

# Large supermarkets in the convenience sector – good for consumers or cause for concern?

Paul Muysert and Mike Walker, *Charles River Associates*

Over the past few years Tesco and Sainsbury's have been steadily expanding their interests in what is sometimes referred to as the convenience store sector of the grocery market.<sup>1</sup> According to a recent article in the *Financial Times*, Tesco now has a five per cent share of the convenience store business, and is perhaps set to take the top position from the Co-operative Group during 2005.<sup>2</sup> To date regulators have expressed little concern at Tesco and Sainsbury extending into this business area. Is this relaxed approach justified, or should the regulators be taking a closer look at this trend?

The approach taken by the Office of Fair Trading and the Competition Commission has been to treat convenience shopping and 'one-stop' grocery shopping in large stores as being in relatively, though not totally, separate markets. In other words, from the so-called *demand* side perspective (that is, the view of the market that considers the behaviour and reactions of consumers), convenience stores and one-stop shopping supermarkets have relatively little competitive interaction. It follows from this line of argument that acquisitions in the convenience store sector can be considered from the perspective of the potential impact on competition in the convenience store sector alone, with little or no consideration of the purchaser's position in other grocery markets. The standard concern in merger analysis is that a merger will allow prices to rise by allowing two firms that previously competed to merge. If the two firms operate in different markets, with little competitive interaction pre-merger, then this concern does not arise.

Whether or not the 'separate markets' characterisation is a reasonable reflection of the market reality is largely a question of fact to be settled by empirical analysis. This factual question is one that has been reasonably thoroughly

explored during a number of competition investigations into grocery and supermarket markets, such as the Competition Commission's inquiry into the Safeway merger in 2003. The Competition Commission effectively segments the market into one-stop shopping, secondary shopping and convenience shopping. Whilst secondary shopping overlaps to some extent with both one-stop and convenience shopping, one-stop and convenience seem to be distinct in the CC's view. So whilst there may be some competitive overlaps due to secondary shopping taking place in both large supermarkets and convenience stores, this overlap is limited. Given the amount of time the CC has put into this analysis, it may well be reasonable to argue that there is no pressing need to re-examine this question. However, even if this is correct, demand-based analysis is only one side of the competitive impact question. The other side is what is referred to as the *supply* side of the market. This, as its name suggests, considers the behaviour and reactions of suppliers to changes in the marketplace.

On the supply side of the market it is not at all clear from previous regulatory inquiries that developments in the convenience store sector can be considered to be independent of developments in the wider grocery market. In its 2003 report on the acquisition of Safeway, the Competition Commission considered buyer power to be a significant competitive issue related to the transaction. It stated:

1.20. Turning to the third issue, buyer power, we find that the acquisition of Safeway by any of Asda, Morrisons, Sainsbury's or Tesco may



be expected to aggravate further the imbalance in the respective bargaining positions of that party and its suppliers. As a result, we would not expect competitive prices to emerge. The consequences of uncompetitive prices may include 'waterbed' effects (where suppliers seek to recoup the lower prices they receive from large retailers through higher prices to smaller grocery retailers) or a further general weakening of some suppliers' bargaining positions, with the result that some grocery manufacturers are likely to find investment in new products or innovative manufacturing techniques more difficult or no longer possible.

# Large supermarkets (continued)

In its report the Commission decided to analyse buyer power within the context of a market defined as 'the supply of groceries to supermarkets with a share of 8 per cent or more of groceries purchased for resale from their stores in the UK'. However, in our view it is clear that the concerns voiced at the time by the Commission are not dependant solely upon aggregations in any particular class of retail outlet. Rather, they relate to issues associated with the potential for ever-increasing leverage through increasing purchasing power in the wholesale markets between manufacturers and retailers. In general, such purchasing power is a function of the volume that a particular retailer is able to purchase. This volume will be generated across all the retail outlets that a retailer stocks from its purchasing and supply operations.

This brings us back to the incremental expansion of major supermarket chains into the convenience store sector. Even if the competition regulators are correct to disregard the current aggregations on the grounds that convenience and one-stop grocery shopping are effectively separate markets on the demand (consumer) side of the market, it is not at all clear that regulatory concerns do not exist on the supply side of the market. If the regulatory authorities believe that Tesco's and Sainsbury's size in one-stop shopping gives them a worrying level of buyer power, it is not clear why they should not be worried that increases in that size, regardless of where they come from, will not further increase their buyer power.

It is of course true that individual acquisitions in the convenience store sector will have *de minimis* impacts on the concerns expressed by the Competition Commission in 2003, as the convenience store sector is highly fragmented. This leads to the difficulty that a series of individually un concerning deals might, when viewed in aggregate, be problematic, yet fail to trigger any of the traditional thresholds for a competition investigation. One solution to this would be for a dedicated inquiry into the potential for this pattern of incremental expansion at the

retail level to harm the maintenance of effective competition, including a healthy level of investment and innovation, at the supplier level.

Such an inquiry would need to be based on empirical analysis of the marketplace because the potential competition concerns come down to questions of fact. The Competition Commission has shown itself to be worried about the potential for increased buyer power to lead to a reduction in innovation and investment by suppliers. Whether this worry is warranted can only be settled by looking at the evidence: has increased buyer power led to a reduction in supplier innovation and investment? If not, is there any reason, grounded in fact, to expect that future increases in buyer power might nonetheless have this effect?

Another competition policy concern expressed by the Competition Commission in the Safeway merger inquiry was that buyer power on the part of the large supermarket groups led to lower wholesale prices to these groups, but at the cost of higher prices to other groups with less buyer power (for example, wholesalers or retail groups in the convenience store sector). This could potentially lead to higher convenience store prices (although presumably not from Tesco given its buyer power), which would harm consumers who do not have access to the large superstores and could even lead to convenience stores exiting the marketplace. Whether these concerns are well-founded is again an empirical question: have lower input prices to the large supermarkets been associated with higher input prices to other grocery outlets?

The need to settle this matter empirically is made pressing by the fact that we normally expect increases in buyer power to be pro-competitive: lower wholesale prices paid by supermarkets should feed through to lower retail prices paid by consumers. The Competition Commission's 2000 *Supermarkets* inquiry concluded that wholesale price reductions had been passed through to consumers. This was the same report that raised the concerns about buyer power discussed above.

## Conclusions

It is clear that the expansion by the large supermarket groups into the convenience sector raises some important competition policy questions. What is less clear is what the answers are to these questions. The answer on the demand side may actually be reasonably clear: limited interaction between the convenience store sector and the one-stop shop sector may imply that there are no demand-side concerns. The empirical evidence considered in past inquiries certainly suggests this, but of course the facts of the marketplace change and so a fresh look at the evidence may lead to a different result. We doubt it, but it is clearly a possibility.

The answers on the supply side are certainly much less clear cut. Our natural economists' presumption in favour of buyer power may not be the right answer in this case. We may have reached the point at which even small incremental increases in buyer power actually harm competition and consumers. Only a full analysis of the facts can confirm or refute this claim.

<sup>1</sup>For instance, through Tesco's acquisition of Adminstore and T&S Stores in 2003/4 and Sainsbury's acquisition of Bells, Jacksons and Beaumont stores in 2004.

<sup>2</sup>Tesco treads with care as it extends reach', *Financial Times*, 18 February 2005. The data cited by the *Financial Times* comes from Verdict.

## Brands beyond business

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