



6th June 2006

T J Oyler
Inquiry Secretary (Groceries market inquiry)
Competition Commission
Victoria House
Southampton Row
London
WC1B 4AD

Dear Mr Oyler

Market investigation: the supply of groceries by retailers in the United Kingdom

- 1 Thank you for your letter of 12th May with your invitation to provide information that may be relevant to the Competition Commission's enquiry into the groceries market and our comments on the reasons for the OFT's referral.
- 2 To give some background, the British Brands Group is a trade organisation whose members comprise brand manufacturers operating in the UK. Our members range in size and supply a variety of branded goods including food, drink, household, toiletry, pharmaceutical, DIY, clothing and sports goods. Most distribute their products through grocery retailers, including supermarkets and convenience stores, and for many this is their main route to the consumer.
- 3 We believe that the perspective of brand manufacturers is important to this market investigation because:
 - (1) in many product categories supplied by grocery retailers, brand manufacturers are the drivers of innovation and set the benchmark for quality. These are vital components of consumer welfare;
 - (2) brand manufacturers provide choice to consumers, and their products are the preferred choice of millions of grocery shoppers;

- (3) While a brand represents a close pact or relationship between producer and consumer, access to the consumer is dependent on retailers who act as gatekeepers to consumers;
- (4) brands are comparable across retailers and therefore, through price comparisons, facilitate competition between retailers for the obvious benefit of consumers.

4 **OFT's reasons for referral**

We have the following comments on the reasons given by the OFT for the referral of this market:

5 (1) The planning system

We acknowledge that the planning system in the UK may raise the cost of, and limit the scope for, new market entry for larger format stores. However, were a remedy to be found to address this barrier, we believe that other barriers to entry would remain impossibly high, in the one-stop grocery market (stores >1,400m²) in particular. Any new market entrant to this market would still face the significant barriers of establishing an efficient supplier network, setting up a competitive supply chain including logistics, warehousing and data processing, building and equipping a competitive store network, developing an appealing and recognisable retail brand, developing a competitive own label range, building a consumer franchise through the acquisition and application of customer information, and acquiring sufficient buyer power to be able to compete at the procurement level.

6 (2) Land holdings and restrictive covenants

We have no specific comments to make about land holdings reinforcing current market positions and restrictive covenants being anti-competitive.

7 (3) Buyer power

Conditions for the exercise of buyer power clearly exist in the UK grocery market, with the one-stop grocery market recognised as concentrated in the Supermarkets report in 2000 (Supermarkets Cm 4842, Table 2.2). This report also recognised that retailers with more than 8% share of grocery purchases could control their relationships with suppliers (para 2.458). The OFT's report "The Grocery Market" (2006) noted that the top four retailers now hold around 75% of the total grocery market.

8 We do not consider that buyer power *per se* gives rise to competition concerns. We do however recognise that problems may occur when that power is abused, for example, when it is used not just to drive down prices charged by suppliers but to extract non-cost related discounts and other payments from suppliers with no corresponding benefit in return.

9 We consider retail competition to be typified not just by competition between fascias but also by competition between vertically integrated supply chains. Each major supermarket has its own fully integrated supply chain (integrated via information rather than fixed assets). Independent retailers who do not own an integrated supply chain rely on a separate and legally distinct supply chain

comprising wholesalers, whether delivered or cash & carry. Such wholesalers service some 20% of the grocery market and are crucial to the viability of small shops, independent chains and new entrants. Were this independent supply chain to become less competitive due to reduced volume (arising from the loss of outlets via acquisition by a major supermarket), existing independent retailers would suffer from a deterioration in buying terms. As indicated in the OFT's reasons for the referral, this will eventually lead to the independent grocery sector ceasing to be viable. Furthermore, barriers to entry would be raised significantly as new entrants would be deprived of a competitive and freely available source of supply.

- 10 The disparity in buying prices paid by independent retailers (buying through wholesalers) and the major supermarkets was raised in the CC's 2000 inquiry. The Supermarkets report showed that there was evidence of a strong relationship between retailer market share and supply prices - such that small chains like Budgens were up to 11% worse off than the market leader Tesco in terms of the prices they obtained from the same suppliers. The 2003 Safeway inquiry alluded to the fact that the gap may have widened. It is not clear that this "relative gap" (which may or may not be due to a waterbed effect) leads to consumers being overall better off as a result of increased retail concentration. Even if lower supply prices are directly transferred into lower retail prices in the major supermarkets, smaller retailers may have to set higher prices. This has the immediate effect of favouring customers using the former retailers and working against those using the latter retailers. More importantly though, it will shift market share away from the small retailers, to a position where small retailers are driven out of business. We suggest that the CC investigates whether there is evidence of smaller chains paying higher (absolute) prices as the big retailers negotiate lower prices.
- 11 The OFT refers to the "tipping point" for the wholesale sector being nearly reached. If the CC found a widening relative gap, then this can be expected to result in wholesalers losing further volume in their businesses, to the point at which scale economies break down and wholesalers cease being economically viable. At that point independent retailers and small chains will not have access to supplies at all and so go out of business, resulting in further retail consolidation. Both issues are worthy of examination.
- 12 Reduced competitiveness of the independent supply chain is certainly a threat to effective competition in the grocery market. This arises not so much from the failure of the independent convenience business model but by the ability of major supermarkets to leverage their buyer power in one market and apply it to another. There has been a significant decline in the convenience store sector since the 1960s (estimated to be about 80%) and the growth of the major supermarkets in this sector may hasten the decline and closure of those independent convenience stores that still survive. There is an important consumer benefit in the continued existence of convenience shops that are genuinely convenient – the proximity of low value items and items that consumers need to buy separately from their major weekly shop. These include newspapers, magazines, tobacco, confectionery, soft drinks, ice cream and National Lottery tickets – items that are often the primary reason for a shopper's to visit a convenience store. The CC investigation should therefore, we suggest, focus both on the consumer benefit of shop proximity and

13 on a wider range of categories than the OFT's definition of 'grocery' because these categories are so essential to the long term profitability and survival of convenience stores.

14 (4) Pricing behaviour

The practices of below-cost selling and price-flexing do not of course give rise to competition concerns in all instances. For example, pricing low to clear old stock and charging different prices due to differences in costs are both legitimate practices and should be considered as such. Where such practices are applied over a sustained period with the objective of disadvantaging competitors, however, the implications are different.

15 In the Supermarkets report (2000), both selling below cost and price flexing were recognised as raising competition concerns but a proportionate remedy could not be identified. We are conscious that in those markets where remedies have been introduced (eg. France with the Loi Galland and Eire with the Groceries Order), problems have persisted in the market and remedies have given rise to distortions of their own. While sales below cost and price flexing may in certain circumstances be anti-competitive, the challenge remains of identifying a remedy that addresses concerns while not curtailing legitimate pricing behaviour or giving rise to unintended consequences.

16 **Brand owners' concerns**

There are a number of areas in the UK grocery market where further investigation may be warranted to identify whether competition concerns arise:

17 (1) Competition between branded and own label goods

The major supermarkets control access to significant (and increasing) proportions of the grocery market, acting as powerful gatekeepers to the consumer. As such they are vital commercial customers for our members. At the same time they are powerful competitors, with own label ranges which now represent close to 50% of the product market, available at price points ranging from value to super premium.

18 It is this "double agent" role of the retailer, as both essential customer and direct competitor, which underscores brand manufacturers' relationships with supermarkets. Any abusive practices by retailers (for example those identified in the 2000 Supermarkets report) are imposed on brand manufacturers not just as suppliers but also as direct horizontal competitors. This may distort competition.

19 (2) Ongoing consolidation (in the one-stop market)

Ongoing consolidation in the one-stop grocery market raises concerns due to the implications this has for consumer choice, competition and abuses of buyer power. Since the Safeway merger, consolidation has grown further amongst the top three retailers, with Sainsbury's acquiring 22 stores and Asda acquiring 12 stores from Morrisons for example. Consolidation in the procurement market has also increased with the move of Tesco and Sainsbury's into the convenience market.

20 Each recent acquisition by the major supermarkets has been deemed by the OFT to result in only small increases in grocery purchases from suppliers and competition concerns have therefore been deemed not to arise in the procurement market. However each has contributed to further creeping concentration and has further strengthened the bargaining positions of supermarkets.

21 Increasing concentration has specific implications:

- (i) As the buyer power of major supermarkets increases, enabling them to negotiate better terms from suppliers, so they are able to leverage their advantage over smaller retailers, weakening the ability of local retailers to compete (Supermarkets, para 11.114);
- (ii) Increasing consolidation in the retail and procurement markets and the consequent increase in dependency of suppliers (both large and small) on a few major retailers increases the scope for abusive practices identified in the Supermarkets report (para 2.548);

22 The exercise of buyer power, in all its forms, may not be necessarily beneficial to consumers. Nor should consumer welfare be the sole measure for competitive analysis. The procurement market was considered by the CC both in its Supermarkets and Safeway reports, and was considered by the European Commission in the analysis of major European retail mergers such as Kesko / Tuko (1996), Rewe / Meidl (1999) and Carrefour / Promodes (2000). We suggest it is appropriate to consider it as part of this market investigation.

23 (3) Abuses of buyer power

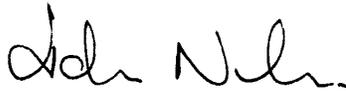
We have commented in the past to the OFT on the Supermarkets Code of Practice and its effectiveness in addressing the practices identified by the CC in 2000 as distorting competition (Supermarkets, para 2.548). This market investigation presents an opportunity to assess formally both the prevalence of practices that distort competition and the effectiveness of the Code of Practice.

24 (4) Copycat packaging

An example of the tension created by a retailer that is both customer and competitor is the stocking of products, including some own label products, in packaging designs very similar to familiar brands. Such similar packaging prompts shoppers to draw mistaken assumptions about a product's quality and manufacture, thereby influencing their purchasing decisions. Some go so far as to buy the wrong product by mistake. The effects are particularly strong in relation to own label products as consumer uncertainty exists over their source. Copycat packaging harms shoppers while benefiting the copier (if it had no effect, the practice would have died out years ago), distorts competition between products, and distorts competition between retailers.

- 25 There is no effective competition or other remedy in the UK to such free riding, in contrast to other countries. The market study represents an important opportunity to investigate the practice, including in relation to own label. Indeed, the Trade & Industry Select Committee recommended the CC investigate it in 1998 but it did not do so, although the practice was mentioned as one of the contributory factors to the enquiry (Supermarkets, para 3.313(c)).
- 26 We would be happy to expand on any of the points we have raised, should that be helpful.

Yours sincerely

A handwritten signature in black ink, appearing to read "John Noble". The signature is written in a cursive style with a horizontal line at the end.

John Noble