

Response to the Office of Fair Trading's

Proposed Decision to Make a Market Investigation for the Grocery Sector

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INTRODUCTION

The Retail Enterprise Network (REN) is a research and academic enterprise unit at Manchester Metropolitan University (MMU) specialising in the independent retail sector and its role in supporting vital and vibrant towns, cities and other centres. It is funded by MMU and the European Social Fund. REN recognises the difficult position of the Office of Fair Trading (OFT) given the grocery sector has already been investigated twice in recent years. However, the dynamics of the small retail sector have consequently meant that the competition authorities have been working with an imbalanced evidence base leading to the unsuccessful resolution of various problems inherent within the sector.

REN therefore welcomes the opportunity to work with the OFT and the Competition Commission (CC) in the coming months to help formulate the answers which will benefit all consumers.

In this document, REN sets out its response to the proposed market investigation of the grocery sector in two sections. The first examines the evidence base on which such an investigation should be made and the second sets out our response to specific elements contained within the consultation document.

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EVIDENCE BASE

With the important role played by the competition authorities it is imperative that a solid evidence base is used on which decisions can be made. The competition authorities can only work from evidence alone as opposed to assumptions. However, judging by the views expressed in the most recent document¹ and other previous documents² this evidence base does not reflect the grocery sector in its entirety and is heavily slanted towards issues concerning the 'Big Four' only.

There are a number of reasons for this imbalance. Undoubtedly the 'Big Four' will be investing heavily in preparing for any possible inquiry into the grocery sector as they have for the previous inquiries. The small retail sector however, is in the unfortunate position of having little representation in comparison. Small shops do not have the resources, skills or time to effectively influence competition and consumer policy. For example, it was highlighted in High Street Britain 2015³ that rural retailers can work up to 72 hours a week. The challenges of being an owner or manager of a small shop make non-core business activities such as taking part in consultations extremely difficult to conduct.

While trade associations like the Association of Convenience Stores (ACS) and the National Federation of Retail Newsagents (NFRN) have worked hard in this respect they will always be limited by the resources of their members. Not all small shops will become members of trade associations and not all members of trade associations have the resources to give organisations like ACS and NFRN their undivided attention regarding data collecting.

Furthermore, these trade associations are struggling to maintain the existence of the Independent Retail Confederation, the collection of trade associations representing the independent retail sector, as resources are so stretched. This means the presence of a

¹ Office of Fair Trading: Grocery Market 'Proposed Decision to Make a Market Investigation Reference' March 2006

² Competition Commission: Supermarkets 'A report on the Supply of Groceries from Multiple Stores in the United Kingdom' 2000

³ All Party Small Shops Group: 'High Street Britain 2015'

legitimate representative for all small shops is at threat. To compound matters the British Retail Consortium (BRC) has, in our opinion, been misrepresenting small shops on issues of conflict between the larger organisations and the smaller organisations. During the High Street Britain inquiry, the All Party Small Shops Group received contradictory evidence from the BRC and one of its members who represents small shops. The evidence the two organisations gave differed greatly yet the BRC positions itself as the voice of the entire retail sector. This positioning is both misleading and dangerous for small shops.

For some of the issues facing the market, even those outside the retail sector are no longer a useful source of information. The buying power of the 'Big Four' is intimidating to suppliers of all sizes. The threat of being 'dropped' by any of the Big Four is something suppliers cannot ignore and as such consultation with suppliers will not reveal the full extent of anti-competitive practices unless full anonymity can be guaranteed.

The flaws in the consultation process are prevalent and the competition authorities are not without criticism. There appears to have been little attempt to address these issues proactively either through actions or recommendations. As such the competition authorities have been acting without a holistic understanding of the retail sector. This has been reflected in the decisions of the last few years. Inabilities in understanding the dynamics of the small retail sector and alienating suppliers by not providing a process for organisations to speak honestly have been evident.

It must be remembered that for various reasons many consumers either wish for or rely on small shops. Not only does the current document⁴ ignore some of the issues important to consumers, as has been done in the past; the competition authorities could potentially alter the market in a way that further tilts the trading environment against small shops. No competition authority should contradict the will of consumers. We feel legitimate and serious questions should be raised about the role of the competition authorities and their methods of investigation.

⁴ Office of Fair Trading: Grocery Market 'Proposed Decision to Make a Market Investigation Reference' March 2006

The competition authorities need to address these problems rapidly to avoid another ineffective inquiry or indeed a seriously damaging one. REN and other representatives of the small retail sector are willing to help in this process but there must be change of thinking within the competition authorities.

For example, the competition authorities should acknowledge that there are issues that disproportionately affect small shops and that have not been recognised in the proposal.

These issues include:

- Rents and Rates;
- Tax and VAT;
- Crime;
- Business Support; and
- 'Red Tape';

Although these are not currently directly linked to competition or consumer policy, much like planning issues, they can heavily affect competition. For example, a delicatessen called Real Meals was forced to close one of its two stores in the North East recently due to an upward only rental review. This is an important case study because in 2002 Real Meals was judged to be the best food retailer on the British mainland according the BBC Food and Farming awards. The main losers in such a situation are consumers. If the competition authorities are loyal to the needs of consumers then such issues should be paramount in their priorities, not ignored altogether. We believe competition authorities should research these issues and make the necessary recommendations to the relevant government departments, to protect and promote competition.

REFERENCE TO SPECIFIC ELEMENTS WITHIN THE CONSULTATION DOCUMENT

The definition of the market in Chapter 2 ('two markets' approach) is less than clear. There is little in the way of analysis of the All-Party Parliamentary Small Shops Group's (APSSG)

claim that the lines have become increasingly blurred between the 'top-up' and 'one-stop' shopping markets and that the ruling should be revised. It is felt that the increasing presence of multiple retailers in both markets is something that the Competition Commission should be considering further, a point the report makes in paragraph 2.6.

Chapter 3, on the market structure, would appear to concentrate principally on comments and data drawn from the supermarkets (as well as publicly available information, as acknowledged in paragraph 3.1). The extent to which the OFT has drawn on the views of other retailers and trade associations from across the sector is not made clear. This is a concern, as the potential for bias prevalent in evidence drawn from only one part of the grocery retail sector, the multiple one, could be significant. We would argue that, should the referral take place, the OFT, and by extension the CC, should attempt to develop as full a picture as is reasonably possible, taking into account the views of independent retailers, suppliers, and wholesalers, for example, when considering the market structure. It is clear from this chapter that the market share of the 'Big Four' is considerable, yet the sheer size of the market, as acknowledged in this chapter, suggests that independent retailers still constitute a considerable proportion (28%). We would agree that the OFT is right to point to the growth of the multiples in the convenience sector (as in paragraph 3.18). Nevertheless, it is a little disingenuous to suggest that 'it is notable that co-ops and symbol groups have also expanded' (paragraph 3.18): given that from Figure 3.19 the grocery multiples have more than trebled their market share, as opposed to the much more modest increases in the other 2 store types.

Another major concern of Chapter 3 is the reference to isochrones (paragraph 3.25) as a tool for analysing the geographic spread between shops. It is hoped that there is an alternative tool which analyses walking distance between outlets rather than just driving time. If so then it should be used as a primary indicator to allow for the fact that:

- a) not all consumers have cars, especially those who are less well off,
- b) not all consumers wish to use their cars for all shopping.

If an assumption is being made that grocery shopping is reliant on owning a car, then this is a completely unacceptable situation and demonstrates a lack of ability to understand the diversity of consumer needs.

When figures are given for consumer access to fascias have statistics on car ownership and car usage been taken into account? If not, then it is predictable that these numbers will decrease significantly. Furthermore, have alternatives to the offers to multiple stores ever been taken into account when using the isochrones? It would be interesting to compare consumer satisfaction against genuine choice in local areas.

REN agrees with the theory that many of the features of the market are interlinked as mentioned in paragraph 8.4. However, this raises serious questions regarding the shallow analysis offered in Chapter 4. REN is concerned that there is no inter linkage between price, range and quality. The Big Four are able to sell products 10% cheaper than competing stores (4.4), but with the differences in buying power it has to be ascertained whether this is actually being funded through pressured suppliers. If this is the case then in the longer term changes to range and quality of products will adversely affect consumers as suppliers struggle and consolidate.

Whilst it is clear that prices have fallen, there is little other evidence in this report to suggest that this is a good thing for consumers. An increase in larger, typically out-of-town supermarkets, which it can be argued have driven this fall in prices, does not benefit the older or mobility-impaired consumer. Neither has an attempt been made to calculate whether a fall in price of some products is in anyway off-set by, for example, car usage costs. Driving to retail outlets puts a cost on the consumer (in relation to petrol and car 'wear and tear' for example) and on society, in relation to increased carbon emissions and increased traffic congestion. In short, evidence which takes into account the 'bigger picture' is required.

The use of range is a rather crude measure, and increases could well be due to the increasing amount of own-label products now stocked by the 'Big Four'. During the course of a potential Inquiry by the Competition Commission there must be an analytical tool put in place which genuinely measures diversity taking into account product types, brands, sourcing etc. Unlike the OFT document⁵, an inquiry by the Competition Commission must make some effort to measure the range of goods offered by independent businesses and other multiples outside the 'Big Four'.

We also suggest that the OFT should not automatically liken increased amenities with increased consumer satisfaction, as it does in paragraphs 4.16 to 4.19. Indeed, it is telling that the retailers with the highest levels of customer satisfaction, *viz.* Waitrose and Marks and Spencer, typically have far fewer amenities (as shown in Figure 4.8) than the 'Big Four'. As such, and in the light of an apparent lack of any evidence comparing directly independent retailing with their multiple competitors, care needs to be taken as to whether the growth of multiple supermarket retailing is by default a 'good thing' for consumers.

Concern is also raised over what is apparently the sole use of retailer data on below cost selling, as dealt with in Chapter 5. It would seem that if conclusions are to be drawn as to whether products are sold at very low margins, data should be incorporated from suppliers as well as retailers, thus enabling direct comparison. The apparent lack of the use of any other data apart from those supplied by the 'Big Four' calls into question the validity of claims such as 'the 2,708 lines sold below cost represent around 1.8 per cent of all grocery lines across the Big Four as a whole'. In essence, can there be confidence in data that are only provided by organisations wishing *not* to find evidence of below cost selling? Clearly, further research needs to be undertaken in this area, to include investigation into whether below-cost selling differs across the 'Big Four's' fascias. In terms of price flexing, the truncated time which the OFT has had to produce this referral suggests that, rather than stating 'there is no evidence to suggest that this [price-flexing] is widespread' (paragraph 5.23); there should be acknowledgement that much more detailed and in-depth research is needed across the

⁵ Office of Fair Trading: Grocery Market 'Proposed Decision to Make a Market Investigation Reference' March 2006

country and across different fascias of the 'Big Four', in order to enable whether the phenomenon is prevalent. At the least, the OFT could examine the three other cases of price flexing identified in paragraph 5.20, despite not being persuaded by the Proudfoot example.

The focus in Chapter 6, on Buying Power, would also provide a welcome element of any future CC Inquiry, we believe. The code of practice that was established after 2000 has failed, we would argue, in part on the grounds that a lack of anonymity discourages suppliers from coming forward with concerns. The report states in paragraph 6.15 that 'it is not clear how suppliers would be able to charge significantly above cost to smaller retailers without rivals undercutting them in the market'. It would seem that the answer to this confusion lies in the fact that certain brands are so central to the British customer, that essentially they become irreplaceable in the mind of the consumer. Hence, most smaller retailers are not able to replace such brands as Marmite, Tetley Tea, Weetabix; to name but three, as substitutes simply would not sell. The report also states 'it is not clear why suppliers would price persistently below cost to the Big Four' (paragraph 6.15). In answer to that, the mere threat of de-listing by the Big Four, which take such a large proportion of suppliers' domestic sales, strongly discourages any supplier from achieving a higher price for their product.

Other omissions exist in this Chapter. REN strongly recommends a more thorough analysis of the information offered on suppliers in High Street Britain 2015 and then suggests that the second paragraph to 6.5 should be extended to include how buying power is reducing consumer choice of brands by damaging the brand equity of suppliers' products while protecting own labels.

Furthermore, 6.10 and 6.11 fail to state that the buying power manifests itself in more than just differential pricing, but also non cost related discounts. The relationship between the 'Big Four' and suppliers has developed into a business model in its own sense with the pressurised sales of advertising and marketing space and the funding of staff costs. This has been outlined in High Street Britain 2015 and warrants investigation.

Turning to Chapter 7, on planning and land banks, the report seeks to point out the findings of an OECD Economic Survey into competition, noting that planning restrictions could be relaxed (paragraph 7.4). The evidence for this contention is not considered in the OFT report, which is worrying, given the perceived need for an evidence-based approach to competition policy. An established element of planning law in this country pertains to the planning system not interfering in market decisions. Indeed, it is noted in the report that the availability of remedies is limited. We have a system of planning in place that seeks to encourage development primarily in town and city centres. That is in place because the strong competition for land in the UK means that there is a general awareness in government to seek to protect sites that have not yet been developed. Allowing competition concerns to assume primacy in this matter appears to be perverse in the extreme. The issue of land banks, however, could be an issue which the CC could look into, in order to explore whether the 'Big Four's' dominance in this regard is stifling smaller competitors.

Paragraph 7.24 states the planning system encourages less efficient retailers. REN would ask for a definition of the word 'efficient' as there is some concern over this statement. The link between efficiency and consumer needs are obscure. Some retailers can genuinely add to the vitality of towns and cities regardless of levels of efficiency, which is potentially why the planning system seeks to protect them. The health of a retail district is highly important for consumers but this is not always achieved through efficiency.

In summary, the referral to the CC is to be welcomed. However, it is to be hoped that any account of the sector considers the role of the smaller operator as well, and how they are affected by the behaviour of their larger counterparts.