



# The Competition Commission's Groceries Market Investigation and Remedies

Peter Barron  
Senior Business Adviser

TCA and Pamukkale University  
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## Overview



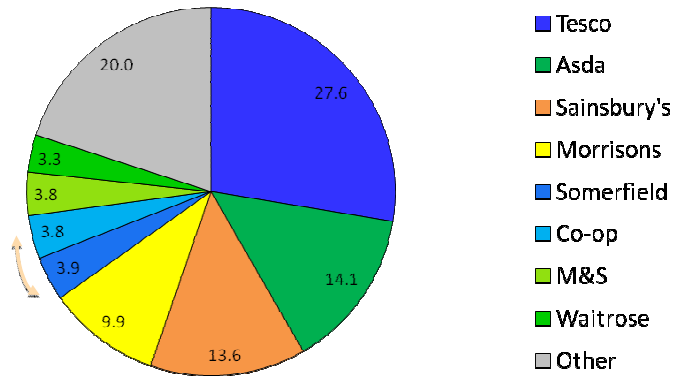
- **Background and context**
- Findings
  - Market definition
  - Summary of harm identified
  - Local market concentration
  - Supply chain issues
- Remedies
  - Land and planning
  - Supply chain



# UK groceries market overview

	Stores	Sales £ billion
Total	97,500	110
Large / mid sized	5,500	80
Convenience	50,000	20
Specialist	41,000	5
Limited assortment discounters	1,000	3
Internet	n/a	2

Retailer market shares



Source: 2008 Groceries Market Investigation Report, based on 2007 data

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# Previous CC investigations into groceries

- CC market investigation into supermarkets in 1999-2000
  - recommended establishment of the Supermarkets Code of Practice (SCOP);
  - recommended a system of consent for new supermarkets – not implemented
- CC merger inquiries into the acquisition of Safeway in 2003 and Morrisons sale of 100 stores to Somerfield in 2005
- Events leading up to the current market investigation
  - background of complaints about the SCOP and other issues
  - initially the OFT decided not to refer the market to the CC. After a court challenge the OFT made the referral in 2006

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- The OFT was concerned the following may be distorting competition:
  - The land planning system - by raising the cost and limiting the scope of local entry
  - The land holdings of large grocery retailers, reinforcing their existing market positions
  - The pricing behaviour of large grocery retailers through below cost selling and price flexing
  - The buyer power of large grocery retailers undermining the viability of alternative business models (wholesale distribution and convenience stores segment) and the effect on small shops generally)
- Other issues included:
  - Possible coordination between retailers
  - Power of Tesco
  - A substantial number of non competition issues were also raised

# Key steps of the Groceries Investigation



- Two year investigation, large amount of evidence received
- 6 CC Commissioners (decision takers) plus 28 members of staff (including 12 economists)

Referral      May 2006

Issues statement      June 2006

Emerging thinking      January 2007

Provisional findings      October 2007

Provisional remedies decision February 2008

Final report published      30 April 2008



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- Retailers' assessments of geographic scope of competition
- Scale of national and local competitive initiatives by grocery retailers
- Consumer shopping patterns and catchment areas
- Model of consumer demand for groceries
- Geographic variations in store-level profit margins
- Impact of new store entry of revenues of incumbent stores
- Impact of internet-based grocery shopping



## National and local competitive initiatives

- Most retailers thought competition was local
- Even though prices generally set nationally
- We still found markets were local because:
  - Demand-side substitution is local
  - National pricing is a choice made by retailers
  - Retailers take account of local competition faced by stores when setting national prices
- Small impact of internet

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## Consumer shopping patterns and store catchment areas

- A catchment area is the area from which a store draws most of its customers
- CC analysis found:
  - The majority of customers (>80%) shopped at large stores within a 15 minute drivetime
  - A similar proportion shopped at medium stores within a 10 minute drivetime
  - 64% of customers visited convenience stores within a 5 minute drivetime

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## Econometric model of consumer demand

- Data on shopping behaviour of 13,000 UK households
- Modelled consumer choice of grocery store
- Used to predict how households would react to a change in QRS
- Stores most likely to benefit from deterioration of retail offer at a competitor store were those located nearby
- Stores located more than 10 minutes drivetime likely to benefit much less than those located closer

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## Geographic variation in store-level margins

- Looked at relationship between profit margins and strength of local competition
- Margins capture all aspects of PQRS
- Regression analysis found a negative relationship between margins and number of competitors
- Number of fascia and distance to nearest competitor store also important

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## Revenue impact of new store entry

- Looked at impact of opening a new store on incumbent store revenues
- Controlled for size of store when doing this to isolate distance effect
- Revenue impact of new entry decreased with distance of new store from incumbent
- Biggest effect when store opened within 5 minute drive-time
- No effect above 15 minute drivetime

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## Conclusions on geographic market

- Larger grocery stores constrained by other larger grocery stores within 10-15 minute drivetime
- Mid-sized grocery stores constrained by other mid-sized grocery stores within 5 to 10 minute drivetime and by larger sized grocery stores within a 10 to 15 minute drivetime
- Convenience sized stores constrained by other convenience stores within a 5 minute drivetime, by mid-sized grocery stores within a 5 to 10 minute drivetime and by larger sized grocery stores within a 10 to 15 minute drivetime

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## Summary of findings:

- **In many important respects, competition in the UK groceries industry is effective and delivers good outcomes for consumers**
  - There were no significant distortions of competition through:
    - targeted price or product promotions, vouchering, below cost selling
    - a ‘waterbed effect’ through favourable supplier prices to large retailers increasing supplier prices to convenience stores and wholesalers
    - conditions for (tacit) co-ordination may be present – but there was no strong evidence co-ordination is effective

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## Summary of findings (contd):

- **However a significant number of local markets for grocery retailing are highly concentrated and barriers to entry allow this to persist**
  - Consumers suffer harm from grocery retailers providing a poorer retail offer in highly concentrated local markets; and charging higher national prices than if local market competition was more effective
- **Grocery retailers are able to use their buyer power to pass on excessive risk and unexpected costs to their suppliers**
  - Consumers suffer harm as a result of reduced supply chain investment and innovation

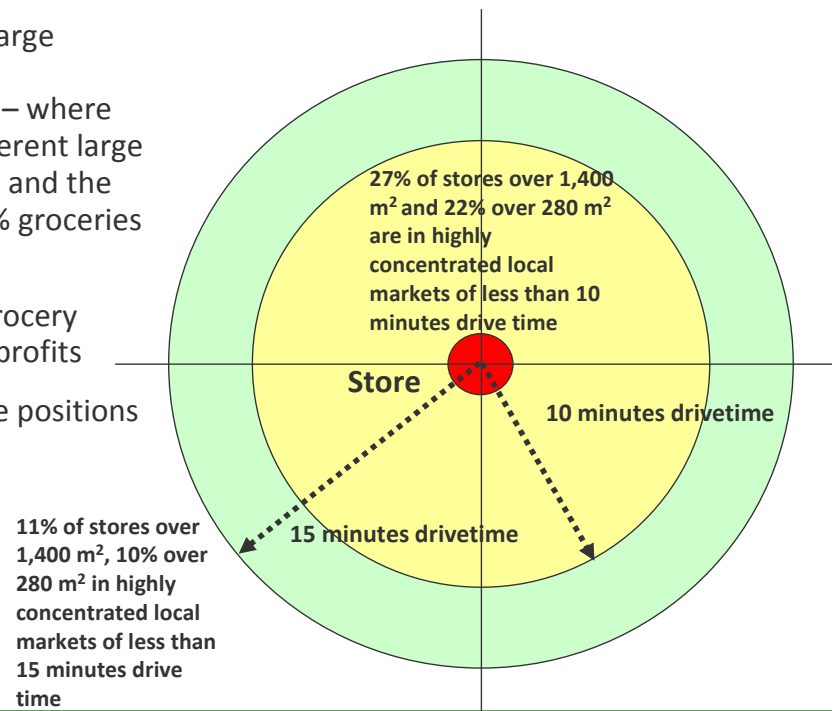
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## Local market concentration

- A significant proportion of large grocery stores are in highly concentrated local markets – where there are less than four different large grocery store fascia present and the largest retailer has over 60% groceries market share
- Weak competition allows grocery retailers to earn additional profits
- Barriers to entry allow these positions to be sustained



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## Barriers to entry

- **Planning (zoning)**
  - the planning regime aims to meet a number of public policy objectives
  - its focus is on the appropriateness of the use, not the occupier
  - it caps supermarket capacity and allows grocery retailers to secure strong local market positions that other retailers find difficult to challenge
  - the planning system is long standing and complex – there is a risk of unintended consequences from changing it
- **Controlled land**
  - given the restricted amount of land available for supermarket development, grocery retailers are able to restrict entry opportunities for competitors by preventing certain land sites being used for competing stores
  - land holdings, restrictive covenants, and exclusivity arrangements are used by grocery retailers to do this

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## Supply chain issues were a significant part of the concerns leading to the groceries market investigation



- Concerns were raised despite the Supermarkets Code of Practice (SCOP), that was established as a result of the CC's 2000 supermarkets investigation
  - The SCOP was established to address 27 supply chain practices identified in the 2000 inquiry as harmful
  - It applied only to the four largest grocery retailers
- However concerns were raised about the SCOP:
  - terms such as 'reasonable'
  - lack of anonymity (so-called 'climate of fear')
  - there have been a limited number of complaints brought under the SCOP

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## Factors that made suppliers reluctant to complain under the SCOP also made them reluctant to come forward in the early stages of our investigation



- Evidence gathering strategy
  - Analysis of complaints
  - Information gathering powers used
  - Supplier survey
  - Review of emails between two retailers and their suppliers over 6 week period
  - Evidence on supplier profitability and innovation
  - Vertical supply chain slices in some fresh product categories

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## The CC protects competition, not competitors (or suppliers)



- Many parties raised with us the buyer power of large grocery retailers as a concern – however buyer power allows a grocery retailer to obtain a better deal from its suppliers - in general, positive for consumers
- If competition is effective grocery retailers would pass on lower supply costs to consumers
- Buyer power can act as a countervailing force to supplier market power

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## However buyer power can have negative consequences for consumers in certain limited circumstances



- Strong competition between grocery retailers can provide an incentive for grocery retailers to use their buyer power to transfer excessive risks and unexpected costs to suppliers
- Extreme pressure is also placed on buyers
- The search for short-term competitive advantage can, in the long term, damage investment and innovation in the supply chain, which will ultimately harm consumers
- Our concern was not with the proper allocation of risks or costs between retailers and suppliers, but with the transfer of excessive risks or costs that may affect suppliers' willingness to invest or innovate

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## Two particular types of practices were significant causes for concern



- Retrospective changes to supply agreements
  - creates a lack of certainty over future income streams which holds back supplier investment
- Excessive transfer of risks
  - a grocery retailer has the ability to affect the degree of risk that is incurred but if it can transfer risk to a supplier, the retailer has less incentive to minimize that risk (eg shrinkage costs)

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## Evidence and finding on buyer power



- Size of grocery retailers relative to suppliers a significant factor - large grocery retailers, wholesalers and buying groups are significantly larger than most of their suppliers
- Prices and margins that suppliers obtain are indicative of buyer power. This was supported by qualitative evidence from suppliers, the share of the retail price earned by grocery retailers, and a review of retailer – supplier emails
- We concluded that all large grocery retailers, wholesalers and buying groups have buyer power over at least some of their suppliers
- The buyer power may be offset in some cases by the market power possessed by suppliers of prominent branded goods
- We considered evidence of the extent of supplier innovation in practice but it did not allay our concerns

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## Summary of Remedies

- Planning remedies
- These were aimed at ensuring available capacity is not allocated in a way that is anti-competitive
- Competition Test for store planning applications
- We decided it was generally not appropriate to recommend other changes to the planning system – it has specific and well-defined social objectives
- Controlled land remedies
- An Order was made to free up existing sites that are controlled by retailers and limiting grocery retailers' ability to use restrictive agreements in future
- Supply chain remedies
- Groceries Supplier Code of Practice
- Ombudsman

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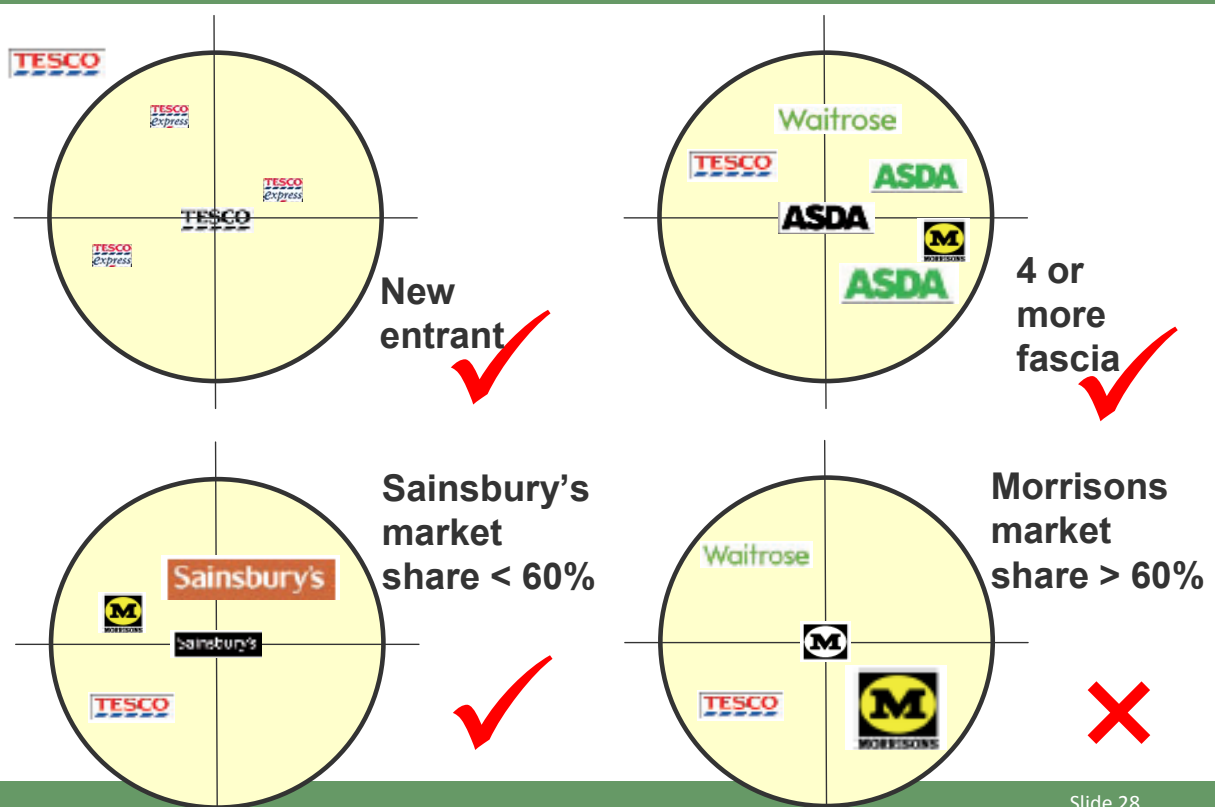
# A recommendation was made to Government to introduce a competition test into the grocery retail planning process



- Clear, bright line test, assesses concentration within a 10 minute isochrone of a proposed development
- A retailer would pass the test if:
  - it is not already present in the area with a store > 1,000 sqm
  - there are 4 or more different large grocery retail fascia > 1,000 sqm in the area;
  - there are 3 or fewer large grocery retail fascia present but the retailer post-development will have <60% share of groceries sales area
  - Recommendation requires Government to pass legislation, we are awaiting its response
- The OFT would act as a consultee to the local authority on the competition test

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## The competition test - examples

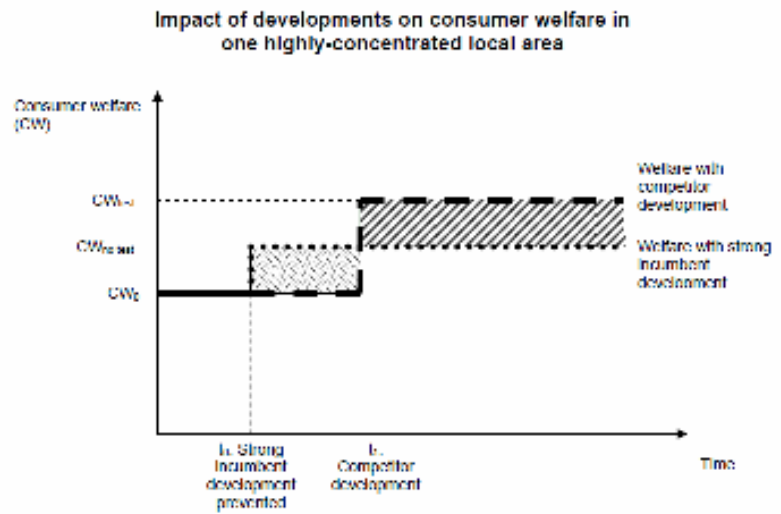


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# Tesco appeal to Competition Appeal Tribunal and remittal



- Tesco appealed our decision to recommend the competition test
- The Tribunal remitted the test to the CC to assess further the effect of the test on consumer welfare
- The CC showed the net static consumer welfare was substantially positive
- We also found there were substantial dynamic benefits (these were unquantified)



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# Controlled land remedies: action by the CC



- Implemented by CC order. Large grocery retailers must:
  - Lift certain specific restrictive covenants (RCs) within 6 months and exclusivity arrangements (EAs) after five years
  - Release other (unidentified) RCs (within 6 months) and not enforce existing EAs (after five years) where, after a request from the landowner or certain other parties, the grocery retailer is assessed by the OFT to have a strong local market position in a highly concentrated local market
  - Not impose new RCs that may restrict grocery retailing or have equivalent effect
  - Not enforce new EAs after 5 years from store opening
- Controlled land order enacted July 2010

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- Overarching fair dealing provision
- Prohibitions on retrospective changes to terms of supply and on suppliers liability for shrinkage
- Procedure for customer complaints and de-listing
- Burden of proof on retailer for 'requests'
- Compliance and enforcement:
  - Written records of agreements on terms of supply
  - Dispute resolution, binding arbitration
  - In-house compliance officer will report to the company audit committee
  - Compliance officer's report will be included in the annual report of retailer
- The Order was enacted August 2009, came into effect February 2010

## Ombudsman recommendation to Government



- Will help tackle 'climate of fear' – important for effectiveness of GSCOP
- Duties of the Ombudsman:
  - Binding arbitration of disputes
  - Compliance monitoring
  - Publication of guidance
  - Reporting to OFT on nature of complaints and disputes, also production of annual report to the OFT
- The CC was unsuccessful in obtaining undertakings from the retailers – therefore a recommendation was made to Government
- Government accepted our recommendation. In 2010 it will begin to introduce legislation to establish the "Groceries Code Adjudicator" (GCA)



## Other GSCOP issues



- Scope
- Enforcement
- Anonymity
- Implementation

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## Thank you



### Further information:

Commission website:

[http://www.competition-commission.org.uk/  
inquiries/ref2006/grocery/index.htm](http://www.competition-commission.org.uk/inquiries/ref2006/grocery/index.htm)

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