented with a seven-strong discount chain called Dales, and Somerfield converted a number of its larger stores to a discount format called Food Giant, but all of these have been converted back to mainstream fascia.

6.53. Perhaps more vulnerable than most to the arrival of the hard discounters was Kwik Save. Its market position rested on being a discounter of leading grocery brands, rather than providing the type of exclusive own labels carried by the overseas-based discounters; and it also carried a product range that was significantly wider than that of the discounters (around 4,000 lines); but it was nonetheless much closer in format to the discounters than most other UK multiples. However, a wider offer meant that it carried more slow-moving lines than the Continental discounters and hence could not operate to the same cost levels. Another difference was that the discounters were multinational operators, benefiting from an international network of stores, whereas Kwik Save was a purely domestic operation. In addition, the latter did not have the ability to buy exclusive own labels on a pan-European scale.

6.54. Caught between the discount and mainstream ends of the market, Kwik Save’s results deteriorated from 1994 onwards. Its response, following a major strategic review in 1996 culminating in the ‘New Generation’ project, was to reposition itself as a low-cost supermarket chain, distancing itself from the discounters, prior to its merger with Somerfield in early 1998.

6.55. An important example of new capacity entry into a different region was the entry of Sainsbury into the Northern Ireland grocery sector in 1994, with a strategy based on building new stores. Sainsbury currently has seven stores there. It told us that its strategy had been one of organic growth through a selection of appropriate stores and the acquisition of an independently-owned store.

Acquisitions and mergers

6.56. Prior to Wal-Mart’s purchase of Asda, acquisition and merger activity in UK grocery retailing had largely been confined to domestic players. Tesco has participated in some of the most important of these, notably its acquisition of Wm Low in Scotland in September 1994 and its purchase of the Stewarts chain in Northern Ireland from ABF plc in 1997 (Tesco had already established a presence in the Northern Ireland sector in October 1996, when it opened a Metro store in Belfast). These acquisitions enabled it to extend its trading coverage into new geographical areas, and account, in part, for its rise to position of market leader in the grocery sector. Safeway has also established a presence in the Northern Ireland market. It established a joint venture grocery retailing business with Fitzwilton Plc in June 1997. Safeway now has 12 stores in Northern Ireland. It has opened three new stores and the remainder are conversions from the Wellworth fascia to Safeway.

6.57. In February 1998 Somerfield merged with Kwik Save, substantially enlarging its store portfolio. The most recent domestic merger, in April 2000, involved the two largest components of the Co-operative movement—CWS and CRS. CWS subsequently put 16 of its larger foodstores up for sale. It is expected that the merger will enable the enlarged entity to operate as a single business, achieve operational savings and be marketed as a unified brand.

6.58. We were told that while such mergers were usually seen as a way to improve performance of one or both players involved, there were challenges to be met in terms of integrating different stores and brand images. The Somerfield/Kwik Save merger illustrates these. The merged entity initially began to convert many of the existing Kwik Save stores to the Somerfield fascia. However, difficulties were encountered in bringing the different store formats together under one fascia, partly reflecting the fact that shoppers at some of the Kwik Save stores relied on having a discount-type offer available. At the end of 1999, the merged group put 349 Kwik Save outlets up for sale, as well as 140 of the larger Somerfield stores. It subsequently sold 46 of the larger Somerfield stores and withdrew the Kwik Save outlets from sale.

6.59. The entry of Wal-Mart into the European market—via its purchases of Wertkauf and InterSpar in Germany and Asda in the UK—indicates that merger and acquisition activity in grocery retailing has begun to move beyond national confines. Wal-Mart is the world's largest retailer. Its group turnover represents about one-sixth the size of the total European grocery market—a share that is taken by the top five players in Europe. It is also a general merchandise retailer. The Wal-Mart discount stores and 'supercenters' in the USA alone generate grocery sales of over £23 billion, which is around a third the size of UK grocers' total sales.

6.60. Wal-Mart's entry into the European market has been heralded by some as signalling a major change in the competition facing European grocery retailers. Certainly this was a view put to us by some of the UK grocery multiples involved in our inquiry. Wal-Mart's reputed strengths in areas such as logistics, buying power and non-food retailing were seen as placing increased pressure on domestic grocery retailers to improve the efficiency of their distribution and secure improved terms of trade from suppliers. Sainsbury told us of reports that, in Germany, Wal-Mart had introduced more efficient delivery systems into the businesses it had acquired there, and that it had negotiated its requirements with brand owners on a global basis, shipping US-sourced products to Germany. Such global sourcing was expected to be one way in which UK grocery operators would seek to achieve improved buying terms in the future, particularly from multinational suppliers of branded grocery products. It has also been suggested that Wal-Mart's purchase of Asda, followed by the Carrefour-Promodès merger shortly afterwards, was likely to trigger further defensive alliances or mergers among European grocery retailers in order to match the efficiency and buying scale of Wal-Mart.

6.61. On the prospects for further consolidation more generally, nearly all of the main parties told us that they expected to see further merger and acquisition activity in grocery retailing over the next few years, either in a domestic or cross-border context.

Diversification

6.62. As the grocery market matures, diversification into new product areas or markets has become an important aspect of strategy for a number of the larger multiple grocers. As diversification can take different forms, we describe it under a number of headings, as follows.

Retail formats

6.63. Sophisticated replenishment systems have enabled the major UK multiples to stock and display a wider range in a smaller space than a few years ago, thereby facilitating the development of smaller store formats. Tesco, Sainsbury and Safeway each has a version of such a compact (Tesco's term) store, though Safeway's version is not separately branded. Tesco's first experiment was to open city centre stores, called Metros. These are city centre stores offering a range of about 10,000 products. Such stores require high footfall (number of transactions per sq metre), but are able to offer a convenience range with a large fresh and ready-prepared food offer. Sainsbury has a similar format called Central which started opening stores in late 1999 (see Table 5.12 for an outline of its different store formats).

6.64. Some of the diversification into new store formats has been achieved through joint venture with non-grocery companies. Tesco and Safeway have developed convenience store formats based at petrol stations, largely in partnership with Esso and BP respectively. Similarly, Somerfield has formed a venture with Elf to provide petrol station forecourt shops. One of Iceland's store formats has been developed through concessions operated within Littlewood's high street stores.

6.65. The role of store format in competitive strategy is addressed in more detail in paragraphs 6.130 to 6.134.

Non-grocery

6.66. A second form of diversification that has been adopted to varying degrees by UK multiples is to extend into non-grocery retailing. As the ability to offer non-grocery lines is ultimately constrained by store space, it has tended to be those operators with a portfolio of larger stores that have been able to pursue this route more successfully. Clothing has been a key non-grocery area for Asda, with its George label generating sales of over £500 million. Tesco is also building up a clothing range. Other important areas of non-grocery product retailing by the multiples include petrol, newspapers (which follows the easing of restrictions on newspaper distribution in 1994), mobile phones, and home entertainment (CDs, computer games and software).

6.67. Additionally, a couple of the major multiples—Tesco and Asda—have sourced a limited number of non-grocery products, typically major fashionware brands, from overseas via the 'grey market' (ie outside the usual national distribution channels for such products). Such products are then usually sold at a discount to those retailed from manufacturer-authorized dealers. Sainsbury has also sourced non-grocery products from overseas via the 'grey market', for example cosmetics and perfumes.

6.68. M&S has been involved in the financial services arena for some time. More recently, other major multiples have become active in the provision of financial services. Sainsbury established Sainsbury's Bank as joint venture with the Bank of Scotland in February 1997. Tesco Personal Finance was established as a joint venture with the Royal Bank of Scotland in February 1997. The company also opened an in-store financial centre, which is effectively a bank branch, at Baldock in October 1997.

6.69. The impetus for diversification into non-grocery, we were told, arose from several factors:

(a) traditional grocery lines, as mentioned earlier, offered few opportunities for commercial growth;

(b) the presence of attractive non-grocery lines could generate higher numbers of customers at stores;

(c) the larger multiples had the logistical ability to offer these products with minimal disruption to the supply chain;

(d) in some instances there were opportunities for cross-promotion between the two sides of the business, for example offering additional loyalty card points to purchasers of financial services, or advertising financial services within stores; and

(e) the retailing of grocery and non-grocery lines offered scope for cross-subsidy between the two sides of the business.

Overseas diversification

6.70. A couple of the largest UK grocery operators have diversified into overseas markets. Tesco has extensive grocery interests in overseas markets, including Eastern Europe and the Far East. It told us that its hypermarket innovations in Thailand and Central Europe had been transferred to the Extra format in the UK. Sainsbury owns two grocery businesses in the USA, Shaw's Supermarkets Inc and Star Markets

Company Inc. It also has an interest in the Egyptian grocery market, taking a 25.1 per cent share in Edge SAE in March 1999, a shareholding that was subsequently increased to 80.1 per cent in October 1999.[1]

Retail innovation

6.71. The UK grocery sector is regarded as being one of the more innovative when compared internationally. Two forms of innovation are commonly distinguished, 'product innovation' relating to improvements in goods and services available to customers, and 'process innovation' relating to developments that improve production or enhance the supply chain. The larger UK multiples have been to the fore in both of these areas of innovation. In this section we consider product innovation at the retail or customer level.

New products and services

6.72. We were given examples of particular innovations by supermarket chains. The growth of the chilled ready-made meals sector is often cited as an example of product innovation attributable largely to the major supermarket chains. Service or meal counters—such as chicken rotisseries, delicatessens and pizza bars—are increasingly common in many of the larger stores of the major supermarket chains. Other examples include the introduction of organic food ranges and service initiatives such as Tesco's one-in-front policy on queuing times. Safeway has introduced initiatives such as self-scanning of purchases.

Own label

6.73. Retailer own-label products were pioneered towards the end of the nineteenth century, initially by the Co-operative Movement and slightly later by Sainsbury.[2] Prior to the prohibition of resale price maintenance in 1963, the use of own labels was largely seen as a way of countering the power of branded manufacturers who could set the retail prices of their branded products. In the 1960s and 1970s, own labels tended to consist of cheap alternatives to branded goods, although there were exceptions. However, during the 1980s, own labels began to improve in quality and achieve increased consumer acceptance. Various suggestions were made as to the reasons for this development. For example, it has been suggested that it was at least partly due to the development of superstores. These required the offer of a broader product range than hitherto, and allowed more scope for development of own labels, including those in new product areas such as chilled meals. It was also suggested that the development of high-quality own-label products was a competitive response to the successes of M&S and Sainsbury. Furthermore, many multiples measure consumer acceptance of their own-label products through blind testing against branded alternatives. Multiples' own-label products also had an advantage in that they generally sold at a lower price than their branded counterparts.

6.74. The role of own labels in the supermarket offer has become more complicated in recent years as retailers have begun to segment their own-label products into different categories. The introduction of a limited number of 'value' or 'economy' lines was the first sign of this. More recently, a new tier of premium own-label products has evolved. Tesco now offers three sorts of own label: the low-priced Value range of over 300 product lines, a standard own label, and a premium range called 'Finest'.

6.75. Asda supplies two own-brand ranges; its standard Asda brand and an economy Farm Stores range which is intended to match the branded products in terms of quality.

6.76. Morrison offers premium, standard and economy own-brand ranges. The premium 'Morrisons' label is intended to compete with the brand leader in terms of quality but is generally offered at a lower price. The Bettabuy economy range is cheapest on display and is often sold at a gross margin loss. The Farmers Boy range, designed to be somewhere between the other two in terms of quality and price, is being phased out.

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[1]Source: *Verdict on Grocers 2000*, p122.

[2]The history of own brand in this paragraph draws on *Own-label in the UK—the Grocery Trade Poised for Change*, Corporate Intelligence on Retailing, 1998.

6.77. Safeway offers premium, standard and economy (called ‘Savers’) own-brand ranges. It told us that it had recently introduced a premium range of around 80 products called ‘The Best’.

6.78. Sainsbury offers standard and economy ranges of own-brand products. Sainsbury also has a range of own-brand and branded products marked as ‘Special Selection’ which are targeted at the upper end of the product market.

6.79. Despite the seemingly compelling attractions of own label from a retailer’s perspective, there is a difficult balance to be struck in terms of the allocation of space between own labels and brands. Sainsbury told us that it decided in 1996/97, in response to customer feedback, to increase the number of branded products, although tertiary brands had largely been replaced by budget own-label lines. It said that, over the period 1996/97 to 1999/2000, own-label sales had declined from [✄] to [✄] per cent as a result of this rebalancing exercise.

6.80. Safeway submitted TNS data showing the proportion of sales accounted for by own-brand goods at several supermarket groups.[1] As described in Chapter 4, the TNS SuperPanel is a sample of 10,000 shoppers who record the outlets they visit and the amount spent. The information obtained can be used to track expenditure on brands and own-label products. These data are shown in Table 6.1.[2] Own-brand sales for all outlets averaged 35.3 per cent over 1999, with Sainsbury having the highest proportion of own-brand products sales and Safeway the lowest. The category ‘all outlets’ includes supermarkets, convenience stores and specialist retailers (ie baker, butcher). Expenditure at these specialist stores (for example, on meat) is counted as own-label purchases. This will tend to overstate the relative importance of own label in grocery sales. It should be noted that, given the different bases for calculation and definitions used, these figures cannot be compared directly with the parties’ own estimates of own-label proportions, to which we now turn.

TABLE 6.1 **TNS data on proportion of own label**

	1995	*1997*	*1999*
All outlets	31.9	35.2	35.3
Safeway	35.5	39.2	36.7
Tesco	41.8	41.9	39.7
Sainsbury	47.8	46.7	42.4
Asda	34.0	42.0	41.8
Somerfield/Kwik Save	20.1	22.9	28.3

Source: TNS Retailer Sharetrack.

6.81. Tesco told us that the relative share of own-label and branded goods had remained fairly constant in the 1990s. It submitted data showing that the proportion of own label by sales in Tesco stores was [✄] per cent in 1991/92, increasing to [✄] per cent in 1993/94, and then declining to [✄] per cent in 1999. When measured by volume,[3] the share of own label in Tesco’s stores increased over the period, from [✄] per cent in 1991/92, to its highest share of [✄] in 1994/95, before falling back to [✄] per cent in 1999.

6.82. Despite the size of the overall market, own-label penetration varies significantly between product groups. For example, for some products such as rice own-brand share is high, while for other products like detergent its share is relatively low. Tesco told us that there are broadly two situations where it would not offer an own-label product to fill a gap in its existing product range. The first situation would be where customer research indicates that customers are too brand loyal for an own-brand product to be successful (for example, confectionery). The second would be where Tesco cannot source an own-brand product from existing suppliers and technical scale barriers mean that there are no alternative sources of supply. It told us that it was difficult to provide an own-label product where a high level of technical expertise or scale was necessary to manufacture a product of sufficiently high specification to compete with existing brands.

[1]These data were from the TNS Retailer sharetrack.
[2]Somerfield told us that it did not recognize these percentage figures in relation to own label.
[3]Tesco calculates the sales and volume figures from information recorded on its systems. Its information systems record the value and quantity of grocery items ordered by Tesco from suppliers. The volume figures are obtained by aggregating the quantities ordered of different grocery items.

The role of own-label products

6.83. We asked the main parties about the role of own-label products in their organization. They identified a range of benefits which are outlined below.

6.84. From a marketing perspective, the presence of a successful own-label range can strengthen the branding of the retailer and hence customer loyalty. The provision of own labels can also be an important point of difference that enables a multiple to gain a competitive edge. The provision of different categories of own label can also allow a multiple to appeal to a wider socio-economic base.

6.85. Own-label suppliers do not have advertising or marketing costs, so multiples can purchase these products more cheaply. Some of a multiple's own marketing costs may properly be allocated to own-label products, though the amount allocated may be much smaller. Operating costs are likely to be the same, implying similar cash margins, or even higher if the multiple has a lot of chilled, fresh own-label and associated costs such as wastage.

6.86. Tesco noted that the provision of economy own-label products enabled multiples to compete with limited line discounters at the beginning of the 1990s. This was demonstrated by the increasing provision by multiples of economy own-label products which coincided with the arrival of limited line discounters. In addition, own-label products offered competition to brands, allowing multiples to exert greater leverage in negotiations with brand manufacturers.

6.87. Involvement in the manufacture of own-label products allows multiples to expand and diversify their businesses and greater operational control affords a more direct response to changes in consumer preferences. Several of the parties identified the example of ready meals where multiples had driven product innovation.

6.88. From a consumer perspective, own-label products have the benefit of offering an alternative to brand products. Importantly, consumer choice can be unambiguously improved in cases where no other products are crowded out. We asked respondents to our consumer survey about their perceptions of the degree of choice between supermarket own labels and manufacturer brands. On balance, respondents did not perceive that the choice of branded manufacturer products was getting less (31 per cent agreed, 57 per cent disagreed). Just over half (51 per cent) agreed that generally they would like to see more supermarket own labels available as an alternative to the major brands, while 37 per cent disagreed. A majority of respondents had not experienced difficulty in finding their usual manufacturer brands. Almost three-fifths (59 per cent) disagreed with the statement 'I've noticed some of my usual/favourite manufacturer brands no longer seem to be available', while one-third agreed with the statement'. 62 per cent disagreed that with the statement that 'I often find that some of my usual manufacturer brands are out of stock and I have to buy the supermarket own label instead', while 31 per cent agreed.

6.89. Own-label products may also provide greater certainty of quality for consumers as well as improved product functionality. The proprietary name of the supermarket may be a more effective signal of product quality than the labels on lesser-known secondary and tertiary brands.

Store interiors

6.90. Examples were given of innovations in store interiors. Morrison has adopted a 'Market Street' format for the layout of its food hall. Some of the ideas adopted by Morrison, such as chicken rotisseries or hot meals/curry bars, have spread more widely in the sector. Facilities such as coffee shops and in-store bakeries are to be found in many of the stores of the larger multiples. Other facilities offered in some of their stores include photo processing booths, in-store pharmacies, and crèches (the latter mainly by Safeway).

Process innovation

6.91. UK grocers were early adopters of technology, introducing centralized distribution, its attendant systems and bar-code scanning from the early 1980s. The use of this technology resulted in gains in operational efficiency and improvements to performance, which in turn helped to fund further investment in yet more sophisticated systems. It has been suggested that UK grocers have gone further down the road of centralized control of supply than their European counterparts. Sales-based reordering (in which sales automatically trigger orders to restock) is used by several of the major chains, with frequent deliveries from centralized warehouses minimizing stockholdings in-store and freeing up space for a wider product choice.

6.92. Perhaps the most significant change brought about by the increasing use of technology relates to the way retailers now use information services. IT can be used to improve most aspects of the business:

(a) to generate information on consumer preferences and shopping patterns, for example from loyalty card data;

(b) to facilitate the category management of products; and

(c) to improve the efficiency of the supply chain.

6.93. Some companies operate a data warehouse, ie a repository for all the key data within an organization. The data warehouse enables the same information to be made available to different parts of a retail organization, in the form required, while segregating analytical from operational activities.

6.94. The key role of the data warehouse in grocery retailing stems from its ability to highlight trends quickly, in time for effective action to be taken, and to recognize relationships that might otherwise escape notice. While initially used to analyse customer behaviour, it is now also used to analyse product sales and the impact of promotions.

6.95. Key inventory management applications of data warehousing include:

(a) Merchandise and range planning. Applications include relating demand to sales, establishing best size ratios (ie ensuring that the right mix of product sizes is stocked in a given store), micro merchandising (ie assessing how merchandising and space allocation should be organized at the store level, rather than using a standard company planogram), or colour analysis (ie blocking groups of products together to give a certain visual effect).

(b) Sales and stock management. Applications include relating sales to stock levels, identifying under-performing departments or stores, analysing whether individual lines are meeting sell-by dates, and analysing store performance in terms of selling stock by sell-by dates.

(c) Promotions management. Applications include the analysis of sales during promotions, and the *assessment* of effects on non-promoted items.

(d) Markdown management. Applications include ensuring that the level of markdowns (ie price *reductions* in order to clear stock near its sell-by date) in a store is kept to a minimum; and identifying reasons for an excessive level of markdowns in a given store.

(e) Category management. Information technology can provide accurate and timely data so that changes in demand can be responded to quickly.

6.96. In terms of the analysis of customer behaviour, key applications include:

(a) Customer relationship marketing. Examples include analysing store/loyalty card utilization, checking changes in cardholder population, ranking cardholders by size or frequency of sales, assessing numbers of new recruits and defectors, and indicating reasons for defections with appropriate reactions.

(b) Database marketing/customer loyalty. Examples include matching sales to demographic data, offering complementary or higher margin items to targeted customers, tailoring offers and marketing strategies to suit types of customer, and identifying customers and products offering greatest profit.

(c) *Market basket analysis.* This involves analysing the shopping patterns of different types of shopper within a store (for example, to identify average spend per visit or clusters of products that tend to be purchased together).

Efficient consumer response

6.97. ECR is essentially a business process linking the demand- and supply-side aspects of grocery retailing, designed to ensure rapid and accurate response by multiples to changing consumer preferences. On the demand side, it includes category management (defined below), and, on the supply side, efficient product replenishment. The link between the two lies in the application of enabling technologies (for example, EPOS, EDI, email etc) to ensure effective coordination between retailers and their suppliers.[1]

6.98. The drivers behind ECR are threefold. First, it can yield supply chain efficiencies, as suppliers can align production schedules with retailers' replenishment requirements to a high degree. Second, from a commercial viewpoint, space for groceries can be used more effectively, freeing up space for higher-margin non-food lines. Third, on the consumer side, it may result in improved stock availability or category presentation.

Category management

6.99. As mentioned above, category management is one of the key components of efficient consumer response. The basic theory behind 'category management', a concept originally derived from the US grocery sector, is that it is more efficient to analyse a category of products (for example, coffee or detergent) as a totality rather than simply track the progress of individual brands. A special promotion on brand X, for example, might boost sales of that line but could reduce sales of brand Y, a more profitable product, so the overall result might not be as commercially beneficial as first appeared. Various software applications have now been developed so that grocery retailers can determine the optimum sales mix in such circumstances.

6.100. Category management has now become increasingly associated with types of customers rather than simple product groupings. Products are linked with customer profiles and preferences, for example through the analysis of data obtained from loyalty card usage. Techniques such as market basket analysis are used to identify any linkages between products that tend to be purchased together. Another aspect of category management is space allocation, with computer modelling used to improve space allocation in stores, complementing the use of conventional techniques such as planograms (a graphic representation of how products are to be displayed). The use of category management has also brought about a change in the way retail functions are organized in some grocery retailers, with the formation of 'category teams' of marketing, merchandising and IT specialists to develop a strategy for a group of products which may not be obviously linked.

Home shopping and electronic commerce

6.101. Much has been made of the potential of home shopping and electronic commerce to change the face of traditional retailing. Various initiatives in this area are currently being operated or trialled by the larger multiples, based on different business models, with no single approach yet to emerge as dominant. The various models are as follows.

Home delivery

6.102. The most basic service is where customers come into a store, select the goods they want and pay for them, but instead of taking the goods home, these are delivered to the customer's home. Iceland offers such a service from all its stores. Home delivery would seem to be suitable for the elderly and

[1]*Grocery Retailing in the UK,* Corporate Intelligence on Retailing, pp13–14.

infirm, and those without cars, who would find difficulty getting home with heavy shopping. As a business model, however, combining the costs of free home delivery (although the service does not necessarily have to be free) with the expense of running an extensive shop network will only make sense if significant incremental turnover can be generated.

Call and collect

6.103. This is where consumers phone, fax or e-mail their orders through to a store but go and collect the goods at a time convenient to them—such as on the way home. When they sign on to the service, consumers set up a personalized shopping list of the products they are most likely to purchase. By using this form of service, consumers avoid both delivery charges and the need to wait at home for deliveries. This service is most suitable for those consumers who insist on selecting their own fresh foods, as it automates the routine side of food shopping but still allows the opportunity to choose other products. Sainsbury and Safeway are the main exponents of this approach.

Office deliveries

6.104. Waitrose is pioneering the approach of making its products available on an individual company's intranet, receiving e-mail orders and delivering the goods to that company's office location. This can only work economically with a limited number of major sites.

Electronic home shopping

6.105. The full service involves using the Internet (or phone or fax) to order groceries, pay online, select a convenient delivery time and wait for the ordered goods to be delivered. Even here, two approaches are being used. The first is to service this demand from existing stores. Iceland offers this from all stores while Tesco does so from selected outlets (the latter told us that it has over 100 stores offering home shopping and is hoping to extend this to 300 stores by the end of 2000). The advantage of this approach from a retailer perspective is that it offers a relatively low-cost way into the market. However, if demand does build, then there is the danger that servicing home shopping will cause conflict with customers using the stores. Against this, Tesco pointed out that 24-hour opening makes store-based operations more workable even as demand increases. Asda and Sainsbury are starting to develop dedicated depots from which home shopping services can be operated. These can be set up for efficient picking of groceries. The costs and benefits of providing a home shopping service are easier to identify when the service is run from dedicated depots. Somerfield had a home delivery arm called '24-7' but pulled out of the home shopping market, closing its two dedicated depots in London and Bristol.

6.106. Asda has opened depots in Croydon and Watford to offer home delivery services. Sainsbury told us that it had found a suitable picking centre to serve customers within the M25 area.

6.107. In their evidence to us, the main parties cited a number of competitive benefits that might result from the growth of home shopping and electronic commerce:

(a) if operated from warehouses, electronic shopping could potentially reduce store costs and might offer scope for new entry to the grocery market;

(b) it offered an opportunity to expand for those operators whose portfolio is predominantly high-street based, or who are otherwise constrained in terms of retail selling space; and

(c) on the demand side, the Internet could provide the means to create greater visibility of retail prices for consumers;

6.108. Of the views put to us by the main parties, Tesco and Sainsbury were generally the most optimistic in terms of their assessment of the prospects for the growth of e-commerce in grocery retailing. Sainsbury cited a Goldman Sachs report estimating that at least 5 to 7 per cent of European food sales would be transacted on the Internet over the next ten years. It suggested that, while Internet access was not currently universal, research indicated that by 2007 up to two-thirds of the population would be on-line. It considered that the reach of electronic retailing would be significantly expanded through digital interactive television services provided by satellite, cable or terrestrial networks.

6.109. Some main parties felt that the development of electronic shopping might bring about a change in the way grocery shopping was done. In one scenario, suggested by Sainsbury, traditional grocery shopping would become more oriented to top-up or convenience purchases, with online services used mainly for purchases of bulk grocery items. Asda also noted the possibility that home shopping might be confined to larder replenishment (ie purchases of staple and relatively uniform items), with customers continuing to shop for fresh food in the traditional way.

6.110. Most of the main parties were cautious in their assessment of the likely prospects for e-commerce in the grocery sector, noting the costs involved in launching such services and the uncertain outlook in terms of eventual consumer take-up. On the demand side there were a number of obstacles to wider take-up, including the extent of consumer access at present to the Internet and the need to develop consumer trust in online services. The latter would depend in part on improvements to security, privacy and payment systems.

6.111. A number of the main parties referred to the difficulties in making online grocery retailing commercially viable. Asda told us that it did not consider that store-based home shopping ventures were sustainable in the longer term. Dedicated depots were more efficient, and were more likely to gain planning permission, but in the short term the fixed costs of operation were likely to be high in relation to revenues earned from home shopping ventures. Safeway felt that grocery retailing was likely to be one of the sectors least affected by the growth of e-commerce, as the economics of online retailing tended to favour products that were non-perishable, high margin and portable. Safeway noted the experience of North America, where, despite high levels of Internet penetration, there were no online grocery retailers currently trading profitably. For existing operators, an additional complicating factor was the extent to which online ventures reduced sales from their own customer base.

6.112. All in all, there were mixed views on the prospects for significant growth in electronic shopping and its likely competitive impact on the grocery market. Some felt that while it might intensify competitive pressures, the main beneficiaries would be existing players who could leverage their brand name into the new delivery channels. A majority of the operators told us that they did not expect demand to be high over the next three years and that, at best, the emergence of a mass market for online grocery retailing would be a long-term development. Only Tesco and Sainsbury were inclined to dissent from this less optimistic view of the impact of home shopping on grocery retailing.

European comparisons

6.113. The nature of European grocery retailing is converging as retailers adopt similar strategies. Despite the size and affluence of Western European markets, their maturity makes grocery retailing challenging. Planning laws are increasingly restricting opportunities for large out-of-town stores. As a result, sales growth in food has increasingly to come from existing floor space and this has required the development of innovative added-value products. Some of this new product development has been in the form of exclusive premium ranges. Such exclusive ranges enable retailers to differentiate themselves and target specific customer groups, as well as helping to build loyalty to the retailer’s brand name.

6.114. Comparative data on market concentration levels across Europe are difficult to provide on a consistent basis, and generally relate to sales by all food retailers, rather than a more closely defined economic market based on supermarket shopping. Bearing in mind these caveats, Tables 6.2 and 6.3 provide a comparative perspective on concentration levels in European grocery retailing. Grocery retailing in Western European countries is dominated by large multiples that have achieved their stature through successful store expansion and by the acquisition of weaker rivals. As can be seen from Table 6.2, this results in a high level of concentration, especially in Germany where the top five players control more than 80 per cent of food sales.

TABLE 6.2 **Western Europe: share of top five food retailers in each country**

Country	*Share of food retailers' sales %*
Germany	80.3
Austria*	74.3
Belgium*	70.8
UK	64.8
France	58.1
Ireland†	57.1
Netherlands	51.8
Switzerland†	49.6

Source: Grocery Retailing in Europe, Corporate Intelligence on Retailing, 1999.

*Top four retailers.
†Top three retailers.

6.115. Looked at in terms of Europe-wide market shares (Table 6.3), the situation looks more fragmented with no single player having a dominant position. Newly-merged New Carrefour (now the second largest retailer in the world after Wal-Mart) has the biggest share at 6.5 per cent. All the top European grocers are based in Western Europe. Together the top 15 Western European grocery multiples control just over 40 per cent of total European food sales.

TABLE 6.3 **Western Europe's leaders: share of European food retailers' sales**

per cent

Rank	*Company*	*Country*	*Share*
1	New Carrefour	France	6.5
2	Rewe	Germany	4.0
3	Edeka	Germany	3.8
4	Tesco	Britain	3.3
5	Aldi	Germany	3.1
6	Intermarche	France	2.8
7	Auchan	France	2.7
8	Leclerc	France	2.7
9	Sainsbury	Britain	2.3
10	Wal-Mart*	USA	1.9
11	Casino	France	1.5
12	Tengelmann	Germany	1.5
13	Metro	Germany	1.5
14	Safeway	Britain	1.4
15	Ahold	Holland	1.2

Source: Grocery Retailing in Europe, Corporate Intelligence on Retailing, 1999.

*Asda, Wertkauf, Interspar.

6.116. There are signs that the process of consolidation in European retailing is still at an early stage, and may be about to gather further pace. Defensive mergers/acquisitions may be triggered by a number of factors, such as the desire to achieve economies of scale and compete on a more equal footing with Wal-Mart on the global stage. It has been suggested that such mergers are becoming possible because of the increasing sophistication of international logistics operations and the widespread use of supply chain and other retail systems to control complex organizations.

6.117. There was an agreed merger between Carrefour and Promodès in 1999. More recently, Ahold has pursued acquisitions in Scandinavia and the Iberian peninsula. In its home market its wholesaler subsidiary Schuitema has recently acquired 131 A&P stores from German retailer Tengelmann. Rewe and Tengelmann have engaged in a store-swap exercise to strengthen their positions in Italy and Spain respectively.

The competitive behaviour of the main parties

6.118. This section focuses on the different forms of competition that have evolved among the main parties. We first consider the role of price versus non-price aspects of competition in multiple grocery retailing, reviewing the different strategies adopted by the main parties in this respect. Product differentiation is one way in which firms may seek to compete on non-price terms, and would appear to be an important aspect of the grocery market in the UK.

The role of price versus non-price aspects of the supermarket offer

6.119. Of the larger main parties, nearly all were of the view that consumers' decisions of where to shop for groceries were made on the basis of a range of factors, and that the role of price could not be isolated from that of quality, range and service. Tesco's view was that retailers who failed to provide the right value-for-money offer would suffer a loss of customers, as evidenced by the varying fortunes of different grocery retailers in recent years, which had seen Asda, Morrison and Tesco gain market share at the expense of other operators.

6.120. Somerfield told us that the importance to consumers of non-price aspects of grocery retailing, particularly range, could be judged from two observations. First, there was the fact that the limited-range discounters had not gained significant market share, despite generally being recognized as having a substantial relative price advantage over other multiples. Second, it observed that Waitrose could operate successfully with a relative price disadvantage compared with other multiples, presumably because its customers valued other aspects of its retail offer more highly than they did elsewhere. Somerfield noted, in a similar vein to Tesco, that the retailers who had been gaining market share in recent years were those that appeared to have improved their price position, allowing for quality (ie Asda/Morrison, and Tesco, compared with Safeway and Sainsbury). This was one of the factors, in addition to costs and profitability, which should be taken into account when considering whether the premium for higher service and range was acceptable.

6.121. Certainly as far as the larger multiples are concerned, a wide array of measurement techniques are employed both to identify consumer preferences towards the disparate elements of the grocery offer, and to assess performance in respect of each of these elements. These techniques include analysis of customers' store choice determinants, surveys tracking consumer perceptions of supermarket performance over time, and review of in-store performance (for example, to identify service levels or stock availability). Some of these are set out in more detail in Appendix 6.4.

Consumer attitudes to non-price competition

6.122. Our consumer survey was used to explore consumer attitudes to the non-price aspects of the supermarket offer.

6.123. Two-fifths of those interviewed agreed that there were aspects of the service or facilities provided by their regular supermarket that they regarded as particularly important, while 56 per cent answered in the negative. For those who did regard some aspect of their regular supermarket as particularly important, the most frequently mentioned aspects tended to be rather basic services, such as 'good customer service' (mentioned by 22 per cent), followed by availability of toilets (18 per cent), coffee shop (12 per cent), low prices/special offers (9 per cent), and car parking (9 per cent).

6.124. The survey was used to investigate consumers' reported willingness to pay for specific extra facilities or services. Respondents were shown a list of nine specific store facilities or services and asked about their willingness to pay more for their groceries at a store that had the facility or service in question, compared with a store that did not. For each of the nine features in question, the majority of respondents indicated that they would not be willing to pay more. The frequency of negative responses varied from 90 per cent in the case of 'an information desk', to 67 per cent for 'good availability of products'. For those who indicated some willingness to pay, most said that this would be 1 to 2 per cent extra.

6.125. Asked about their general willingness to pay for 'extras', almost seven out of ten (69 per cent) indicated that they did not think it was worth paying more for groceries at supermarkets that had such extras, compared with those that did not. 29 per cent said that they would be prepared to pay a bit more for groceries at supermarkets that had extras, compared with those supermarkets that did not.

6.126. Our consumer choice model, described in Appendix 7.8, also provided insight into some non-price aspects of the supermarket offer. The results of the model indicated that consumers value the aspects of non-price competition included in the study—for example, store size (an indicator of range) and amenities such as coffee shops and in-store bakeries—in that these were shown to be significant determinants of where consumers choose to shop.

Consumer attitudes to overall supermarket offer

6.127. We asked respondents to our survey how they would rate the different dimensions of the grocery offer provided by their regular supermarket; these were overall value for money, quality, product range, and service. In terms of overall value for money, 24 per cent of respondents to the CC's survey rated their regular supermarket as 'excellent', and 57 per cent as 'good'. The proportion rating the supermarket offer as either 'excellent' or 'good' was 90 per cent for quality, 89 per cent in the case of product range, and 86 per cent for 'service'.

Perceptions of the supermarket offer in Northern Ireland

6.128. As mentioned earlier, the Northern Ireland grocery sector has changed following the arrival of several of the Great Britain-based multiples from the mid-1990s onwards. A survey conducted by the GCCNI, referred to in Chapter 4, asked consumers what they thought of these changes. A majority of respondents to the above survey reported favourably on these changes, with two-thirds (67 per cent) saying that consumers in Northern Ireland are now better off than they were prior to the arrival of the Great Britain-based multiples. Only 12 per cent believed that consumers were now worse off than before, and 13 per cent felt there had been no difference.

Other aspects of product differentiation

6.129. Additional forms of product differentiation are observed among main parties, namely store formats and loyalty cards.

Store formats

6.130. In terms of store format, the main parties fall into two broad groups: those who operate a fairly standardized portfolio of stores, and those whose store portfolio is more diversified.

6.131. The first group broadly comprises Asda, Morrison, and the limited range discounters—Aldi, Lidl and Netto, who told us that they worked largely to a single store type. Product range is determined centrally. In the case of Asda and Morrison, there is slight variation in product range across stores to reflect local or regional differences in tastes (for example, demand for local specialities) and store size variations. A relatively uniform store format is seen as important in keeping running costs low and minimizing build/fit-out costs.

6.132. The second group largely comprises Safeway, Sainsbury, Tesco and, to some extent, Iceland. Sainsbury and Tesco have been at the forefront in terms of experimenting with alternative store formats, though it continues to be their conventional supermarkets and superstores that account for the vast majority of turnover in each case. Tesco has developed five store formats, which cover each end of the size spectrum. Sainsbury has also developed a range of different store formats, six in all, from conventional superstores to convenience formats. These were discussed in more detail in Chapter 5.

6.133. We were told by Sainsbury that it flexed its offer across store formats to reflect the socio-economic profile of customers. As for pricing policy across formats, both Tesco and Sainsbury indicated that prices were slightly higher in their smaller store formats (ie Metro/Express and Local), reflecting the different cost structure involved in running these stores as opposed to a conventional supermarket (for example, a higher fresh food content leading to higher wastage levels, or the costs associated with longer opening hours).

6.134. Safeway has a relatively mixed portfolio of stores, with some presence in the convenience end of the market. As with Tesco and Sainsbury, however, the majority of its space, two-thirds, is accounted for by larger stores. These larger stores are distinguished from those of other multiples in that less space is dedicated to non-grocery products. Safeway also has a portfolio of smaller store formats, but, unlike those of Tesco and Sainsbury, these are not separately branded. These smaller formats, we were told, either serve main shopping in small catchment areas, or have a significant secondary shopping function. 'Core' (Safeway's term) stores for main shopping have a reduced product range, around three-quarters of that in the large stores, with a spread of the extra facilities found at larger stores. 'Core' shops for top-up and convenience shopping have an average size of about 1,040 sq metres (11,200 sq feet), typically located on high streets or in suburban locations. Product range is also narrower.

Loyalty cards

6.135. Two of the multiples—Tesco and Sainsbury—currently operate a loyalty card scheme. Safeway announced in May 2000 that it had decided to discontinue its ABC loyalty card scheme. Asda briefly trialled a loyalty card scheme in some of its stores, but has subsequently decided against introducing such a scheme. In Chapter 7 we describe the background to the introduction of supermarket loyalty card schemes, the type of discounts involved, and the way in which multiples use the schemes (for example, in terms of data collection).

Advertising and marketing

6.136. For the larger multiples, the principal advertising media are television, local press and radio, and, to a lesser but still significant extent, point-of-sale material. Advertising strategies are usually determined centrally, though a couple of multiples (Asda and Lidl) allow some advertising expenditure to be controlled by managers at regional level. Television advertising tends to be used principally to support the multiple's brand, though for some operators it will also highlight current initiatives. Some multiples told us that, due to the costs involved, their advertising strategy would reflect their store portfolio, with more television airtime purchased in areas where their market share was higher.

6.137. Local press and radio tended to be used much more to highlight events or promotions happening in-store, or to advertise new store openings, extensions, or refits.

6.138. Apart from the conventional forms of advertising above, loyalty card schemes and product line promotions are also used by some multiples as an aid to marketing. Total expenditure on these items is significant, but only a small part of this constitutes a marketing element, with the major part being the cost of giving the discounts involved (for example, on multi-buys or loyalty card points).

Product mix

6.139. The larger multiples vary the product mix across their stores to a limited extent, usually to reflect regional tastes for particular products or brands. Some multiples flex their product mix to reflect the socio-economic or ethnic profile of individual store locations.

6.140. Tesco told us that, historically, ranging had been based on size of store, with the range offered by the smallest store (classed as Category A) considered to be the core range. It had since moved to flexible ranging, which retained the core range but varied the offer in each store according to geographic requirements and customer specifications. This approach to ranging was made possible through increased use of customer profiling, and identification of customer segments, with the result that ranging was no longer dependent solely on store size. It told us that it had begun developing systems that would enable this approach to be carried out centrally using Clubcard data and information on the space constraints at particular stores. This approach also enabled regional product variations in its stores.

6.141. Tesco told us that the same approach was used in relation to ranging decisions for its different types of own-label products (Value, Standard and Finest), in that the exact range stocked would depend on the customer segmentation for that store and the size of the store. For example, a store identified as having a large number of ‘Shoppers on a Budget’ (one of Tesco’s customer segmentations) would have a strong ‘Value’ offer, whereas stores identified as having an upmarket customer base would have a range more skewed towards ‘Finest’ products.

6.142. Sainsbury uses a ranging system to determine what product lines to stock at each of its stores, which takes account of the socio-economic profile of people within the catchment area. Profiles are developed for stores on the basis of factors such as location (for example, out-of-town stores), size of transactions, region (for example, there are separate profiles for stores in Scotland, Wales and Northern Ireland), and store format (for example, Central stores). These profiles are then used to determine product range for specific stores.

6.143. In terms of economy brands, Sainsbury told us that its Economy range of 150 products was stocked by all Sainsbury stores, with the exception of Central and Local stores.

6.144. Asda said that, as it had only one store format (superstores), all stores stocked the same range subject to some variations in range depth depending on actual store size. It indicated that, as a general rule, it did not vary its range according to store location (urban/rural or higher/lower income), but that there were some exceptions to this rule, to allow for regional or ethnic demand for products. Asda told us that ranging decisions were taken centrally, and that where an ‘Asda’ or ‘Farm stores’ own-brand was produced, it would be available in all Asda’s stores at the same price.

Consumer switching

6.145. In Chapter 4 we reviewed evidence on consumer switching to gain insight into aspects of market definition, namely the extent to which switching behaviour might indicate which grocery outlets were considered by consumers to be effective substitutes for one another. Evidence of switching behaviour can also be viewed more broadly, however, as one potential indicator of the level of competitive activity within an industry. We therefore considered evidence of consumer switching behaviour within this broader context, both from company sources and from our consumer survey.

6.146. The main parties told us that shoppers were generally very willing to switch between supermarkets in response to variations in the supermarket offer. This was illustrated both by analyses of customer behaviour—for example, switching flows between the major multiples—and, more generally, by the changing pattern of market shares of the larger multiples over recent years (especially, the reversal in the market positions of Tesco and Sainsbury, and the rise in Asda share).

6.147. An analysis submitted by Sainsbury showed it incurring its biggest net losses to Tesco, and, to a lesser extent, Iceland, Morrison and Somerfield. It made net gains from M&S and Safeway.

Experience of switchers/non-switchers

6.148. The issue of consumer switching between grocery outlets was also addressed in our consumer survey. In terms of actual switching, the evidence from the survey indicated that 15 per cent of respondents had begun regularly using a different store for their main grocery shopping within the last 12 months. The main reasons for switching were ‘found a cheaper store nearby’, mentioned by 34 per cent of those who had switched, followed by ‘found a store with better quality and range of products’ (21 per cent). Other factors were that the respondent had moved home (19 per cent), a new store had opened nearby (11 per cent), or that the respondent’s old store had closed (11 per cent). Of those who continued to use the same supermarket as before, 83 per cent indicated that they were ‘very satisfied with overall value provided by current regular store(s)’. Around 1 in 20 indicated that they would like to switch but that there was no other major store nearby.

Potential switching behaviour

6.149. We also asked consumers about potential switching behaviour. Responses to questions of hypothetical behaviour drawn from surveys always need to be treated with a degree of caution, as respondents often do not have a benchmark against which to assess their likely behaviour.

6.150. In Chapter 4 we reported, in the context of market definition, evidence regarding consumers' next-best choice of store. We also asked shoppers about possible factors that might cause them to switch to their next-best choice. One-fifth of main shoppers interviewed said that they would definitely (5 per cent) or probably switch to their next best choice of store if the cost of their groceries there were 1 per cent lower. This figure rises to 44 per cent in the case of a 5 per cent difference in the cost of groceries at their next-best choice of store—15 per cent claimed that they would definitely switch and 29 per cent said that they would probably do so.

6.151. Lower customer responses were reported for other aspects of the supermarket offer, such as improvements in product range or the addition of extra facilities. Just under a third claimed that they would definitely or probably switch to their next-best store if it significantly increased its product range, while just under a fifth would definitely or probably do so if it added lots of extra facilities.

Barriers to market entry

Site availability and the planning regime

6.152. Entry conditions in the UK grocery market are determined mainly by the availability of suitable sites for supermarket development, combined with aspects of the land use planning system.

6.153. In Chapter 12 we present a detailed analysis of the land use planning system in the UK, as well as associated matters such as land prices for different types of commercial development. Here we summarize the effects of the land-planning regime on barriers to entry.

6.154. In terms of perceptions among the main parties of the impact of the current planning regime on site availability and barriers to entry generally, two distinct views were put to us. A minority, principally Tesco and Sainsbury, did not consider that a shortage of sites existed that would act as a barrier to market entry. The effects of the planning policy guidance in PPG6, we were told, had not been to reduce the amount of land available for supermarket development, but rather to alter the type of location where new stores were likely to be developed, and possibly to change the format of stores built. Tesco said that the market had experienced a period of adjustment in the immediate aftermath of the introduction of PPG6, but since 1996 there had been a steady increase in new gross retail grocery selling area each year from 0.315 million sq metres (3.4 million sq feet) in 1996/97 to an expected 0.353 million sq metres (3.8 million sq feet) in 1998/99. Tesco also said that while available land had increased, the cost of that land was falling—Tesco's average cost per acre in 1996/97 was £[✂] and it fell to £[✂] in 1998/99. Tesco also provided some data to suggest that average store size had increased since 1996. For Tesco, the figures showed its average store size increasing from 1,887 sq metres (20,314 sq feet) in 1996, to 2,505 sq metres (26,970 sq ft) in 1999. For both Tesco and its competitors, the average store size increased from 1,453 sq metres (15,636 sq feet) in 1996 to 1,830 sq metres (19,702 sq feet) in 1999. Therefore, it was put to us that the range and suitability of sites available to a particular operator depended largely on whether it had a flexible strategy towards store format.

6.155. It was also put to us that there was potential for new entry by non-grocery retailers who could switch existing capacity to grocery retailing. Such new entry did not require new sites. Sainsbury said that non-grocery retailers of sufficient scale could leverage their brand name into grocery retailing providing the right format could be found. It noted that Waitrose and M&S had built successful grocery businesses on the basis of expertise and reputation acquired in other forms of retailing. It believed that non-grocery retailers could use these skills more easily to enter the market. However, switching retail space from one form of retailing to another requires a different planning permit. While noting these precedents, we were not presented with any evidence that further such entry on any significant scale was likely.

6.156. It was pointed out to us that the overseas-based discounters had been able to enter the UK grocery market in the early 1990s (see paragraphs 6.48 to 6.50) and subsequently expand their store networks under the revised planning regime introduced in 1996. We were also told that some sites and stores did still become available, as evidenced by recent decisions of Somerfield and CWS to sell part of their store portfolios (see paragraphs 6.57 and 6.58).

6.157. The significance of these developments in terms of what they say about barriers to entry is open to interpretation. The hard discounters can operate from small store formats as their strategy is to carry a limited range of products; their experience is not directly comparable with the situation faced by prospective entrants wishing to provide a different kind of grocery retailing with greater product range. The role of scale economies may be significant here, for example if new entrants are unable to find sites sufficiently large to enable them to realize scale economies at store level and compete effectively. This is probably of more relevance to operators in the lower store size range, as economies of scale tend to run out at a comparatively small size of store (see discussion of economies of scale below, and in Chapter 10).

6.158. A majority of the parties told us that lack of site availability, allied to aspects of the planning system, did constitute an important barrier to market entry and expansion. One of the discounters reported finding it difficult to find sites of suitable size and quality, adding that planning restrictions had reduced the availability of sites and increased prices for those that were available. These general sentiments were echoed by other discounters, even though they are among the parties with the smallest stores who might be expected to be least affected by difficulties of site acquisition. One of the limited-range discounters said that obtaining planning permission was a difficult and costly process, with some local authorities putting all foodstores in the same category regardless of size or format.

6.159. Somerfield considered that it was not the current planning regime itself that acted as a barrier to entry, but rather the uncertainty regarding its application. This was a view reflected by a number of operators in their response to the CC's land and planning questionnaire (see paragraph 12.77). Tesco said that, to the extent that the planning regime involved uncertainty as to its application, this was a difficulty faced by all retailers—incumbents and new entrants—and therefore felt that it could not be described as a barrier to entry.

6.160. We were told that the scarcity of land generally meant that larger developments often had to be assembled from several land owners, increasing the costs and risks associated with new developments.

6.161. As mentioned earlier, a view put to us by some of the parties was that some scope for new entry could result from the emergence of online grocery retailing. Some felt that this form of retailing, if largely warehouse-based, could ease barriers to entry associated with planning controls for existing operators wishing to expand their geographical coverage, or for overseas operators wishing to set up in UK grocery retailing. Some cited the example of the US market, where a number of entrants without a grocery background had set up online grocery retailing ventures—Webvan, Netgrocer, HomeGrocer and Peapod.

Asda's unrestricted entry and expansion scenario

6.162. Asda submitted an analysis it had undertaken to simulate what the market coverage of major multiples might be under a scenario of unrestricted entry to the market and expansion. More specifically, the research consisted of four stages:

(a) an analysis of variations in the level of supermarket 'provision' across different parts of the UK;

(b) identification of areas where there appeared to be relative under- or overprovision of supermarket floor space;

(c) an analysis of the diversity of choice in terms of supermarkets available to consumers in these areas; and

(d) an assessment of expansion opportunities in these markets for each of Asda, Tesco and Sainsbury, assuming that there were no barriers to market entry.

6.163. It was estimated by Asda that there were an average of 671 people for about every 90 sq metres (1,000 sq feet) of supermarket floor space. This average was then used to estimate an 'expected' level of supermarket floor-space provision for different postal areas across the UK. This could then be compared with actual provision to identify areas of low and high supermarket floor-space provision. For example, in the Birmingham postal area the population per 93 sq metres (1,000 sq feet) of supermarket floor space is 857, with a total supermarket floor space of 0.2 million sq metres (2.1 million sq feet). The floor space necessary for the Birmingham postal area to have average levels of provision is 0.25 million sq metres (2.7 million sq feet), giving a divergence ('residual') of +0.05 million sq metres (+ 0.6 million sq feet), ie relative underprovision. It identified such areas as having scope for entry if there were no restrictions.

6.164. Asda's research then examined the distribution of fascias across areas of under- and over-provision. Asda said that its analysis showed that Tesco and Sainsbury had a strong brand presence in markets that had a low level of supermarket floor-space provision relative to population, whereas Asda had a relatively weak brand presence in these areas. It concluded that in these areas there was scope for greater entry and a more diverse mix of fascias.

6.165. Assuming that sites were developed in areas of underprovision by fascias under-represented in those areas, Asda modelled the effect of unrestricted entry for each of three multiples—Asda, Tesco and Sainsbury. For Asda, [✄] new locations were identified, increasing its national market share from [✄] to [✄] per cent. In the case of Tesco, [✄] new locations were identified, increasing its national market share from [✄] to [✄] per cent. For Sainsbury, [✄] new locations were identified, increasing its national market share from [✄] to [✄] per cent.

6.166. The analysis was broad brush in scope, but purported to give an indication of the number of new stores that might appear if there were no restrictions on entry. However, new entry is affected not just by the planning regime, but also depends on the availability of suitable sites at reasonable cost. The analysis did not look at whether sites were actually available in the areas examined, or at the cost of sites that were available. The bidding process will also be a factor determining which operators develop particular sites. The analysis also assumed that the 'average' level of provision was the correct level of provision; however, it may be that the average is not the right benchmark for determining which areas need more food retailing provision.

Demand for alternative supermarket(s)

6.167. One question is whether consumers want to shop at supermarkets that are currently not available to them. In other words, are shoppers generally able to shop at their preferred choice of supermarket? Respondents to our consumer survey were asked whether they could think of any particular supermarkets that they would like to use regularly for their main grocery shopping, but were unable to because the nearest store was too far away or otherwise inconveniently located for them. Just under two-fifths (38 per cent) of respondents replied in the affirmative. Of these, 29 per cent named Asda as the store they would like to use, while 22 per cent named Tesco and 21 per cent Sainsbury. Next came Morrison, mentioned by 13 per cent.

Economies of scale

6.168. In principle, there are two types of scale economies that might accrue to multiple grocery retailers. First, there may be economies of scale at the individual store level, if the costs of store operation fall in relation to store size and sales densities. Second, there may be economies of scale at the firm level, which derive from having a large number of stores.

6.169. The CC has undertaken a number of empirical investigations to determine the significance of scale economies, the methodology and results of which are reported in detail in Chapter 10. The evidence indicates that the major economy of scale is in purchasing, ie a larger network of stores allows a grocery multiple to benefit from greater purchasing power. At store level, the evidence is less clear; the pattern varies from multiple to multiple. The evidence suggests the existence of economies in operating cost over the lower end of the store size range, but not for larger-sized stores. There are some indications of diseconomies of scale in relation to capital costs. Economies of density exist (ie unit costs fall as sales per sq metre rise) and appear to be more significant. Sales density depends on the success of the supermarket offer, rather than scale, though some parties argued that lack of larger stores made it difficult to increase sales density.

6.170. It was accepted by some of the parties that there were significant economies of scale at the level of the firm (ie as the number of stores increases). Apart from economies in purchasing, parties mentioned supply chain efficiencies and the ability to obtain a better spread of fixed and semi-fixed costs in areas such as head office functions or marketing/advertising. Economies of scale might also exist, up to a point, in distribution, as the incremental cost of adding a new store to a distribution network may be relatively low. We were also told that a certain critical scale was required for the development of an own-label product range. Tesco disputed this, and said that suppliers would provide own-label products for retailers of all sizes as many suppliers would produce similar products for several retailers.

6.171. However, while the existence of at least some scale economies, either at store or firm level, was not generally disputed by the parties,[1] there was less agreement as to their likely consequences in terms of raising barriers to market entry. One view put to us was that some of the benefits of scale could be achieved by new entrants in other ways, for example improved purchasing terms obtained from buying alliances. Additionally, it was suggested that it was not scale economies which were relevant to the assessment of entry barriers but rather the extent to which supermarket costs were sunk, ie whether they were recoverable in the event of exit from the industry. We were told that very few supermarket costs were sunk, as the assets could be resold for other purposes. However, this is only partly true, as the value of these assets in their next-best use is likely to be substantially lower than for grocery retailing.

The 'virtuous circle' argument

6.172. The effect of scale economies in grocery retailing had the effect, we were told, of allowing some multiples to enter a 'virtuous circle' of growth while others were trapped in a vicious circle, owing to their small scale. Safeway developed this argument in the most detail. It identified three types of scale dynamics:

(a) those attributable to store size;

(b) chain-wide economies in areas such as distribution, marketing, and support costs; and

(c) those attributable to sales intensity.

It argued that the significance of economies of scale in grocery retailing, allied with the effects of tightening barriers to entry, had in effect left Safeway and other medium-sized players facing a 'spiral of disadvantage', unable to match the costs of the largest players and thereby invest to achieve growth. The essence of this argument is that greater scale generates enough funds for further growth, which can then be used to reduce prices and increase sales intensity. This in turn yields a circle of further cost and price reductions. [*Details omitted. See note on page iv.*]

6.173. It seems likely that such an effect plays some part in the dynamics of the industry. However, the virtuous and vicious circles described appear by no means to be stable. Sales density is likely to depend on rather more than just the achievement of economies of scale, and most of the main economy of scale, namely better purchasing terms, will be available to a firm the size of Safeway. The last ten years has indicated that being the largest player is no guarantee of success.

Access to distribution networks

6.174. No significant barriers appear to be associated with access to distribution centres or facilities. New entrants who do not wish to set up their own distribution network have a number of options open to them, including contracting out their distribution requirements to third party providers of such services. Sainsbury told us that the introduction of more efficient distribution systems, such as just-in-time delivery, had resulted in increasing spare capacity among independent distributors, suggesting a greater availability of contractors' services at lower cost. As described in more detail in Chapter 10, there are some multiples that outsource all or part of their distribution. Against this, it should be noted that it tends to be smaller players that have outsourced all distribution, suggesting that it may not be feasible for a new entrant on a large scale to buy in all its distribution functions. On the other hand, if a new entrant is operating on a small scale, it may face higher rates for contractors' services, ie access to third party distribution is available but a lower scale will usually lead to a higher cost.

[1]Although Tesco was of the view that scale economies at store level were not large.

6.175. An alternative way for a new entrant (or smaller player) to gain distribution economies would be to provide distribution functions on a collective basis with other retailers.

6.176. For new entrants wishing to establish their own distribution facilities, the hurdles may be somewhat higher. As location of distribution centres is less important than it is for stores, which must by necessity be near consumers, the availability of land and planning permission for distribution centres may appear to be less critical. However, one of the smaller operators felt that difficulties in obtaining land and planning consents for distribution centres did operate as a barrier to entry.

Brand presence and marketing

6.177. It is widely recognized in theory that advertising expenditures and brand-related effects can in some circumstances exacerbate barriers to entry, for example by increasing product differentiation, increasing consumer-switching costs, or exploiting scale-related economies. Against this, advertising and brand presence sometimes serve as a signal of quality assurance or provide other intangible benefits to consumers, so that the overall effect on consumers' well-being can be difficult to evaluate.

6.178. Paragraph 6.136ff outlined the general strategies of multiples towards advertising and marketing. While the larger multiples clearly spend significant absolute amounts on advertising and marketing, this tends to account for a very small proportion of overall turnover.

6.179. In marketing and brand presence terms, any entry barriers that do exist are likely to operate asymmetrically for different types of new entrant. Unit marketing costs would generally be greatest for complete new entrants to the grocery market, given the need to achieve customer awareness and the time taken to build a sufficiently large customer base. The scale of entry barrier in marketing terms could be somewhat lower for an established non-grocery retailer, which might be able to transfer its brand name across to the grocery business.

Actions by others in the market

6.180. Incumbent operators may seek to prevent entry by rivals, for example by undertaking actions which raise potential entrants' costs or deny access to important inputs. Generally, we did not find evidence of such entry deterring strategies practised by multiples. There were three limited exceptions to this. One was the use of value lines aimed at discounters referred to above, and another was below-cost selling (examined in Chapter 7). Safeway disputed this, saying that it did not consider that the use of value lines or below-cost selling could be characterized as a form of strategic entry deterrence or, more specifically, as a form of predation. The third concerned aspects of land/property use and the planning regime, the detailed evidence of which is discussed in Chapter 12. There it is noted that most multiples rarely let or sub-let surplus stores to other food retailers, and, in a number of cases where stores are sold, they frequently restrict subsequent use as a supermarket even though this adversely affects the price obtained for the property. Although there was little evidence to indicate intentional blocking purchases, there were some cases where multiples had purchased or acquired options on small parcels of land which had not been developed, with the effect of substantially reducing the risk of competing stores being built on the whole site. In terms of strategic use of the planning system, Chapter 12 notes that retailer objections at planning appeals were not commonplace, with the exception of one multiple.

Other potential barriers

6.181. We considered whether there were any other features of grocery retailing that might potentially raise entry barriers, including the use of loyalty schemes, provision of services or facilities other than groceries, and other government regulation (apart from the planning regime). There was no evidence to indicate that these were likely to form entry barriers of any significant scale. Some multiples perceived an increase in the amount of regulation with which they had to comply, though few felt that this would actually prevent entry into the industry.