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Consultation Response

Friends of the Earth's response to the Competition Commission: Grocery Market Investigation

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Introduction

Friends of the Earth welcomes the OFT's referral of the grocery market to the Competition Commission (CC). Friends of the Earth called for a new investigation into the dominance of the major supermarkets in 2004, with the Association of Convenience Stores, the National Federation of Women's Institutes and FARM.

We are pleased that the OFT has agreed that the increased concentration in the grocery market since the last CC investigation may be harming smaller retailers and consumers. The increase in concentration has resulted from the takeover of Safeway, the takeover of various convenience stores and expansion of the biggest supermarkets by building new stores. The latter two means of expansion of the big four are continuing trends.

We consider that the market is failing because it is becoming increasingly hard for smaller retailers to stay in business and for new small businesses to enter the market. We have seen an alarming increase in the rate of loss of small shops in recent years which has serious implications for consumer choice. We also believe that the biggest retailers are using their market power to engage in unfair trading practices with suppliers which is having the effect of smaller suppliers becoming unviable as well as making it hard for suppliers to meet ethical and environmental standards. These trends harm consumers by lowering the quality and choice of goods available.

Our original, and subsequent, submissions are attached to this response. We have not repeated all the detail from those submissions here and trust that the CC will consider these documents as part of our submission to this investigation. We intend to submit further evidence during the course of the investigation and we would welcome the opportunity to meet with the CC to discuss our concerns.

The OFT's terms of reference

We strongly urge the Competition Commission to extend the terms of reference to include the sale of non-food goods in supermarkets. Since the time of the last CC report of 2000 the major supermarkets have rapidly increased their market share of non-food goods including petrol, books, DVDs, magazines and newspapers, as well as services such as insurance and financial services. Non-food sales in the major supermarkets have been showing stronger growth year on year than grocery sales[1]. Many non-food items have become a regular part of shopper's main shop in the supermarket to the detriment of smaller high street stores.

By growing their market share supermarkets have gained additional buyer power in these areas with inevitable impacts on suppliers of these goods. We consider that the practice of aggressively cutting prices on popular non-food items such as best selling books is having an adverse impact on smaller and specialist retailers. Supermarkets offer the convenience of being able to buy a wide range of goods from vegetables to books under one roof but they

[1] 'Non-food driving sales in grocery, The Grocer, February 18 2006

cannot offer the same choice within each category as a specialist retailer. Consumer's choice of items such as books and magazines will therefore be reduced as specialist stores go out of business. The loss of key non-food stores in a town centre or high street can have a knock on effect as less shoppers frequent the centre possibly making other stores unviable.

Whilst some consumers will value convenience and will be content with the choice of such goods on offer in a supermarket other consumers will value choice much more highly and will be harmed by the loss of specialist retailers. Consumers without access to a car will also be harmed more by the loss of local high street stores. The CC must recognise that consumers have different needs and priorities.

Issues covered by the OFT's referral

1. Planning

Whilst we do consider that there are aspects of the planning system which may distort competition we fundamentally disagree with the OFT's analysis that planning policy on out of town development acts as a barrier to entry for large format stores. Although planning policy has sought to concentrate retail development in town centres the evidence is that a significant amount of development of large format stores still takes place out of town and on the edge of town centres. Recently revised national planning guidance (PPS6) actually encourages the provision of sites for large format stores on the edge of town centres – so it is our view that planning policy contains a bias *in favour* of big supermarkets and other retailers that operate out of large format stores. We consider that this policy may distort competition because it favours large supermarkets over smaller retailers and we would urge the CC to recommend a revision of PPS6 to remove this policy bias.

We also urge the CC not to recommend any weakening of the policy to restrict out-of-town development since this would give the green light to the big supermarkets to expand significantly and grow their market share further. Allowing rival chains to open in locations where one or two large supermarkets already exist will not do anything to increase genuine consumer choice but will instead harm consumer choice since it will inevitably lead to the loss of more independent and smaller retailers. It will also cause disproportionate harm to consumers without access to a car who are more dependent on town centre and high street shops. Travel to out-of-town stores adds a significant cost to low-income households.[2]

Development in out-of-town or edge of centre sites is also continuing by means of extensions to existing stores. Last year Tesco opened 18 Extra hypermarkets, mostly through extensions to existing stores. Extra stores now represent 31% of Tesco's total sales area – these large format stores are most likely to be located out-of-town or on the edge of town centres. Another 28 Extra stores are planned to open in the coming year, again mostly through extension of existing superstores[3]. National Planning guidance requires that

[2] NCH The Children's Charity found that travel costs could add 23% on the average shopping cost for low income families.
[3] Tesco Annual Review and Summary Financial Statement 2006

significant extensions to stores are treated in the same way as new stores but these figures show that expansion via extensions is continuing. Any further weakening of planning policy on out-of-town sites would allow Tesco, already the most dominant retailer, to accelerate its expansion plans.

In its investigation into planning issues we consider that the CC should also consider the anomaly whereby a supermarket with a dominant position in a local area can build a new store with no consideration to the increase in its market share because the local planning authority cannot take into account ownership of the store. This position is in contrast to a takeover situation where local dominance would be considered before a particular store could be purchased as it was in the Safeway/Morrison's merger.

We have also gathered evidence that the big supermarkets use their powerful position in the market to give them leverage over local authorities to influence planning decisions – this is not something that smaller retailers are in a position to do.

Our views on planning are covered in more detail in our attached submissions to the OFT and we would be willing to provide more evidence to the CC on these issues during the course of the investigation.

We also urge the CC to consider other barriers to entry for smaller stores. For example the entry of the major supermarkets into the convenience store sector has raised prices for purchasing small stores. The big supermarkets can cross-subsidise the inflated cost but smaller businesses cannot.

2. Land holdings

We agree that the issue of land holdings should be investigated. We accept that restrictive covenants on land could create a barrier to entry for other retailers. However the CC should consider carefully the implications of freeing up this land for the building of new supermarkets. As stated above we also consider that the CC should focus on other barriers to entry and in particular look at barriers to entry for smaller retailers.

The CC should also consider the implications of supermarket land banks where the intention is clearly to build a new store rather than restrict competitors from building. There is evidence that Tesco alone has consent for building on 56 sites and has applied for planning permission or been linked with development of a further 95. This gives Tesco significant potential for expansion compared to other retailers with smaller land banks and would allow the company to increase its market share to 45%[4]. If this expansion were to take place Tesco would further increase its power in the grocery market exacerbating all the problems which have been identified for investigation by the CC.

3. Buyer Power

We welcome the recognition that the buyer power of the big supermarkets has increased since 2000 and that this could harm consumer choice by undermining the viability of alternative smaller retailers.

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[4] More details can be found in Friends of the Earth's briefing 'Calling the Shots – how supermarkets get their way in planning decisions', January 2006

However we also urge the CC to investigate the impact of increased buyer power on suppliers. As the CC recognised in its 2000 report the trading practices engaged in by supermarkets with significant buyer power can adversely affect consumers by reducing choice, quality and innovation. We consider that the CC must look at the Supermarket Code of Practice – see below

4. Pricing behaviour

We welcome the recognition that the practices of below-cost selling and price flexing may distort competition and harm consumers. The CC concluded in its 2000 report that these practices were operating against the public interest due to the reduction in quality and choice of goods; potential loss of smaller stores; an the additional cost of groceries in some locations.

These issues have remained unresolved since 2000 and the market has become more concentrated since that time. We would urge the CC to look at existing evidence on these issues including cases brought by smaller retailers, and to concentrate on finding a workable solution. The CC should review measures taken in other countries to address these problems.

Supermarket Code of Practice

We consider that the failure of the supermarket Code of Practice to protect suppliers from the trading practices identified in the CC's report of 2000 should be a key part of the CC's investigation. There is already plenty of evidence from suppliers that the Code is ineffective. The lack of specific complaints being brought forward is a result of suppliers being afraid to be identified. We believe that suppliers will be willing to provide examples of breaches of the Code to the CC in confidence. However in amending the Code a key change must be for the dispute resolution process to be made truly independent of the supermarkets so that individual suppliers cannot be identified.

However the Code is also very vague making it hard for suppliers to prove that a breach of the Code has taken place. We consider that a Code which is more in line with the original recommendations of the CC in 2000, and put on a statutory footing, would be much more effective than the existing Code. The Code can easily be put on a statutory basis without the need for primary legislation using the powers given to the CC by sections 138 and 161 of the Enterprise Act.

We are particularly concerned about the impacts of supermarket trading practices on farmers. Consumer polls reveal a clear desire for shoppers to be able to buy local and British food which requires that British farmers are able to make a viable living. Farmers are effected by supermarket trading practices whether or not they supply the retailers directly or via a third party such as a processor. We believe it would be useful for the Competition Commission to consider how the code could be applied to farmers who do not sell direct to supermarkets especially where they supply via large companies such as dairies.

We also urge the CC to clarify how the Code can best protect overseas suppliers that supply UK supermarkets. Evidence gathered by Action Aid, Bananlink and others shows that the trading practices identified by the CC in its 2000 report are being used by the supermarkets in their dealings with overseas suppliers. The same issues arise as for UK suppliers in terms of being unable to invest in product innovation or small suppliers becoming unviable which reduces choice for UK consumers. There are other serious impacts along the supply chain such as workers being unable to make a living wage or having to work in unsafe conditions. Although such issues are not directly the responsibility of the CC they are important to consumers wishing to make more ethical purchases. Friends of the Earth considers that the CC should consider that lowering of ethical and environmental standards equates to a lowering of the quality of goods on offer to shoppers.

We acknowledge that most overseas suppliers will deal with a UK based intermediary to whom the Code will apply. The CC should therefore consider whether and how these intermediaries could then apply the Code in their dealings with suppliers (and to require all the suppliers and intermediaries up the chain of supply to apply the same terms so that are applied right back to the primary producer).

The Breaking the Armlock alliance, of which Friends of the Earth is a founding member, will be submitting more detailed suggestions for how the Code of Practice could be strengthened.

Effects on Consumers

We are very concerned by the OFT's assessment of effects on consumers and in particular its emphasis on cheap prices. We are aware that price is a key measure of consumer benefit considered by the competition authorities. However the CC needs to make a more sophisticated assessment of the impacts of low supermarket prices. As stated above the supermarkets ability to aggressively cut prices has a detrimental impact on independent retailers and can therefore reduce choice to consumers. Suppliers are often required to meet the cost of supermarket promotions – in the long run this will lead to suppliers going out of business or cutting costs with the result that there may be lower quality goods or less choice available to consumers.

We also consider that the OFT's use of average supermarket prices on a limited range of commonly bought items is too simplistic a measure of consumer benefit. Price is of course important to low income households. Food poverty effects over 4 million people in the UK[5] so this is a significant group of consumers. But the solutions to food poverty are complex and cheap prices in supermarkets are not necessarily benefiting disadvantaged communities As stated above transport costs to out-of-town supermarkets can add significantly to the shopping costs for low income families but the OFT has not taken this into account. Similarly if price promotions are on multiple purchases or bulky goods this is not necessarily easy to take advantage of for a household without a car or for elderly shoppers who live on their own and do not need to buy the quantities on offer. Price promotions are often on processed or unhealthy foods rather than on fresh fruit and vegetables so may be of limited benefit to a low income family trying to obtain a healthy diet. The OFT states that access to

[5] Sustain, April 2006, A response by Sustain's Food Poverty Project to the OFT's proposal for a grocery market inquiry

a healthy diet is not within its remit. We disagree. The CC should consider access to a healthy food as a crucial aspect of whether the market is working for consumers.

There is increasing evidence that consumers are concerned with issues other than price and that this applies to low income shoppers as well as affluent shoppers. Such issues include being able to make ethical and environmental choices. The ability to make such choices should be open to all consumers and should not be considered to be a 'niche' market as implied by the OFT.

We are also concerned by the way in which the OFT measures choice. It puts more emphasis on choice of goods sold within a large store. But a large supermarket does not offer the same diversity as a range of independent stores. The OFT acknowledges the rapid decline of specialist high street food shops including greengrocers and butchers but does not give enough weight to the impact that this has on consumer choice. Consumer polls reveal that people value local shops. For example, in a Grocer poll in 2004 44% of respondents said they would prefer to buy meat from a butcher and only 23% said they would prefer to buy meat from a supermarket.

Some aspects of consumer benefits may be harder to measure. For example the level of service provided in small independent shops; the knowledge of the staff at a specialist high street retailer, the additional services provided by a village shop. But these aspects may be extremely important to shoppers. By contrast a recent survey for Harris Interactive found that over half of Tesco shoppers say they were bored, stressed, frustrated or overwhelmed[6]

Friends of the Earth has included more details about consumer concerns in its previous submissions, which are attached, and we are willing to submit more evidence on these issues during the course of the CC investigation.

We urge the CC to take a more sophisticated view of whether the market is working for consumers. It must consider a wider range of indicators of consumer benefit than price and its must recognise that there are different types of consumer with different needs and different priorities.

Remedies

Friends of the Earth will be working with other interested organisations to put forward suggested remedies to the CC during the course of the investigation. Meanwhile we have set out below the suggestions previously made to the OFT on potential remedies.

Market share limits/divestment of stores/wholesaling

It is our view that Tesco's share of the grocery retail market is already at a point where it is damaging consumer choice and engaging in unfair trading practices with suppliers. We consider that it should be required to divest stores. The Competition Commission will need to investigate how to do this most effectively including consideration of a cap on national

[6] Harris Interactive survey reported in The Grocer, March 25, 2006

market share. It should also carry out local and regional assessments so that Tesco would be required to divest stores in areas of high dominance.

In addition, the Competition Commission could consider prohibiting vertical integration; e.g. require retailers with more than 8% of the market to divest wholesaling activities so that all retailers can have access to comparable terms; there is an analogy in beer where brewers were banned from owning too may pubs;

Local competition assessment/links to planning system

A mechanism is needed to assess the local competition impacts of new stores, the Competition Commission should investigate the best way of doing this. For example Local Planning Authorities could be required to consult the OFT over all applications for new stores submitted by or on behalf of the biggest supermarkets (those with over 8% of market share). Alternatively authority could rest with the Local Planning Authority to consider ownership in its retail policies and development control decisions concerning the biggest supermarket, this is likely to require training for local authority staff and councillors.

In the case of mergers the impacts on consumer choice should be fully assessed in the terms we have outlined above.

Measures to stop aggressive use of price flexing and below cost selling.

As stated in previous submissions the Competition Commission recognised that these practices distorted competition but no remedies have been brought forward. We agree with the Association of Convenience Stores that these practices are damaging to small stores and consumer choice. The Competition Commission should look again at these practices including gathering specific case studies from independent sources (such as local media) from c-stores and other independent shops, and by demanding full disclosure by the supermarkets themselves of local pricing details, discounts etc.

Strengthened Code of Practice and Ombudsman

This issue remains unresolved to the detriment of farmers and other small suppliers and therefore consumer choice. Friends of the Earth maintains that the Code of Practice could be made more effective without the need for further investigation. The problems are more about the ineffectual wording of the Code than the lack of compliance with it.

Moratorium on mergers

If a new investigation into the grocery retail market is conducted there should be a moratorium on mergers involving the biggest supermarkets (those with over 8% of market share) during the course of the investigation.