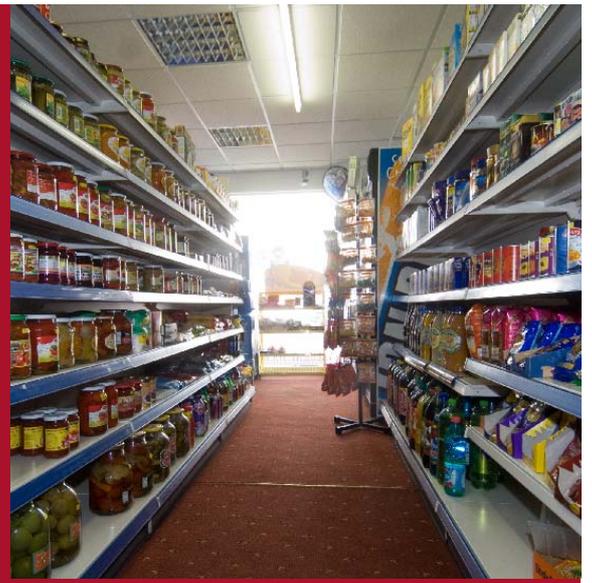


Retail in London: Working Paper C

Grocery Retailing

October 2005



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Executive summary

This working paper forms part of GLA Economics' study of London's retail sector. It considers grocery retailing in London and draws out relevant policy implications from the analysis.

Spending on retail is the largest single component of expenditure for London residents. Within retail expenditure, spending on food and non-alcoholic drink is the single biggest expenditure item. An understanding of the retail sector and within that the grocery retail market in London is therefore important.

There are three distinct forms of grocery retailing:

- *One-stop shopping* is a form of shopping where all, or a substantial part, of a household's weekly grocery requirements are purchased together in one place and during one shopping trip, rather than from a number of different outlets or during different shopping trips.
- *Top-up*, or secondary, shopping involves topping up the main weekly shop and can take place in a variety of different sized stores.
- *Convenience shopping*, which usually involves emergency or impulse purchases, takes place in a range of stores including very small stores that operate extended opening hours (including opening on Sundays).

All forms of grocery retailing tend to take place in local geographic markets. However, the density of population and the number of stores in close proximity to one another in London may mean that these local geographic markets are linked by a chain of substitution that stretches across most, if not all, of London. Indeed our analysis suggests that 93 per cent of London's population lives within one mile of a store of one of the top five grocery retailers in London (Asda, Morrisons, Sainsbury's, Tesco and Waitrose). The strength of this chain, or linkages, determines the extent to which competition in grocery retailing occurs across London as a whole, rather than in individual local markets.

Data from Experian Business Strategies suggests there are almost 9,000 grocery outlets in Greater London. Around four-fifths of these outlets are *independents*, that is, not multiple-retailers (although the precise proportion is not known owing to the generally poorer coverage of small grocery retailers in the data). Despite the high absolute number of independents, the vast majority of these outlets are small; independent grocery retailers account for around two-fifths of all grocery floor space in Greater London. In terms of actual sales, the independents' share is even smaller, accounting for around 13 per cent of spend on grocery items in London. Therefore, whilst multiple grocery retailers own around one-fifth of all stores in London they account for 87 per cent of spend on grocery items.

Office for National Statistics data shows that whilst the overall price difference for all goods and services between London and the UK as a whole was almost ten per cent in 2004, it was only three per cent for food. This may be largely due to the fact that the

large supermarket groups (Asda, Morrisons, Sainsbury's and Tesco) adopt a national pricing policy, where prices are the same for the same goods across all the group's stores (of the same store format) across the country.

Of the total costs incurred by supermarket retailers in supplying groceries in the UK, the cost of goods for resale is the largest single component, accounting for more than four-fifths of the cost. Evidence shows that the larger the buying group, the lower is the price paid for such goods from suppliers. This greater buyer power, through lower costs, can provide the scope for large retailers to invest in customer facilities or price reductions which in turn lead to further sales and through this even greater buyer power. Therefore, there is a significant cost advantage for large supermarket retailers compared to small retailers in buying goods for resale, which can lead to more sales and therefore ever increasing buyer power, further reducing the ability of small grocery retailers to compete.

Other costs likely to be particularly relevant to London are staff costs and land costs. Retail staff costs are higher in London when compared to the rest of the country. Evidence suggests that whilst there are economies of scale in staff costs, these economies exist primarily at stores that are smaller in size and diminish rapidly as store size increases. The cost of land for grocery retail is higher in London when compared to the rest of the country (whether it be land for purchase or premises to rent). The cost of land for grocery retail is also higher when compared to other countries around the world.

Analysis by the Competition Commission suggests that many of the conditions that are necessary for firms to engage in anti-competitive behaviour exist in the UK with respect to grocery retailing – although it should be noted that no supermarket retailer has been found to have engaged in anti-competitive behaviour. As noted earlier, the level of concentration in grocery retailing in London is high – higher than for the country as a whole. For instance, almost half of all grocery spending in London is accounted for by Sainsbury's and Tesco. In the largest sub-section of grocery retailing, one-stop shopping, the level of concentration is even greater with 70 per cent of one-stop shopping in London accounted for by Sainsbury's and Tesco (compared to 55 per cent for the largest two supermarkets across the country as a whole).

This analysis suggests that the vast majority of London's population is within reasonable distance (one mile) of a grocery store of one of the large five grocery retailers in London. The extent to which areas in London are underserved by retail is considered in the *Retail and Regeneration in London*¹ paper. The analysis also finds that one of the main competitive advantages of large grocery retailers compared to small grocery retailers is in the buying power of the former. This issue is considered in more detail in the *Small Retailers in London* paper,² however the reinforcing nature of greater buyer power suggests it will become more and more difficult for small grocery retailers to

¹ GLA Economics, 2005, Retail in London: Working Paper B – Retail and Regeneration

² GLA Economics, 2005, Retail in London: Working Paper – Small retailers in London (forthcoming publication)

compete with large grocery retailers over time. Indeed, the analysis shows that the grocery market in London, in terms of sales, is very concentrated – more so than for the UK as a whole. Therefore, should the exercise of market power become possible, London may be affected more than other parts of the UK, although this is an issue – should it arise – for national competition authorities rather than regional government.

1. Introduction

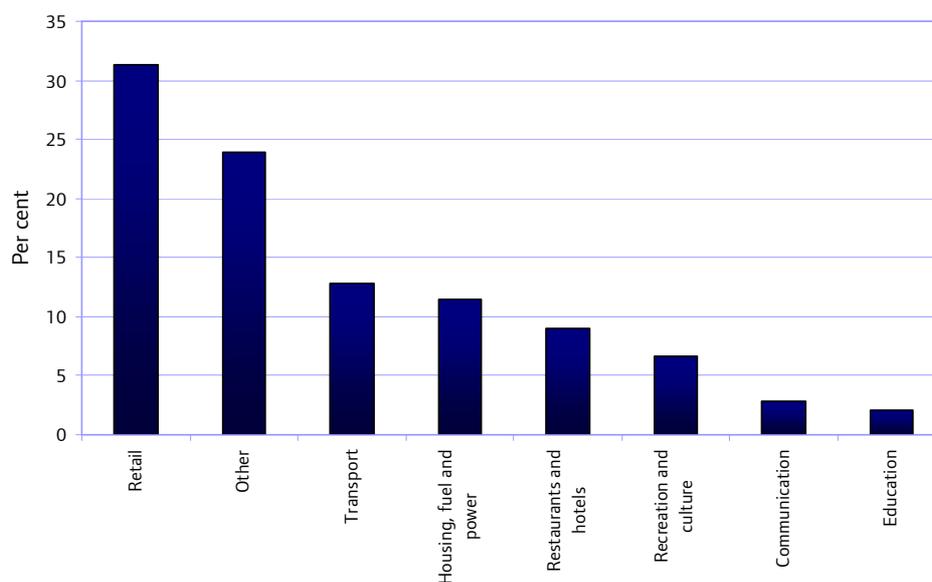
This working paper forms part of the wider GLA Economics' study of the retail sector in London and focuses on grocery retailing in London. The paper starts by looking at the spending patterns of London's residents, focusing particularly on spending on grocery items. It goes on to examine the issue of market definition – considering both the product and geographic markets relevant to grocery retailing. Product and geographic market definition is basically a framework which helps in the analysis of the environment within which businesses operate. As such it informs of the competitive constraints that are likely to act upon firms and provides information on what factors are likely to affect the prices charged by grocery retailers, for example. Therefore, market definition is probably best considered as a tool that allows a better understanding of the environment within which businesses compete with one another.

The paper then looks at the number and type of grocery retailers in London and their market shares. Costs incurred by grocery retailers are considered – both general costs and costs which are more specific to London. Finally the paper considers some of the competitive factors likely to have an impact on grocery retailing before drawing out the main conclusions and any implications from this analysis for public policy.

2. Expenditure by London residents

Figure 2.1 shows data from the Expenditure and Food Survey for 2002/03. It shows that just under one-third of London residents' expenditure goes on retail – the single largest expenditure group. This includes spending on food and drink, clothing and footwear, audiovisual equipment, games, books, and toiletries amongst other things. The share would be higher if the retail sale of vehicles and motor parts was included, but for these purposes the retail sale of vehicles and motor parts is included in the transport category.

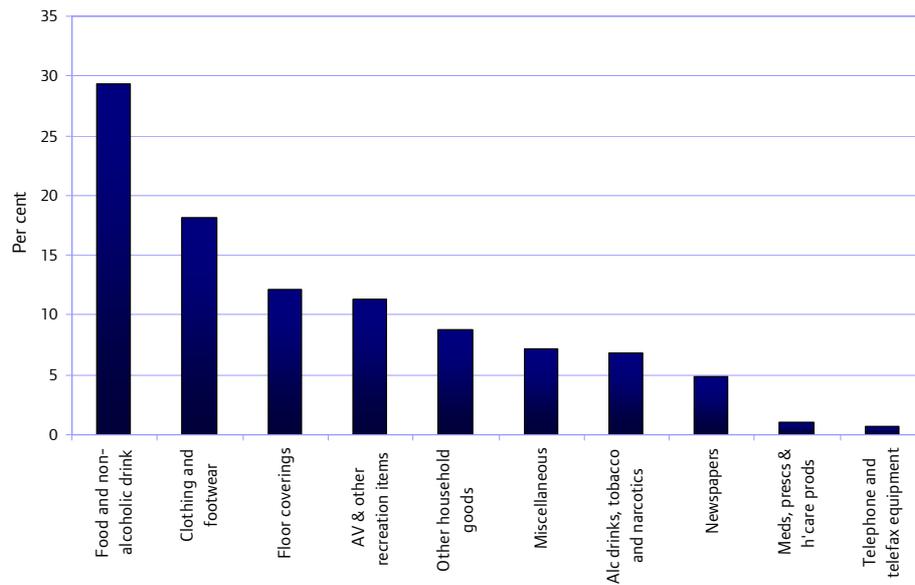
Figure 2.1: Share of expenditure on various goods and services by London residents, 2002/03



Source: Office for National Statistics, 2002/03, *Family Spending: A report on the 2002-2003 Expenditure and Food Survey*

Figure 2.2 shows how the amount spent on retail breaks down. It shows that expenditure on groceries is the largest single item of expenditure, accounting for almost 30 per cent of London residents' retail spend. Therefore, it is clear that it is important to understand the retail sector in London and within that the grocery retail sector.

Figure 2.2: Share of retail spending on various goods by London residents



Note: Floor coverings includes furniture, furnishings, carpets and other floor coverings; AV = audio-visual; Alc = Alcoholic; Meds, prescs & h'care prods = Medicines, prescriptions and healthcare products.

Source: Office for National Statistics' Expenditure and Food Survey, 2002/03

3. Market definition

Product market definition

The Competition Commission (CC) conducted a detailed investigation of grocery retailing in 2000³ and then again in 2003 as a result of the investigation into the acquisition of Safeway⁴. In what follows, the paper refers to the CC's 2000 supermarkets report as the 2000 report and to the 2003 Safeway report as the Safeway report.

Whilst some supermarkets have increased their sales of non-food items since 2000⁵, non-food items are very rarely cited as a main reason for visiting or choosing to shop at a grocery supermarket. For instance, a report by Mintel⁶, showed that whilst 55 per cent of the 1,011 adults surveyed said that they would like to shop for groceries at a supermarket where they could also buy non-food items such as clothing and housewares, 74 per cent said that they would like to shop for groceries at the store which had the widest range of foods, and 85 per cent said that a good range of fresh foods was particularly important in attracting them to a store. Moreover, according to Tesco, consumer surveys show that non-food never comes into the top ten reasons why customers choose stores. Similarly, according to Asda, its food business drives traffic into its stores and competition with other supermarkets centres on grocery offers. As a result, the CC in its 2000 report decided that competition between grocery retailers takes place, in the main, on grocery items and so non-food goods should not be considered as part of the economic market.

One-stop shopping

In the 2000 report, in order to best understand grocery⁷ retailing, the CC concluded that one-stop shopping constituted an economic market. In effect this means that the CC saw one-stop shopping as distinct from other forms of grocery shopping. One-stop shopping is a form of shopping whereby all or a substantial part of a household's weekly grocery requirements are purchased together in one place and during one shopping trip, rather than from a number of different outlets or during different shopping trips. The other forms of grocery shopping, considered in more detail a little later are 'top-up' or secondary shopping and convenience shopping.

In support of its view about one-stop shopping, a survey conducted by the CC found that 70 per cent of consumers carry out their main grocery shopping once a week. However, this finding is for the UK as a whole and is likely to be a result of a combination of factors that may not be as relevant to London as the rest of the country. In particular the density of population in London, which results in a large number of

³ Competition Commission, 2000, Supermarkets: A report on the supply of groceries from multiple stores in the UK, Cm 4842

⁴ Competition Commission, 2003, Safeway plc and Asda Group Limited (owned by Wal-Mart Store Inc), Wm Morrison Supermarkets plc, J Sainsbury plc and Tesco plc: A report on the mergers in contemplation, Cm 5950

⁵ For instance see paragraph 7.263 of CC's Safeway report.

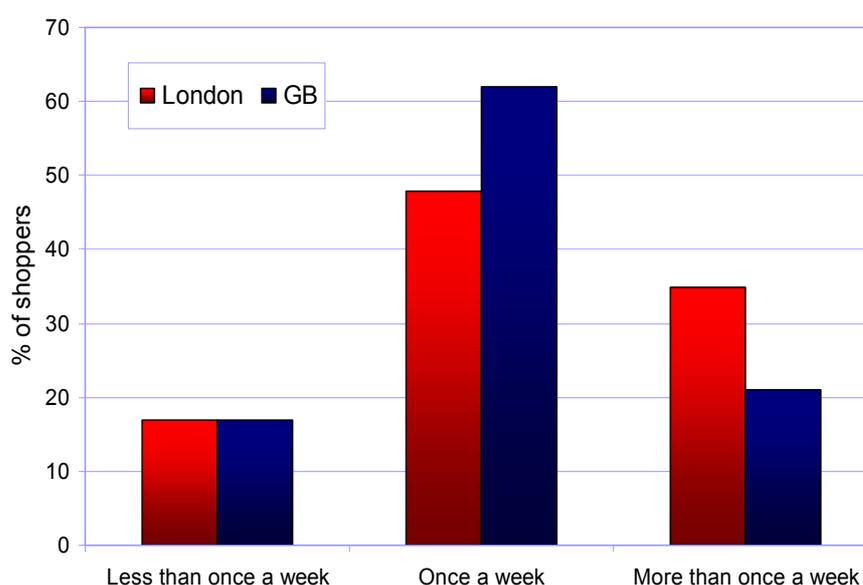
⁶ Mintel, June 2003, UK Retail Briefing

⁷ Groceries include food, drinks (alcoholic and non-alcoholic), cleaning products, toiletries and household goods, but exclude petrol, clothing, DIY products and financial services.

grocery stores in relatively close proximity to one another (as shown in Section 3: Market Definition), and the lower level of car ownership in London are two factors that might suggest that one-stop shopping is less relevant to consumers in London as compared to the rest of the country. This is because one-stop shopping is more dependent on car travel (in order to transport groceries home) than other forms of grocery shopping and is more likely to be the most usual shopping pattern in an area that is not particularly well served by a number of grocery stores (so trips to the store are less frequent)⁸. Whilst the CC data looks at shopping patterns for the UK as a whole, data from IGD⁹ can be used to look at this issue at the London level and enables comparisons to be drawn with Great Britain (GB).

Data from IGD's *Shopper Insight* survey conducted in 2004 finds, similar to the CC results, a high proportion of weekly shoppers for GB. Figure 3.1 shows that in GB as a whole 62 per cent of shoppers go grocery shopping once a week with around one-fifth shopping more frequently than once a week. Figure 3.1 also shows that in London, around half of shoppers go grocery shopping each week, with around one-third shopping more frequently than weekly. Therefore, Figure 3.1 shows that, as might be expected, a higher proportion of people shop for groceries more frequently in London when compared to the rest of the country, but despite this the majority (around two-thirds) of shoppers in London shop weekly, or less frequently.

Figure 3.1: Frequency of main shop



Source: IGD

The CC analysis also found that 80 per cent of consumers nearly always, or usually, use the same supermarket for grocery shopping and that 80 per cent of their grocery shopping expenditure was on their main shop (rather than top-up or convenience shopping). This, in addition to evidence on the volume of groceries purchased on a one-

⁸ For more detail on changes in consumer shopping patterns over time, see: I Clarke, P Jackson, and A Hallsworth, 2004, *Retail Competition and Consumer Choice*, Lancaster University Management School

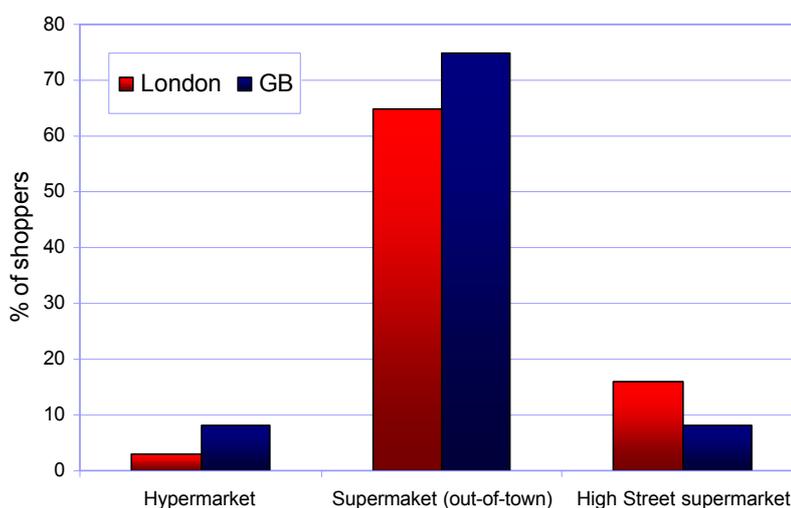
⁹ For more information about IGD, view: <http://www.igd.com/>

stop shop and consumers' preference to switch to another supermarket (were they too switch from their regular supermarket) rather than a variety of smaller shops, was used as evidence that one-stop shopping is distinct from other forms of shopping. Although the IGD data suggest that London consumers tend to shop for groceries more frequently than GB consumers as a whole, this difference is unlikely to be enough for the one-stop shopping conclusion to be irrelevant for London.

Because of the product range and depth required in order to provide a one-stop shop, a minimum store size of 1,400 square metres is thought to represent a reasonable threshold for categorising a store as a one-stop shop. This is because in a store below 1,400 square metres it would, on average, be very difficult to provide the range and depth of goods in order for consumers to fulfill their main shopping needs in one visit.

Data from IGD looks at the outlet used by customers for their main shop. Figure 3.2 shows that the majority of consumers conduct their main shop in an 'out-of-town' supermarket, although the proportion is slightly lower in London when compared with GB as a whole. Figure 3.2 also shows that when compared with GB more London consumers tend to use high street supermarkets for their main shop. This finding is likely to be a result of the high number of town centres and high streets in London compared to the rest of GB rather than any significant difference in shopping habits. This finding may also be a result of the lower level of car ownership in London, particularly inner London, compared to the rest of the country. The relationship between car ownership and out-of-town developments is considered in a bit more detail in GLA Economics' forthcoming publication, *Retail competitiveness and the planning system in London*¹⁰.

Figure 3.2: Outlet typically used for main shop



Source: IGD

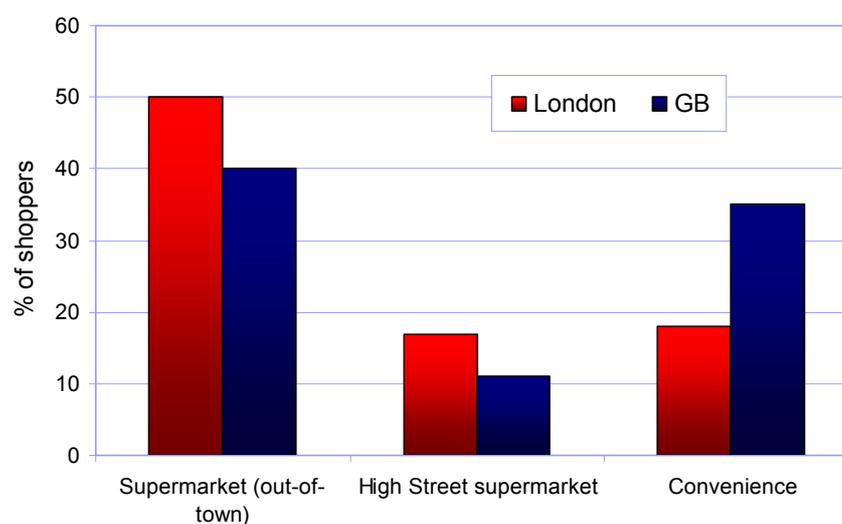
¹⁰ GLA Economics, 2005, Retail in London: Working Paper - Retail competitiveness and the planning system in London (forthcoming publication)

Top-up, or secondary, shopping

As noted earlier, other shopping trips designed to top-up or to complement the main shopping trip (sometimes referred to as top-up or secondary shopping) are usually considered to be distinct from one-stop shopping. The 2000 report recognised that whilst such secondary shopping could take place in stores above 1,400 square metres, it would also take place in stores below 1,400 square metres.

The IGD data also looks at the outlets used for top-up shopping. Figure 3.3 shows that half of London consumers use out-of-town supermarkets for their top-up shopping. It also shows that compared to GB as a whole, fewer consumers in London use convenience stores for their top-up shop.

Figure 3.3: Outlet typically used for top-up food shopping



Source: IGD

Whilst IGD data suggest that a lower proportion of consumers in London do their main grocery shop once a week when compared to GB as a whole, nevertheless the data shows that two-thirds of London consumers shop for groceries once a week or less frequently. Moreover, whilst Londoners shop for groceries more frequently than consumers in GB as a whole, the data suggest that they tend to do more of their top-up grocery shopping in out-of-town or high street supermarkets – which tend to be used for one-stop shopping – rather than convenience outlets when compared to GB as a whole.

Convenience shopping

A third form of shopping is usually defined as convenience shopping. This form of shopping tends to involve emergency or impulse purchases – purchases that might be considered time sensitive. In considering the merger of Tesco and T&S (predominately a small store grocery retailer, ie stores under 300 square metres in size), the Office of Fair Trading (OFT) focused on convenience retailing in supermarkets and convenience stores. Convenience stores tend to have extended opening hours, offer a range of products and serve a local community. According to the Association of Convenience Stores (ACS) the normal industry definition of a convenience store is a store of less than

280 square metres (3,000 square feet) in size. Stores above 280 square metres are restricted to opening for six hours only on a Sunday in contrast to stores below 280 square metres for which there are no such restrictions.

Therefore, three distinct grocery product markets might be considered: the market for one-stop shopping which is carried out in stores of 1,400 square metres or more; top-up, or secondary shopping; and 'convenience' shopping which tends to be more time sensitive and includes shops of less than 280 square metres.

Geographic market definition

Geographic market definition looks at the geographic area over which firms compete with one another.

Shopping patterns are essentially local. Table 3.1 shows that the main reason for using a store from consumer research is, 'Can get there easily', which emphasises the importance of proximity to a store for the store's sales.

Table 3.1: Reasons for using main store, 2003 (%)

Reasons	Main users of:					
	All	Asda	Morrisons	Safeway	Sainsbury's	Tesco
Can get there easily	65	57	56	79	62	66
Low prices	55	73	74	51	15	41
Good quality food	44	44	44	49	63	42
Good range	40	45	40	38	52	40
Good service	28	32	26	32	29	23

Source: Taylor Nelson Sofres (TNS) research from CC Safeway report

Moreover, data from retailers show that most consumers drive no more than ten minutes to a supermarket in urban areas and no more than 15 minutes in non-urban areas for their one-stop shopping needs. Indeed, Asda, Morrisons, Sainsbury's and Tesco all derive between 70 and 90 per cent of their sales from consumers living within ten minutes of their store¹¹. Therefore the overwhelming majority of store sales come from within a ten-minute radius of the store.

Moreover, using the standard methodology for defining geographic markets¹², the market for one-stop shopping is essentially local, because of the limited distance that most consumers are prepared to travel for their main regular shopping trip. However, as noted in the Safeway report, Tesco argue that chains of substitution mean that the geographic market is national because stores outside a particular local area constrain the actions of stores in other areas. Similarly, Morrisons claim that, in some instances, there are clear chains of substitution, where stores are constrained by stores located around the perimeter of the store in question's catchment area. Appendix A considers the issue

¹¹ See paragraphs 5.215 to 5.218 of CC's Safeway report.

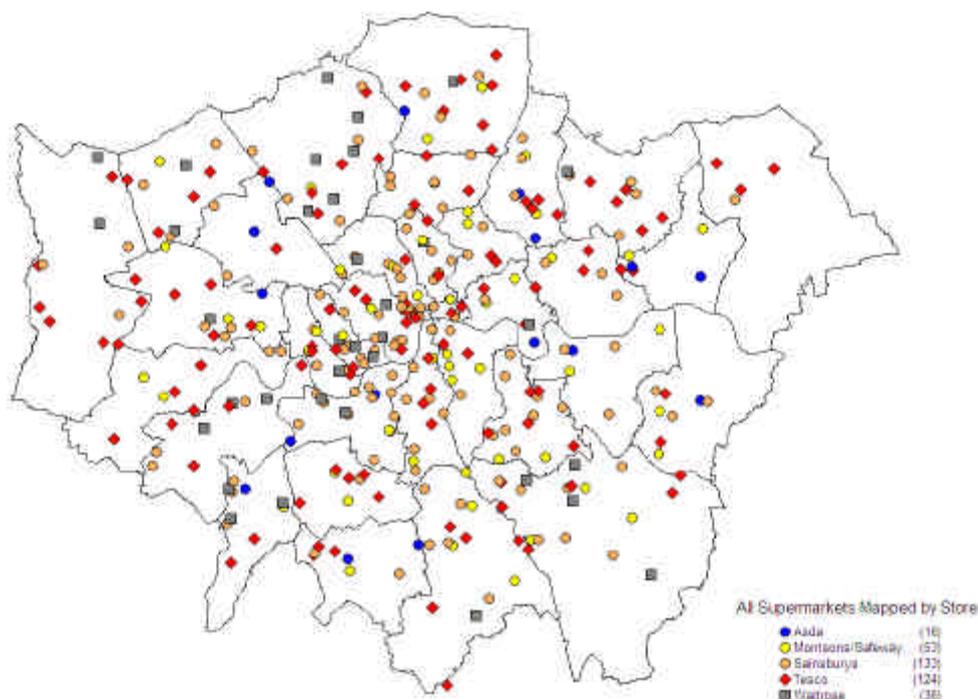
¹² The SSNIP (or hypothetical monopolist) test (see paragraph 5.3 of the CC Safeway report).

of chains of substitution in more detail, but in the Safeway report, the CC did not accept that such chains would be sufficiently powerful or widespread to make the market national (see Appendix A for more detail).

Analysis of the spread and overlap of all grocery retailers across London was beyond the scope of this report. However, a simple model was used to understand better the amount of overlap between the customers of the large grocery retailers in London. Locations of Tesco, Sainsbury's, Morrisons, Waitrose and Asda stores were recorded from the respective company website (or other information) and plotted on a map. Figure 3.4 illustrates the spread of grocery stores across London.

Total resident population figures at output area level from the Census 2001 were obtained and it was assumed that the population is evenly distributed within the output area. A one-mile concentric ring buffer was drawn around each store and the number of residents living within that area was calculated. This showed that 93 per cent of London's population fell within a one-mile radius of one of these stores. The analysis was re-run using a radius of half a mile (which using National Travel Survey data equates to an 11 minute walk). Around 60 per cent of London's population is within half a mile – walking distance – of one of the stores of Asda, Morrisons, Sainsbury's, Tesco or Waitrose. This, together with Figure 3.4, suggests that for most of London the catchment areas of the various stores do overlap quite significantly.

Figure 3.4: Spread of grocery stores for the five large grocery retailers across London



Source: GLA Economics based on information from company websites

The local nature of geographic markets is relevant to top-up or secondary and convenience shopping as well as one-stop shopping, although the area considered may be smaller than that for one-stop shopping. Indeed, in its consideration of Tesco's acquisition of T&S, instead of drive times, the OFT considered the overlap between Tesco and T&S stores within one mile of the T&S store. As noted earlier, the overwhelming majority of T&S stores in this transaction were under 300 square metres in size.

It has been argued that the internet acts to widen the geographic market by making the goods and services on offer at stores outside an individual's usual catchment area an effective choice. Research suggests that whilst the use of the internet as a sales channel has grown across all types of retailer, it has been fastest amongst the large retailers¹³. Moreover, other research suggests that internet retailing is likely to complement rather than replace traditional store-based retailing¹⁴. Indeed, in the CC's Safeway report, Sainsbury's said that although internet sales had expanded rapidly over the last few years, they still accounted for less than one per cent of its turnover. The same proportion applied to Asda. In the case of Tesco, internet sales account for about two per cent of turnover. Morrisons (which now owns Safeway) does not have an internet sales operation. As a result, at present and for the foreseeable future, the internet is not likely to have a significant effect on the geographic market.

Therefore, analysis of grocery retailing across the UK suggests that the geographic market for grocery retailing (be it one-stop, top-up or convenience) is local. However, the situation in London is likely to be different to the rest of the UK. In London, because of the density of population, a number of stores are within close proximity of one another. This might result in individual stores affecting competition in areas outside of their normal sphere of influence (owing to chains of substitution). Therefore, in London it may be that the geographic market is wider, covering most, if not all, of London (see also Appendix A).

¹³ F Ellis-Chadwick, N Doherty and C Hart, 2002, Signs of change? 'A longitudinal study of internet adoption in the UK retail sector' *Journal of Retailing and Consumer Services*, 2002, 9, pp 71–80

¹⁴ P James, C Clarke-Hill and D Hillier, 2002, '(R)etailing in the UK' *Marketing Intelligence & Planning*, 2002, 20/4, pp 229–233

4. Market share

Recent work by Experian¹⁵ provides information on the number of grocery outlets across London and the market shares of grocery retailers in London. Experian created a database of grocery retail outlets in Greater London based on retail locations, Goad data¹⁶ and National Business Database data. Table 4.1 shows that in terms of the 9,000 or so grocery stores across London, around 80 per cent are independents. Looking at floorspace shows that just over two-fifths of grocery floorspace in London is owned by independents, with just under one-third of grocery floorspace being supermarket and superstore respectively. This serves to illustrate the vast number of independent stores operating in the grocery sector in London. It also illustrates that independents are primarily small stores because whilst they account for four-fifths of the number of stores, they account for only two-fifths of floorspace.

Table 4.1: Distribution of grocery stores in London

	Number of stores	As a percentage of total stores	Floorspace (m²)	As a percentage of total floorspace
Independents	7,183	80.8	1,008,457	41.6
Supermarkets	1,531	17.2	721,783	29.8
Superstores	181	2.0	693,329	28.6
Total	8,895		2,423,569	

Note: Independents are non-multiples companies with less than five stores. Supermarkets are stores with a trading floorspace of less than 2,500 square metres, often with car parking. Superstores are stores with a trading floorspace of more than 2,500 square metres, with supporting car parking. This data includes an extra 2,400 independent grocery stores not identified in Experian's Goad data but which are identified in Experian's National Business Database (see paragraphs 4.13, 4.44 and 4.45 of GLA's *Convenience Goods Floorspace* report).

Source: GLA Economics based on data from Experian

Market shares based on floorspace

Floorspace data from other sources show that Tesco, Sainsbury and Morrisons (formerly Safeway) have significant market shares in parts of London. Table 4.2 shows areas where each of these companies has a significant market share (based on the retailers' share of floorspace by postal area).

¹⁵ Greater London Authority, 2005, London Town Centre Assessment (Stage 1): Convenience Goods Floorspace Need in London

¹⁶ For more information about GOAD, view: <http://www.business-strategies.co.uk/Content.asp?ArticleID=401>

Table 4.2: Postal areas with high market (floorspace) shares for selected British retailers, 1999

Supermarket	Postal area	Floorspace share (%)
Morrisons*	East Central London	36.0
	West Central London	49.4
Sainsbury's	East London	30.1
	Bromley	30.2
	South East London	31.7
	South West London	39.1
Tesco	Sutton	32.0
	Enfield	36.1
	West Central London	37.0
	Romford	38.8
	East Central London	41.8
	Twickenham	45.4
	Southall	61.5

Note: *Stores that were formerly Safeway stores

Source: *Regional Studies* Vol 36.6, pp 643–659, Carfax Publishing: Taylor & Francis Group

Table 4.2 shows that there are many areas in London where one grocery retailer accounts for a significant proportion of the market (in terms of floorspace). In addition, it shows that in East Central and West Central London, two grocery retailers account for 77.8 and 86.4 per cent of total floorspace in the area, respectively.

Table 4.3 shows areas in London where Sainsbury's and Tesco have a combined market share, based on floorspace, of over 50 per cent.

Table 4.3: Postal areas with high market shares for Tesco and Sainsbury's combined, based on floorspace

Postal area	Floorspace share (%)
Romford	55.7
Sutton	56.1
Ilford	57.2
Twickenham	61.3
Enfield	62.8
Southall	78.6

Source: R Poole, G P Clarke and D B Clarke, 2002, 'Grocery Retailers and Regional Monopolies' *Regional Studies*, 2002, Vol 36.6, pp 643-659

The paper from which the information in Tables 4.1 and 4.2 is drawn¹⁷ concludes that this data demonstrates the dominant position of Tesco and Sainsbury's in the South East of England. It states that, 'the forced sale of land holdings in the South East would undoubtedly help to increase competition and give other retailers the opportunity to expand their currently limited presence'.

The Experian work referred to earlier also shows the split of expenditure in the different store types. Table 4.4 shows that only 13 per cent of grocery expenditure in London is spent in independent stores with over half of grocery expenditure occurring in superstores.

Table 4.4: Grocery expenditure by store type

	Total spend (£ million)	Share of sales (%)
Independents	1,357	12.6
Supermarkets	3,797	35.3
Superstores	5,588	52.0
Total	10,742	

Note: Definitions are as set out in Table 4.1.

Source: GLA Economics based on data from Experian

The Experian work also illustrates the distribution of grocery spending in Greater London by company. Table 4.5 shows that Sainsbury's and Tesco each account for around one-quarter of all grocery spend in London. It also shows that the five largest grocery retailers in London (Sainsbury's, Tesco, Morrisons, Asda and Waitrose) account for around £7 of every £10 spent on grocery items. Marks and Spencer, Iceland and Somerfield account for a further 11 per cent. Therefore, it is clear that whilst there are a large number of independent stores, in terms of turnover, the large retailers tend to dominate the grocery market in London. In what follows, the market shares in the one-stop shopping grocery market are considered before the market for stores of less than 1,400 square metres is considered.

¹⁷ R Poole, G P Clarke and D B Clarke, 2002, 'Grocery Retailers and Regional Monopolies' Regional Studies, 2002, Vol 36.6, pp 643-659

Table 4.5: Distribution of grocery spend in London, 2001

	Total spend (£ million)	Share of sales (%)
Sainsbury's	2,754	25.6
Tesco	2,547	23.7
Morrisons	881	8.2
Asda	753	7.0
Waitrose	529	4.9
Marks & Spencers	483	4.5
Iceland	479	4.5
Somerfield	250	2.3
Londis	174	1.6
Co-op	165	1.5
Lidl	144	1.3
Costcutter	143	1.3
Budgens	108	1.0
Kwik-Save	87	0.8
Netto	64	0.6
Aldi	44	0.4
Spar	39	0.4
Others	1,097	10.2
Total	10,741	

Source: GLA Economics based on data from Experian

Market shares for one-stop shopping

Given the size of store required to provide a one-stop shop, the CC concluded in both the 2000 report and the Safeway report that only a small number of grocery retailers compete in the one-stop shop market.

Table 4.6 uses data from the Safeway report and so is different to the Experian data used above. The data shows the market share of the main one-stop shop grocery retailers in London compared to GB as a whole. It shows that Tesco and Sainsbury's together account for around £7 of every £10 spent on one-stop shopping in London. This finding is perhaps not too surprising when the coverage of London by Sainsbury's and Tesco stores, shown in Figure 3.4, is considered. Indeed that analysis suggests that considering Sainsbury's and Tesco stores only, around 82 per cent of London's population is within one mile of a store¹⁸. The data below shows that the market is more concentrated in London when compared to GB as a whole.

¹⁸ It should be noted, however, that this includes the smaller format stores of Sainsbury's and Tesco which are not 'one-stop' shops.

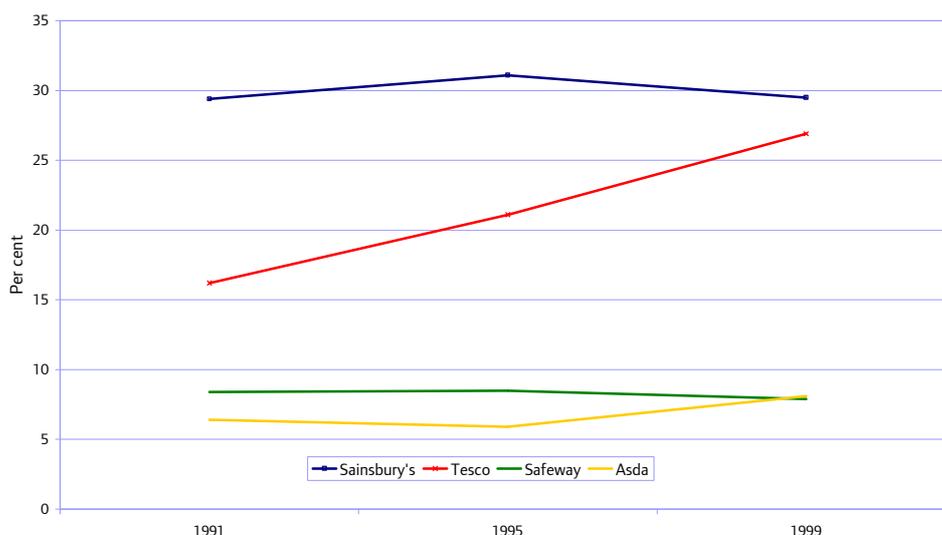
Table 4.6: Shares of grocery sales for the largest four supermarkets for stores over 1,400 square metres for the year ended March 2003

	GB (%)	London (%)
Tesco	32.3	33.4
Sainsbury's	22.7	36.8
Asda	19.4	11.6
Morrisons*	20.1	10.2
Other	5.5	8.0
2-firm concentration ratio	55.0	70.2

Note: *Morrisons includes Safeway.

Source: CC Safeway report, Table 5.18, Chapter 5

Figure 4.1 uses data from Taylor Nelson Sofres Superpanel and shows the trend in market shares in London over the past decade. It shows that Tesco's market share has increased markedly over the past decade with little sizeable change in the other main supermarkets' market share.

Figure 4.1: Change in market shares in London in past decade

Source: TNS Superpanel taken from S L Burt and L Sparks, 2003, 'Power and Competition in the UK Retail Grocery Market' *British Journal of Management*, 2003, **14**, pp 237–254

Sales in stores below 1,400 square metres

In contrast to the situation with one-stop shops (where only a few supermarkets compete with one another for trade), and as shown earlier, the number of firms competing for top-up, secondary or convenience grocery shopping is much greater and includes Marks and Spencer, Aldi, Lidl, Netto, Dillons/M&W, Spar, Costcutter, Londis, Mace, Stop and Shop, Morning Noon and Night, and Cullens, for example. At the convenience end of the spectrum, the market is even more fragmented with a large number of independent operators adding to the competition.

Illustrating the greater number of competitors in top-up and convenience shopping, Table 4.7 shows the market shares of the four largest supermarkets in stores of less than 1,400 square metres for 2003 in GB. These shares are based on TNS data and underestimate the shares of the large supermarkets for top-up and convenience shopping because some of that shopping takes place in stores over 1,400 square metres. As the four large supermarkets have more stores over 1,400 square metres, their share of top-up, or secondary, shopping will be higher than is illustrated in Table 4.7 (which only considers sales in stores of less than 1,400 square metres).

Table 4.7: Shares of sales (percentages) for the largest four supermarkets for stores less than 1,400 square metres in GB for the year ended April 2003

Store	% of sales
Tesco	7.4
Morrisons	7.2
Sainsbury's	4.3
Asda	0.1
Others	81.0

Source: TNS grocery data taken from CC Safeway report

Looking at the share of sales in stores of less than 1,400 square metres across the regions, Tesco's regional shares are broadly similar to its overall GB share. However, Sainsbury's share varies between the regions of GB. It has the second highest share in London (17 per cent), the largest share being held by Waitrose at 20 per cent. Before it was taken over by Morrisons, Safeway's share was strongest in five regions: London, the South, the North-East, Yorkshire and in particular Scotland. This shows that as with one-stop shopping, top-up shopping is more concentrated in London than in the rest of GB.

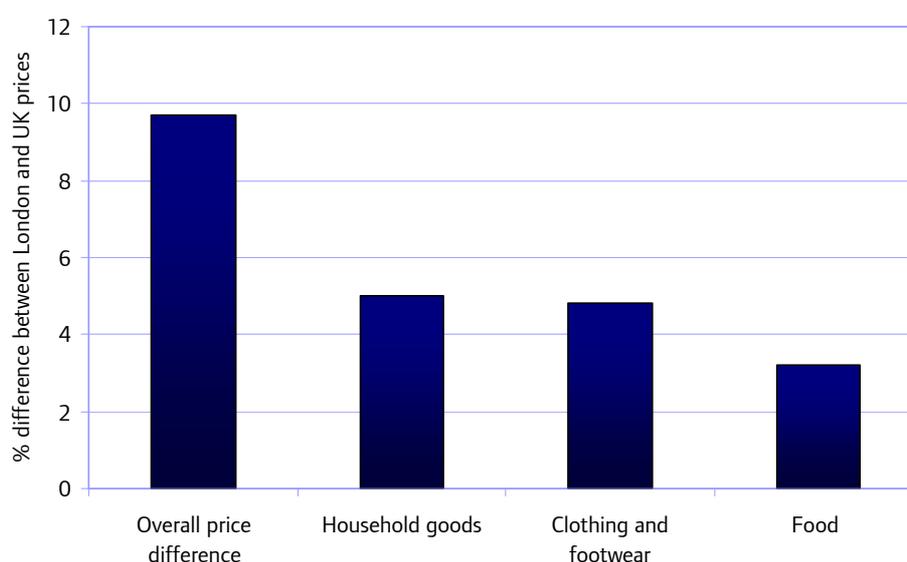
Furthermore, it is likely that the shares of Tesco and Sainsbury, in particular, have been increasing and are likely to increase further as more of their smaller format stores (such as the Tesco Metro and Sainsbury's Local formats) are opened. In addition, Tesco's share in London will be increased with their recent purchase of 45 Adminstore Limited stores, which trade primarily in central London.

5. Prices

In this section the difference in the price of food in London compared to the UK as a whole is considered. The pricing policies of the large supermarket retailers are also considered before going on to look at the costs incurred by supermarkets in the next section.

The Office for National Statistics (ONS) provides data on price differences between regions. Figure 5.1 shows the difference between prices in London and the UK as a whole. It shows that, on average, prices in London are around ten per cent higher than in the UK as a whole. The size of this difference is driven primarily by the higher housing costs in London when compared to the UK as a whole. Figure 5.1 also shows that prices for food were around three per cent higher in London when compared to the UK as a whole.

Figure 5.1: Price differences for London compared to the UK, 2004



Source: ONS, February 2005, *Economics Trends*

All the major supermarkets (Asda, Morrisons, Sainsbury's and Tesco) have a national pricing policy; that is, they set the same price for the same product in all of their stores. Sainsbury's and Tesco set the same prices for their products in each store format. The prices in Tesco Metro and Tesco Express formats are slightly higher than the prices in Tesco's other store formats (such as Tesco Extra for example). Similarly, Sainsbury's sets slightly higher prices in its Sainsbury's Local format as compared to its superstores. In the Safeway report, Tesco said the higher prices in its Tesco Metro and Express formats were a result of the higher operating costs of such formats.

Therefore, one reason why food prices are slightly higher in London compared to the rest of GB may be due to the greater prevalence of Tesco and Sainsbury in the South East (including London) who charge different prices in their different store formats. That is, the smaller store formats that Sainsbury's and Tesco operate charge higher

prices than the larger store formats they operate. If there are more smaller store formats in London, or the South East, when compared to the rest of the UK then the average price in London and the South East will be higher than in the rest of the UK (simply owing to the greater prevalence of smaller store formats in London and the South East when compared to the rest of the UK).

However, another reason for the higher price of food in London compared to other areas may be due to the cost differences in London compared to the rest of GB and the impact of this on the prices charged by other supermarkets and grocery retailers in London.

6. Costs

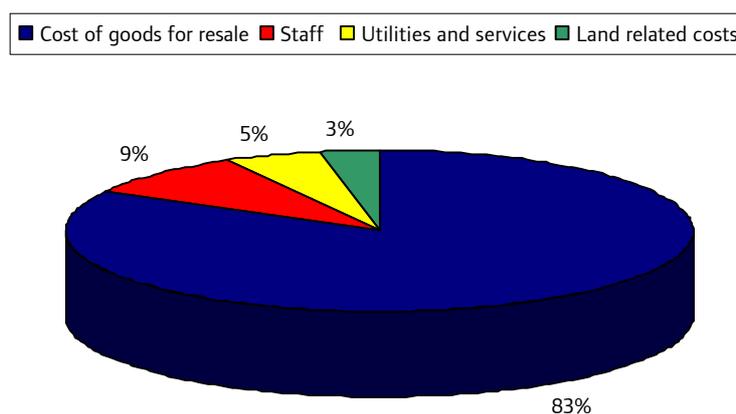
General costs

This section looks at the main components of costs faced by grocery retailers. The analysis primarily focuses on the costs for one-stop shop retailers for which data is readily available. However, many of these costs will be similar to those incurred by other grocery retailers.

As Figure 6.1 shows, in its 2000 report the CC found that, on average, the cost of supplying groceries from Asda, Morrisons, Safeway, Sainsbury and Tesco across the UK comprised of the cost of goods for resale (83 per cent) and operating costs which in turn comprised of the following:

- Staff costs (nine per cent)
- Other operating costs (five per cent), consisting of non-staff operating costs, including utilities, outsourced activities and bought-in services (for example cleaning), but excluding rent and rates
- Capital costs (three per cent), comprising land-related costs, rent, rates, and depreciation of land and property.

Figure 6.1: Cost of supplying groceries



Source: CC 2000 report

Cost of goods for resale

As part of its analysis in the 2000 report, the CC analysed the prices paid by grocery retailers for the top five branded lines from 26 large suppliers.

The analysis found that the large supermarkets, on the whole, paid less than the small supermarkets, with Tesco, Sainsbury, Asda, Somerfield and Safeway paying the lowest prices. The results are given in Table 6.1.

Table 6.1: Suppliers' top five lines: Supermarkets' price paid relative to Tesco's prices

Supermarkets	Lines	Index of prices: 100 = Tesco price	Standard deviation	% of lines for which prices paid is less than Tesco
Tesco	126	100.0		
Sainsbury's	122	101.6	10.0	48
Asda	124	102.3	10.2	32
Somerfield	125	103.0	8.9	31
Safeway	121	103.1	7.7	32
Morrisons	118	104.6	10.2	20
Iceland	66	105.3	13.8	23
Waitrose	103	109.4	13.0	15
Booth	82	109.5	12.3	17
Netto	24	110.1	11.5	21
Budgens	70	111.1	14.4	14

Source: CC analysis of supplier information

Table 6.1 shows that small supermarket retailers pay more for supplies. In this instance Waitrose, for example, pays over nine per cent more, on average, for its goods when compared to Tesco.

For comparison, Table 6.2 shows the relative prices paid by other types of retailers. It can be seen that all these categories of retailers paid much higher prices than the major supermarket buyers.

Table 6.2: Suppliers' top five lines: prices paid by other retailers

Retail category	Number of lines	Price relative to average one-stop shop grocery retailer price (%)	Standard deviation (%)
Warehouse clubs and wholesalers	114	108.7	11.0
Voluntary chains	114	105.4	8.6
Other retailers	96	103.7	11.3

Source: CC analysis of supplier information

Therefore, in general, the larger the firm the lower is the purchase price achieved. Work by Dobson, Waterson and Chu¹⁹ finds that growth of a supermarket chain increases organisational scale, which provides lower unit costs through greater buying power. As a consequence, sales and profits increase which provides the capital and scope to invest in attractive customer facilities (branding/quality/range extension/service etc) or in price

¹⁹ Summarised in S L Burt and L Sparks, 2003, 'Power and Competition in the UK Retail Grocery Market' British Journal of Management, 2003, **14**, pp 237–254. See also P W Dobson, 2003, 'Competition and Collaboration in European Grocery Retailing' European Retail Digest, Autumn 2003, Issue 39, pp 19–20.

reductions, which in turn lead to a further sales increases and relatively lower costs. As a result the potential arises for a 'virtuous circle' of growth dominated by one or two organisations, whose lower unit costs enable them to assume market leadership providing they continue to offer an attractive customer package. Without the same advantages of scale and lower unit costs, the subordinate chains are unable to compete fully on the same terms.

Therefore, the main cost incurred by grocery retailers in the UK is the cost of goods for resale and analysis shows that the larger the buyer, the lower are the prices paid for goods. Large supermarkets, therefore, have a significant cost advantage over small grocery retailers; an advantage that is likely to lead to further increases in buyer power making it more difficult for small retailers to compete with the large grocery retailers.

Operating costs

Staff costs, which as noted earlier are the second biggest single item of cost, and other operating expenditure are incurred in all aspects of one-stop shop retailers' operations. For Asda, Morrisons, Safeway, Sainsbury and Tesco operating costs are principally incurred in store costs (75 per cent), distribution costs (13 per cent) and overheads (12 per cent).

Store costs

The operating costs of individual stores vary widely, both between operators and according to size, location and other factors. In its 2000 report, the CC analysed the store costs incurred by Asda, Morrisons, Safeway, Sainsbury and Tesco.

The major direct cost of running a store is labour. The CC found labour costs to be lowest for the hard discounters and highest for retailers which use quality of service as a major selling point. Other costs include utility bills, service contracts (for example, for cleaning), rent and rates.

Staff costs

Staff costs at a given store depend upon:

- The size of the store (as measured, for example, by net sales area)
- The level of activity at the store (as measured, for example, by the level of sales)
- The quality of service offered (in terms of range of products, queuing time, opening hours and so on)
- The level of additional services provided (bakeries, crèches, cafes and so on)
- Location (since wage rates differ across the country)
- Company pay rates and other terms and conditions of service
- The amount of manufacturing, processing and packing performed in-store
- Levels of efficiency.

Most of the above affect staff numbers; *location* and *company pay rates and other terms and conditions of service* affect wage rates.

Data from the Labour Force Survey (LFS) shows that the mean retail wage in London is around 49 per cent higher than in the rest of the UK. However, mean wages can be affected by small numbers of high earning individuals. As a result, a more informative measure of the difference in wages is the median wage – where the difference between London and the rest of the UK is 30 per cent.

The CC's 2000 report examined the wage rates paid by Asda, Morrisons, Safeway, Sainsbury and Tesco in different regions and compared them with average wage rates across GB, based on data from the New Earnings Survey (NES). The CC found that the wage rates of the major supermarkets tended to reflect the national pattern but in a less pronounced fashion (see Table 6.3), suggesting that their pay policies tend to some extent to offset regional variations. For instance, Table 6.3 shows that NES data for 1999 suggests that retail staff in London are paid around 17–20 per cent more than the average across GB. However, data from Asda, Morrisons, Safeway, Sainsbury's and Tesco show that wages in London are around 13 per cent higher than in GB as a whole.

Table 6.3: Regional wage deviations - Percentage difference between wage in region and the UK as a whole

Region	Full-time non-manual males on adult rates (wholesale and retail trade)*	Full-time non-manual females on adults rates (wholesale and retail trade)*	Majority party stores % I
East	1.6	5.9	3.6
East Midlands	-5.9	-9.9	-5.9
London	17.0	20	13.3
North-East	N/A	-14.85	-5.8
North-West	-6.8	-8.0	-7.3
Scotland	-12.1	-10.2	-4.4
South-East	14.5	15.6	5.6
South-West	-13.2	-12.4	-3.2
West Midlands	-5.4	-11.5	-3.3
Wales	-21.9	-16.0	-4.1
Yorkshire and Humber	-11.3	-13.3	-7.9

* ONS, 1999, *New Earnings Survey, Part E*

I Based on weighted averages for Asda, Morrision, Safeway, Sainsbury and Tesco

Source: CC's 2000 report

Labour market issues, including pay, are considered in more detail in GLA Economics' forthcoming publication *Retail and the Labour Market* (part of the *Retail in London* series of working papers)²⁰.

²⁰ GLA Economics, 2005, *Retail in London: Working Paper - Retail and the Labour Market* (forthcoming publication)

Economies of scale

The 2000 report carried out an in-depth analysis of how operating costs vary by size of store. It has been argued that the lower average size of stores in the UK results in higher costs (as businesses cannot exploit economies of scale at the store level), which result in higher prices in the UK compared to other countries.

The UK has significantly fewer hypermarkets (defined as stores greater than 5,000 square metres) than continental Europe or the USA. The hypermarkets that the UK does have are also considerably smaller than in continental Europe or the USA (see Table 6.4). The UK also has fewer supermarkets, although these tend to be larger than in France or in Germany – but still considerably smaller than in the USA.

Table 6.4: Comparisons of food retailing density in the UK, continental Europe and the USA, 1999

	Spain	France	Italy	UK	Germany	USA
Hypermarkets						
Number of stores	267	496	157	71	635	650
Number of sq metres ('000)	2,138	4,270	1,009	391	10,457	10,000
Average store size ('000 sq metres)	8.01	8.61	6.43	5.51	16.47	15.38
Sq metre/ 1,000 population	53	71	18	7	124	40
Supermarkets						
Number of stores	5,670	8,820	6,073	4,720	23,680	22,000
Number of sq metres ('000)	4,540	10,350	5,491	7,600	16,908	85,000
Average store size ('000 sq metres)	0.80	1.17	0.90	1.61	0.71	3.86
Sq metre/ 1,000 population	113	173	98	127	201	340
Totals						
Total number of sq metres ('000)	6,678	14,620	6,500	7,991	27,365	95,000
Sq metre/ 1,000 population	166	244	116	133	326	380

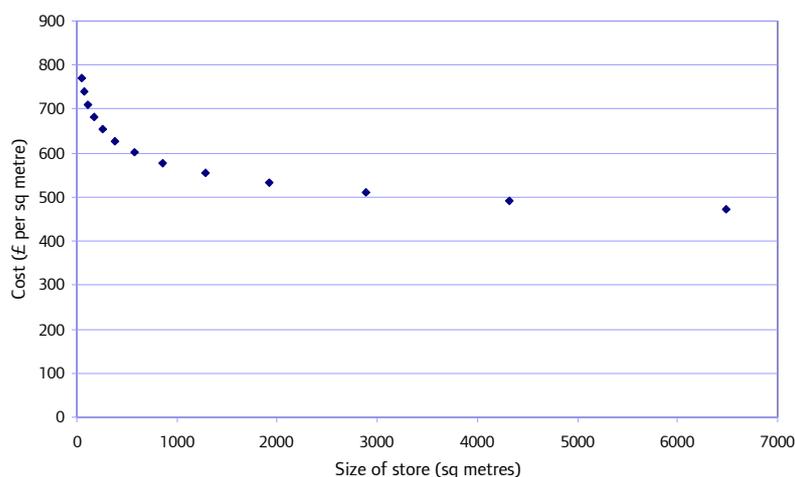
Source: Deutsche Bank Research, 1999, *Global Food Retailing, Part 1*

The 2000 report found that there are economies of scale in staff costs, but that such economies are most significant for smaller stores. Above about 3,000 square metres, the impact on total store costs is modest and, for some, disappears completely.

Figure 6.2 uses the results from the 2000 report to illustrate how staff costs economies vary by store size. The cost per square metre figures used are not taken from any data source but are used to illustrate the findings from the 2000 report in terms of economies of scale in staff costs. It illustrates that there are economies of scale in staff

costs at smaller store sizes (up to just under 1,000 square metres) but that after this point the gains diminish. This illustrates the CC's finding that economies in staff costs occur at small store sizes but diminish quite rapidly. For instance, the findings suggest that increasing the size of a store from 50 square metres to 250 square metres would reduce staff costs per square metre by around 15 per cent. To achieve the same cost saving in a store of just under 2,000 square metres one would need to increase the store size significantly to just under 10,000 square metres.

Figure 6.2: Example of economies of scale in staff costs by store size



Source: GLA Economics based on data from CC 2000 report

Other research has found little evidence of store-level economies of scale in grocery retailing²¹. For instance, in summarising research, Clifford Guy²² finds that above a certain size of store, economies of scale are not generally identifiable. Guy states that as well as the CC work, similar conclusions were reached in research by economic consultants carried out for the Government of Ireland.

Non-store costs

The two main elements of non-store costs are distribution costs and central overhead costs. Together, for the larger supermarket retailers, distribution and overhead costs are typically equivalent to six to seven per cent of turnover, with each separate cost element representing two-and-a-half to four per cent of turnover.

Distribution

A study by Templeton College into retail sector productivity found that higher congestion and logistics costs accrue to retailers operating within the UK (not just London) than to those in France or the USA.

Looking at distribution costs alone, the cost figures for the main supermarket retailers (as a percentage of sales) are very similar (see Figure 6.3). However, the data shows

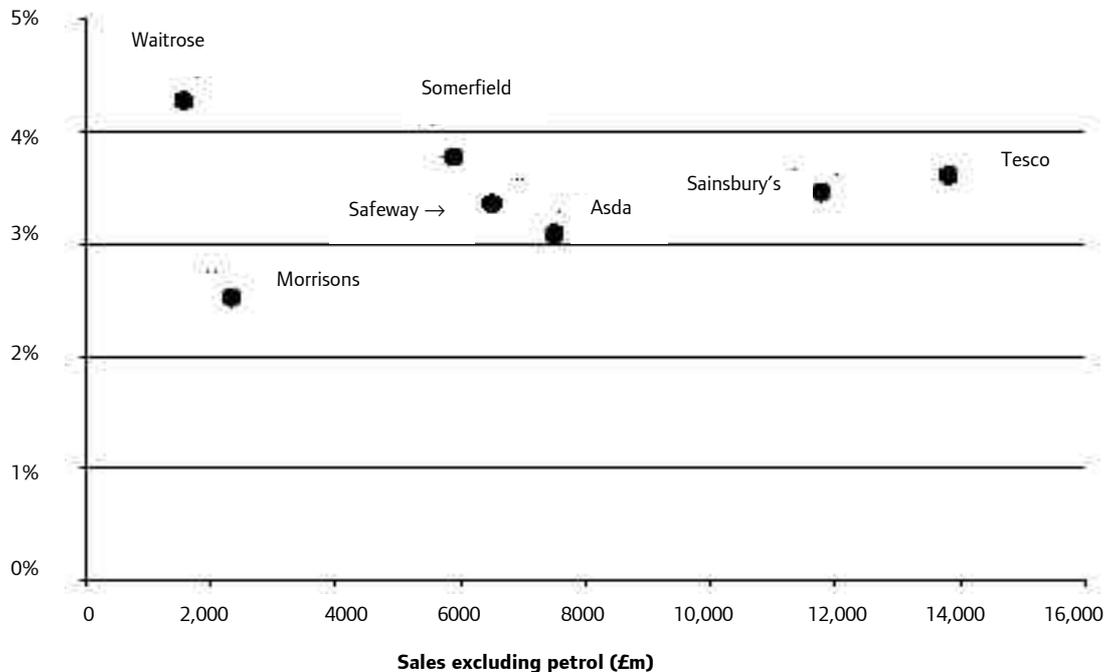
²¹ See paragraph 10.29 on page 215 of the CC's 2000 report.

²² C Guy, 2002, 'Is Retail Planning Policy Effective?: The case of very large store development in the UK' Planning Theory and Practice, 2002, pp 319–330

that Morrisons experiences very low distribution costs. This data is for Morrisons excluding the Safeway stores it has since purchased and may reflect Morrisons past degree of regional concentration as well as the fact that it carries out all its distribution in-house.

Figure 6.3: Distribution costs as a percentage of sales plotted against sales

Distribution costs as a % of sales



Source: 2000 report

All the main supermarket retailers, at the time of the 2000 report, used a two-tier system of distribution for the great bulk of their supplies: primary distribution to the regional distribution centres and secondary delivery to stores. Primary distribution is usually undertaken by the supplier, but there are significant benefits if lorries returning from stores to the distribution centre are able to pick up suppliers' goods en route, a practice that is becoming increasingly common. Secondary distribution is managed by the retailers and is either carried out using their own resources or is contracted out.

In general, the distribution centres handle the vast majority of groceries that supermarkets sell. The most common exceptions are milk, bread and (for those that sell them) newspapers and magazines. For the first two, there are considerations of freshness, and for the latter there are existing distribution networks which provide the required service.

The number of distribution centres used by supermarkets depends on the size of the organisation. In 2000 it ranged from as few as one for Booths (a supermarket operator in the North West) to more than 20. Many of the large supermarkets have specialist distribution centres for some products (for example, fresh produce, frozen goods and wine), according to individual circumstances.

There is a wide divergence among supermarkets of the extent to which distribution is outsourced. For instance, in 2000 Marks and Spencer outsourced all its transport and warehousing, while Aldi, Morrisons and Netto did almost everything in-house. Most other supermarket retailers are in between these extremes, with some in-house distribution and some outsourced.

Moreover, the form of warehouse outsourcing used by supermarket retailers varies. In some cases, all facilities and equipment are owned and all the associated costs paid by the supermarket. In such cases, the operator is paid a management fee (which may be performance related). In other cases, the site and facilities may be owned by the operator, who then charges a rate for use of the site and facilities.

Most of those who have mixed distribution systems cite the ability to benchmark between in-house and outsourced services as a significant advantage over wholly outsourced or wholly in-house distribution.

Over the five years to 2000, the main supermarket retailers claimed that a variety of factors affected distribution costs. Some factors have reduced costs, while others have increased them.

The main factors that have increased distribution costs are identified as the following:

- increases in vehicle excise duty
- increases in fuel prices
- increases in driver costs and lack of availability of good quality drivers
- increased traffic congestion
- restrictions on delivery times and routes to stores.

In the 2000 report, a number of supermarket retailers also mentioned changes to their businesses which increased distribution costs, including expansion (more stores, more widely spread), increases in product range, longer opening hours and more chilled/frozen products.

By contrast, a wide variety of efficiency improvements were cited as having reduced costs. These included:

- improved distribution centre network (in some cases more centres, in some cases fewer but better sited; use of consolidation warehouses)
- improved stock management
- improvements in vehicle technology
- increased use of return journeys
- improved relationships with suppliers (for example, suppliers making up store requirements to avoid double handling)
- radio frequency communication systems for product stock and picking.

More detail on the servicing of and delivery to retailers in London is covered in the forthcoming GLA Economics' *Retail in London* working paper: *Servicing and Delivery*.

Costs of land and property

The 2000 report found that in edge-of-centre and out-of-centre locations, the main one-stop shop retailers generally buy sites freehold or on long leases and develop stand-alone stores themselves. The price paid for a new supermarket site depends on many factors including: location, competition for the site, whether the site is bought with planning permission or not, whether the site is a single plot or in fragmented ownership and whether it is a replacement store or not. Stores in a town or district centre development are more likely to be rented than stand-alone stores.

As previously noted, most one-stop shop retailers prefer to buy sites freehold or on long leases rather than rent stores (though this is not always possible, especially in town centres). However, as part of its 2000 report the CC looked at 20 rental contracts entered into between 1997 and 1999, which covered the whole of the UK. In 16 cases the annual rent was between £110 and £180 per square metre. In three cases, all in central London, it was significantly higher (ranging from £240 to £538 per square metre) and in one poor location it was significantly lower (£73 per square metre). Rents for deep discounters (such as Lidl for example) typically ranged from £80 to £120 per square metre.

This, and other evidence on rent levels by region, shows that if grocery retailers have to rent premises in London, the rental costs are significantly higher than those that would be incurred elsewhere in the country.

The rateable value of property is based primarily on its rental value (a professional view of the annual rent for a property if it were offered vacant on the open market). Figure 6.4 shows that average rateable values are highest in London, for all non-domestic uses (i.e. retail, offices, factories and warehouses). It shows that rateable values for retail space in London are almost £150 per square metre compared to around £100 per square metre for the South East – the closest region for comparison in terms of rateable values.

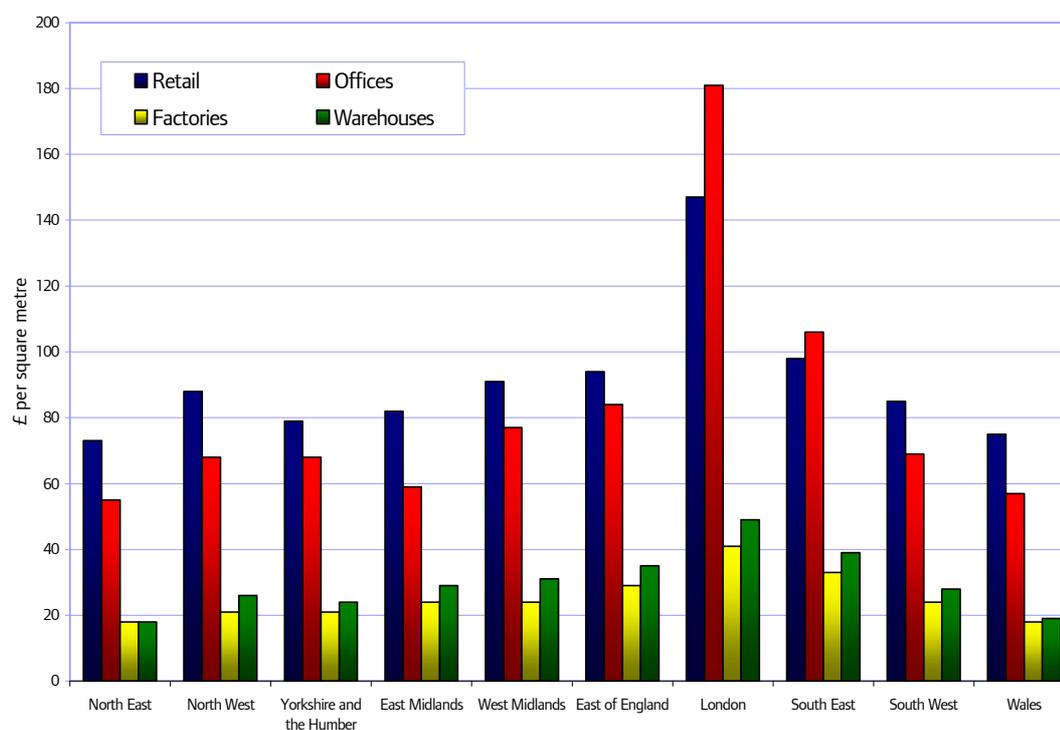
Rateable values are used to work out the non-domestic rates (also known as business rates) that businesses have to pay. Business rates are worked out by multiplying the rateable value of the property by the uniform business rate (which the government sets). For example, in 2001/02 the uniform business rate was set at 43p. So, if the rateable value was £100,000, the 'business rates bill' for the year would be £43,000.

Therefore, Valuation Office Agency (VOA) data shows that both land values (either purchase price or rental levels) and rates are higher in London when compared with the rest of the country.

As part of the 2000 report, the CC compared the land costs for grocery retailers with the land costs for industrial or residential use and with the costs for retailers in non-food and discount food sectors. The CC compared VOA statistics on prevailing industrial and residential values with one-stop shop retailers' data on prices paid for a sample of stand-alone store sites. The CC found that, in the majority of cases, one-stop shop retailers' sites commanded prices substantially greater than local values for residential or

industrial development. The average cost per hectare of the sample of transactions for stand-alone supermarket and hypermarket sites was some six to eight times the VOA's prevailing industrial values and around four times its prevailing residential values (although these factors vary greatly from site to site). This higher value for retail sites compared to industrial land values is also illustrated in Figure 6.4 – with retail rateable values significantly higher than rateable values for factories and warehouses.

Figure 6.4: Average rateable value by bulk class and region, 2004



Source: Valuation Office Agency

As noted, the CC also looked at values of land for non-food retailing. The most valuable non-food sites tend to be those for large-scale retail outlets ('retail warehouses'), for example for electrical goods or DIY. The CC found that the general level of retail warehouse land costs in recent years had been one-half to two-thirds of Asda, Safeway, Sainsbury, Tesco and Waitrose stores.

Land prices for different uses depend on the profit that can be generated from the land in future years. Supermarkets achieve higher sales densities than other forms of retail, although in some cases the profit margin is lower. The CC compared turnover and operating profit per square metre for different retail sectors. Where available, the CC used figures from annual reports, but in some cases it relied on the *Retail Rankings—1999 Edition* (Retail Intelligence, 1999 – taken from CC's 2000 report, p.287²³) for estimates of sales per square metre of selling area. The results are shown in Table 6.5. Given that the data has been gathered from different sources, the figures for different retailers are not necessarily directly comparable and should be treated as indicative only.

²³ http://www.competition-commission.org.uk/rep_pub/reports/2000/fulltext/446c12.pdf

Table 6.5: Sales per m² by retail sector

Retailer	Year	Sales (£/m ²)*	Operating margin (%)	Operating profit (£/m ²)
Grocery Sector				
Sainsbury's	1998/99	11442	5.9	675
Tesco	1998/99	11465	5.37⊥	617
Morrisons	1998/99	8027	6.67	535
Asda ¹	1997/98	9135	5.43	496
Safeway	1998/99	7993	5.62	449
Waitrose ¹	1998/99	9263	4.01§	374
Somerfield	1997/98	5896	3.68	217
Budgens	1998/99	5550	3.6	200
Furniture				
IKEA ¹	1998	2808	18.27	513
DFS ¹	1998	4423	11.39	504
MFI ¹	1998	2033	8.24	168
Furniture Village ¹	1998	2453	3.37	83
Electrical & other durable goods				
PC World ¹	1997/98	7145	6.64 ?	474
Dixons ¹	1997/98	6510	6.64 ??	432
Curry's Superstores ¹	1997/98	5068	6.64 ?	337
Powerhouse ¹	1997/98	4950	3.91	193
Comet	1999	4710	3.87 ?	182
Tempo	1999	3340	5.24	175
DIY				
B&Q	1999	1419	9.86 ?	140
Wickes ¹	1998	2077	4.16	86
Homebase	1999	1260	5.24	66
Focus Do It All Ltd ¹	1999	769	5.3	41

Notes: * Excluding taxes, ⊥ Corrected to 52 weeks, ¹ Sales per sq metre figures from Retail Rankings, § Trading margin, ? Breakdown for the individual companies not available- figure is for Dixons Group in total, ? Retail margin

Source: Table appears as Table 12.22 (p. 287) in the 2000 report. Original source: Retail Rankings – 1999 Edition (Retail Intelligence 1999)

Table 6.5 shows that, in general, the large supermarkets make more profit per square metre than is made by non-food retailers, whereas for smaller operators the differences are less. However, the most successful non-food retailers achieve levels of operating profit per square metre similar to those of the large food retailers.

The CC also found some evidence that property costs in the UK were high in international terms. Table 6.6, based upon analysis by Deutsche Bank, suggests that leading UK grocers face land prices up to six times those of leading continental European retailers.

Table 6.6: Comparison of the cost of land between UK, European and US retailers (US\$/m² of selling space)

	US \$		
	1991	1996	1999*
Tesco	2150	3000	3040
Sainsbury's	2700	3350	3400
Safeway	1280	2700	3150
Asda	1680	2240	2800
Morrisons	1600	2000	2560
Stoc (Carrefour group)	200	350	500
Albert heijin (Ahold group)	450	500	750
Pryca	800	900	1000
Colnuyt	400	500	550
Safeway Inc	250	280	300

Notes: * Estimated

Source: Deutsche Bank Research, 1999, *Global Food Retailing*

Deutsche Bank Research concluded that land costs tended to be higher in the UK than in other countries because of the following:

- population density
- planning constraints
- poor road infrastructure.

It should be noted that more detail on the planning system and its effect on retail in London is considered in *Retail competitiveness and the planning system in London*²⁴.

Separate analysis, commissioned by the CC, found that land costs for supermarkets outside the centres of cities such as London and Paris are typically five to ten times higher in the UK than in France, two to three times higher than in Germany and five to seven times higher than in the Netherlands.

In summary, the CC found that Asda, Safeway, Sainsbury, Tesco and Waitrose paid much more for land in the recent past than other grocery retailers (including Morrisons). They also paid more for land than non-food retailers or industrial and residential users in the UK and their counterparts in other European countries.

Table 6.7 shows typical values in each case (bearing in mind that land values vary enormously, depending on location and condition).

²⁴ GLA Economics, 2005, Retail in London: Working Paper - Retail competitiveness and the planning system in London (forthcoming publication)

Table 6.7: Comparison of land costs

	Land cost (£ '000/hectare)
Asda, Sainsbury, Sainsbury, Tesco and Waitrose	1,500–3,300
Other UK grocery retailers	500–2,000
UK retail warehouses	1,100–2,700
UK industrial use	180–520
UK residential use	330–800
France food store	140–750*
Germany food store	500–1,600
Netherlands food store	250–500#

Notes: * Excludes 'licence premium'; # Excludes payments in lieu of parking spaces

Source: CC analysis

Summary of all costs

The preceding analysis of costs incurred by grocery retailers has shown that the biggest component of cost is the cost of goods for resale. The analysis shows that the larger the firm buying goods, the lower the price paid. Moreover, it is likely that this buyer power reinforces itself through a 'virtuous circle' of increased buyer power leading to lower prices (or improved customer facilities) leading to more sales and even greater buyer power. Therefore, the large supermarkets have a distinct and probably ever increasing cost advantage over small grocery retailers. Of the other costs incurred by grocery retailers, there is evidence to show that retailers in London face higher staff costs and whilst there are economies of scale in staff costs at the store level, these economies diminish rapidly as the store size increases. There is also evidence to suggest that London retailers face higher costs for land (be it for purchase or for rent) when compared to the rest of the country and also when compared internationally.

7. Competition

Concentration

Appendix B, which is taken from the CC Safeway report, sets out how competition can lead to low prices and favourable economic outcomes. It shows that when there is a high level of concentration in a market then the level of competition can, in certain circumstances, be diminished.

With respect to London, and as shown earlier, the level of concentration in grocery retailing is high with four companies accounting for almost two-thirds of all groceries consumed in London. Moreover, the level of concentration in the one-stop shopping market, the largest sub-section of the grocery market, is higher than in GB as a whole, with only two firms accounting for seven-tenths of all one-stop shopping purchases in London (see Table 4.6).

A paper by Burt and Sparks²⁵ argues that market power derived and leveraged at the national level may allow a differential, store-level market response at the local level depending on local circumstances. Such responses would entail localised activities that raise competitors' costs and reduce returns, making competitors' stores marginal in terms of their rate of return. These activities could include trading hour extensions, payment of premium labour rates, introduction of selective service extensions and local market pricing strategies. The ability to exercise such market power will depend, amongst other things, on the level of barriers to entry or expansion.

Barriers to entry and expansion

In this section the various barriers to entry and expansion that exist in grocery supermarket retailing are examined. Barriers to entry and expansion are features that may prevent or restrict firms from exploiting profitable opportunities in a market and therefore may shield incumbent firms from the full effects of competition.

One such barrier to entry and expansion could be economies of scale. The CC's 2000 report identified several such economies. These included securing more favourable buying terms, improving distribution efficiencies and spreading fixed and semi-fixed costs over larger volumes. Such economies of scale might act as barriers to entry because large-scale entry would be necessary to achieve the economies already enjoyed by incumbent operators. There are also substantial economies of sales density at store level, which whilst they may not act as barriers in themselves, might exacerbate other barriers. For example, new entrants may not be able to find sites where there is the potential for the same levels of sales densities to be achieved and may, therefore, be less able to provide effective competition to incumbent operators.

There has been no entry involving the creation of new capacity to the one-stop-shopping market for, at the very least, the past decade or so. In the early 1990s the limited line discounters such as Aldi and Netto for example, moved into the grocery

²⁵ Summarised in S L Burt and L Sparks, 2003, 'Power and Competition in the UK Retail Grocery Market' *British Journal of Management*, 2003, **14**, pp 237–254

retailing sector in the UK. However, these firms are unlikely to compete effectively in the one-stop shopping market owing to the limited range of goods stocked, from which it would not be possible to conduct a comprehensive one-stop shop. Moreover, some of these entrants have since exited the sector – mainly through acquisition by other discounters. For example, Carrefour, which entered through its Ed format in 1993, sold its stores to Netto in 1995.

Moreover in the recent past, Tesco and Sainsbury in particular have stepped up their presence in grocery retailing outside one-stop shopping. As well as organic growth, both companies have been involved in or interested in acquiring smaller companies. For instance, Tesco has purchased T&S stores and Adminstore Limited. One reason for this move into smaller town centre formats may be due to the planning regime which some supermarkets argue has acted as a barrier to expansion in one-stop shopping in the recent past. The planning regime and its effect on retail is considered in more detail in *Retail competitiveness and the planning system in London*²⁶.

Summary of competition

Data shows that the share of the supply of groceries is more concentrated in London when compared to other parts of the UK. Under certain conditions, outlined in Appendix B, such concentration could be a cause for concern. This is especially the case given the barriers to entry and expansion that exist in grocery supermarket retailing.

²⁶ GLA Economics, 2005, Retail in London: Working Paper - Retail competitiveness and the planning system in London (forthcoming publication)

8. Conclusions

Retail is the single largest component of expenditure by London residents. Within retail expenditure, spending on food and non-alcoholic drink is the single biggest expenditure item. Therefore, an understanding of the retail sector, and within that the grocery retail market, in London is important.

Extensive analysis by the CC suggests that there are three distinct forms of grocery retailing. One-stop shopping is a form of shopping where all, or a substantial part, of a household's weekly grocery requirements are purchased together in one place and during one shopping trip, rather than from a number of different outlets or during different shopping trips. Top-up, or secondary, shopping involves topping up the main weekly shop and can take place in a variety of different sized stores. Similarly, convenience shopping, which tends to be more time sensitive than other forms of grocery shopping, takes place in a range of stores including very small stores which operate extended opening hours (including Sundays).

All these forms of grocery shopping take place in local markets. However, the density of population and number of stores within close proximity of one another in London is likely to mean that a chain of substitution stretches across most, if not all, of London. This means that stores in central London, for instance, may affect competition for trade in stores in areas in outer London and vice versa.

There are almost 9,000 grocery stores in London and whilst the majority of these are independents, their share in terms of floorspace and, even more so, sales is much lower. Around £7 of every £10 spent on groceries in London occurs in the stores of five grocery retailers (Asda, Morrison, Sainsbury's, Tesco and Waitrose).

ONS data shows that whilst the overall price difference for all goods and services between London and the UK as a whole was almost ten per cent, it was only three per cent for food. This may be largely due to the fact that the larger supermarket groups (Asda, Morrisons, Sainsbury's and Tesco) adopt a national pricing policy, where prices are the same for the same goods across all the group's stores (of the same store format) across the country.

The cost of goods for resale accounts for over four-fifths of the costs incurred by supermarket retailers in the UK. Analysis shows that the larger the group buying goods, the lower the price they pay. Moreover, it is likely that this buyer power reinforces itself through a 'virtuous circle' of increased buyer power, leading to lower prices (or improved customer facilities), leading to more sales and even greater buyer power. This results in a significant cost advantage for large supermarket retailers compared to smaller retailers.

Costs for retail staff are higher in London when compared to the rest of the country. Whilst there are economies of scale in staff costs, these economies exist primarily at smaller store size, and diminish rapidly as store size increases.

The cost of land for grocery retail is higher in London when compared to the rest of the country (whether it be land for purchase or premises to rent). In addition, there is evidence to suggest that the cost of land in the UK is significantly higher than in other countries.

Analysis by the CC suggests that many of the conditions that are necessary for firms to engage in anti-competitive behaviour exist in the UK with respect to grocery retailing. Data shows that a half of all grocery spend in London goes to Sainsbury's and Tesco and that 70 per cent of one-stop shopping in London is accounted for by Sainsbury's and Tesco. This is a higher level of concentration than is experienced in the UK as a whole.

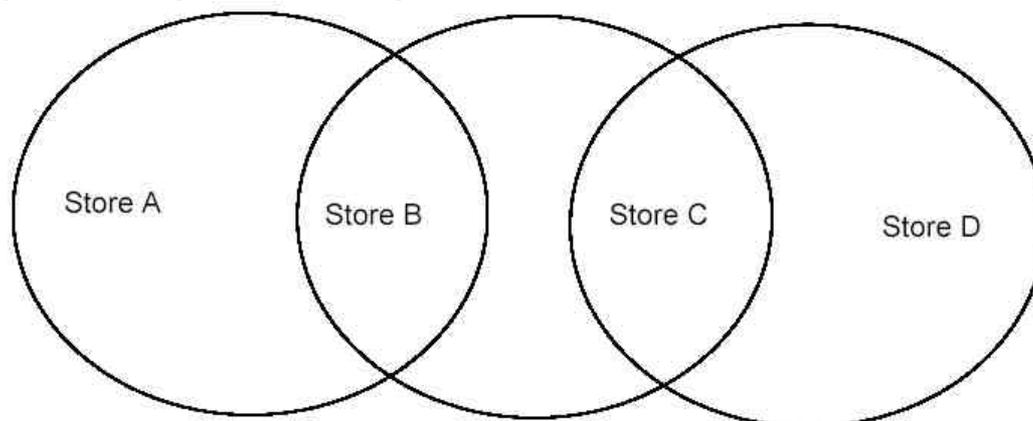
Appendix A: Chains of substitution

This appendix considers the issue of chains of substitution and is drawn primarily from the CC Safeway report.

In the Safeway report, Tesco said that isochrones²⁷ did not represent properly defined local economic markets. It said that chains of substitution meant that stores outside a particular isochrone could constrain stores within the isochrone.

Figure A1 shows how a chain of substitution might operate. In Figure A1, stores A and B are in the same local catchment (because they are in the same isochrone). Store B is also in the same isochrone as store C and similarly store C is in the same isochrone as store D. If store B is constrained by stores A and C (because store B is in the same isochrone as each of stores A and C), then these stores (A, B and C) are likely to be in the same economic market. For example, if a hypothetical monopolist of stores A and B were to raise prices, it would lose sales to store C (since this store is an effective competitor to store B by being in the same isochrone). If the hypothetical monopolist of stores A and B lost enough sales to store C to make the price rise unprofitable, then the economic market should be widened to include store C. Repeating the test could lead to the market being widened to include store D.

Figure A1: Diagram to show a possible chain of substitution



Source: CC's Safeway report

Chains of substitution break down if either isochrones do not overlap or if, in the example used, store C is not an effective competitor to store B. In the Safeway report, Tesco argued that CC's isochrone analysis of stores across the UK showed that many (if not all) isochrones overlapped.

²⁷ An isochrone is a line joining points of equal travel time (usually drive time) from a given point. For instance, a 15-minute isochrone around Trafalgar Square would encompass all the areas from which you could reach Trafalgar Square by driving for 15 minutes. As a result, isochrones correspond reasonably closely to individual shoppers' one-stop grocery shopping behaviour (which depends on the time taken to get to a store) and the likely catchment area of a store (as noted earlier, the vast majority of customers for an individual store come from within a ten or 15-minute drive time). Asda, Sainsbury's, Safeway and Tesco use isochrone analysis when analysing the potential for new sites for stores.

In considering the isochrones around Safeway stores across the UK, the CC found that isochrones overlapped significantly in a few instances only. For instance, out of a total of 337 Safeway one-stop shops in GB, 120 of them contained stores from one or two supermarket groups only. Therefore, more than one-third of the areas considered contained stores from only one or two supermarket groups within a ten or 15-minute isochrone. Indeed, in over one-quarter of these cases the isochrone had to be extended to 25 minutes or more in order to bring in the store of a different supermarket group. As a result the CC did not consider that a strong chain of substitution would operate in such areas because of the lack of significantly overlapping isochrones.

In addition, the CC considered the degree of overlap necessary for strong chains of substitution to exist. As noted earlier, all the parties said that between 70 and 90 per cent of their sales derived from within ten minutes of the store. Therefore the overwhelming majority of a store's sales come from within a ten-minute radius. Given this, isochrones drawn around stores have to overlap very substantially in order to constrain one another. As a result, the degree of overlap required in order for a strong chain of substitution to exist is likely to be significantly greater than that depicted in Figure A1, where each store is at the edge of each isochrone. If it is assumed that Figure A1 depicts ten-minute isochrones, then stores A and B, for instance, are over ten minutes apart because they are at the edges of the isochrone. As a result of this analysis, including the need for isochrones to overlap significantly, the CC considered that there were unlikely to be strong chains of substitution covering much of the country.

As noted in the main body of this paper, however, London, owing to its population density and the resulting high number of stores close to one another, is likely to contain many overlapping isochrones. Table A1 shows, for the five largest grocery retailers in London, the percentage of London's population within one mile and half-a-mile of a store of that grocery retailer. It shows that taking all five stores together, around 93 per cent of London's population is within one mile of a store. As a result, it is quite possible that rather than having tightly defined local markets, London is characterised by a chain of substitution covering most, if not all, of Greater London.

Table A1: Percentage of London's population within 1 mile and half-a-mile of a grocery store

	Percentage (%) within 1 mile of a store	Percentage (%) within ½ mile of a store
Sainsbury's	65	31
Tesco	64	27
Morrisons	42	16
Waitrose	19	9
Asda	11	4
All 5 grocery retailers	93	60

Source: GLA Economics based on data from the grocery retailers

Appendix B: Competition

This appendix, which is taken from the CC's Safeway report, outlines how competition leads to favourable economic outcomes and highlights some ways in which competition can be stifled.

Competition is a process of rivalry between firms seeking to win customers' business over time. This rivalry may occur in a variety of ways. In some cases the emphasis will be on achieving the lowest level of costs and prices in order to undercut competitors. In other cases, firms go beyond this, using entrepreneurial and innovative skills to develop new products and services, exploit particular strengths, abilities or other advantages held by a firm and, by these means, meet consumer needs more effectively than competitors. In the case of supermarkets, range, quality and convenience are all important dimensions of competition in addition to price. In these circumstances competition is likely to be characterised by uncertainty, turbulence and change. Among other things, therefore, this process of rivalry may be illustrated by changes in market structure, the pattern of pricing over time, changes in non-price factors, or the extent of product innovation.

Rivalry has numerous beneficial effects: prices and costs are driven down, and innovation and productivity increase, so increasing the quality and, more generally, the diversity of choice available to customers. Further, markets that are competitive generate feedback from customers to firms, which, in consequence, direct their resources to customers' priorities. In addition, firms are encouraged to meet the existing and future needs of customers as effectively and efficiently as possible. Where this process is dampened, or otherwise hindered, competition may be substantially lessened.

Where markets are sufficiently concentrated, the actions of individual firms can have identifiable effects on their competitors, such that firms recognise their interdependence. The interdependence of firms may lead them to anticipate competitors' responses to their own actions and take this into account in their own decisions. If this interdependence persists through time, the repeated nature of such decisions can have significant effects on business strategies and on competition. In particular, under certain conditions it can become rational to refrain from initiating price cuts, which would be unavoidable in more competitive circumstances.

More specifically, if a reduction in price fails to achieve a significant volume response it will be unprofitable. However, if it does achieve such a response this will, in a sufficiently concentrated market, be likely to provoke a matching price reduction from competitors who will necessarily have lost significant demand. In this instance, the price cut will again prove to be unprofitable. Recognition of this – namely that firms have a clear common interest in avoiding mutually destructive price cuts – may be sufficient to deter a cut in price.

Moreover, in a similar way, price increases by one firm to levels that might otherwise have been uncompetitive may well prove profitable. This is because, of the two possible responses by competitors – to follow or not to follow the price rise – the former will

often be more profitable (the latter is likely to force a reversal of the original price increase and hence eliminate the new profit opportunity). Recognition of this could then provide rational grounds for the initial price rise. Such considerations, whether explicit or implicit in terms of established pricing strategies, understanding of 'going rates' etc, can result in firms tending to match each other's prices at a higher level than could otherwise be sustained.

This type of behaviour is sometimes referred to as 'tacit collusion' or 'conscious parallelism'. However, this behaviour does not require any type of collusion, in the usual active sense of the word, between firms, or even any contact between them. Nor does any such parallelism of price necessarily have to be 'conscious' in the form of an explicit or documented analysis of interdependent price strategies.²⁸ Instead, the behaviour can arise purely from firms' perception of interdependence, with the benefits of such behaviour accruing to all firms in the market. As a result, the effects of such behaviour are known as coordinated effects, whilst noting that no consensual coordination between firms is necessarily required. Such behaviour is nonetheless capable of weakening competitive pressures on prices and, if so, is likely to be detrimental to both consumers and to the extent of rivalry in a market. Similar effects are possible on other factors in the competitive process, innovation, quality, etc. However, the ability to match someone else's change in a reasonable period of time may be significantly less, weakening the degree of perceived interdependence and hence the impact on competition.

Such effects are not the only way in which high concentration in a market may limit competitive pressures. Non-coordinated effects, which are also sometimes called unilateral effects, occur when a firm has the ability to exercise market power independently, without the need to second guess the strategies of other firms in the market. This could give it the power to raise prices or to reduce quality, choice, innovation and service levels, by allowing it to act more independently of competitors, suppliers and customers. It should be noted that whilst the firm generally captures the benefits from such non-coordinated effects, other firms in the market might also benefit. This outcome does not require any form of coordinated behaviour, but could emerge purely from the independent actions of the other firms in the market, each maximising profits, given the output of other firms in the market and without regard for their likely response.

Incentives for firms to engage in what are generally referred to as coordinated effects, arise in markets with only a small number of players or where market concentration is sufficiently high. These conditions do not, however, guarantee such behaviour. There are a number of characteristics of a market which tend to facilitate coordination, such that, where most or all of them exist, it may reasonably be expected that firms will be able to act on the basis of the profit incentives described. Conversely, if few are present, coordinated effects are less likely, despite the scope for higher profits if they could be achieved.

²⁸ Prices need not necessarily move in parallel as non-price factors could also be changing.

How concentrated a market has to be in order to facilitate coordinated effects is to some extent a matter of judgment. The most clear-cut case is in relation to duopoly, i.e. just two major players competing with each other. In this case, with barriers to entry, and subject to the further points below, it is virtually certain that both firms will know that almost all of the impact of any decision aimed at increasing market share will be on its competitor. The need to consider the competitor's likely reaction is therefore equally clear. Beyond that, as the number of players increases and concentration falls, so the likelihood of coordinated effects will fall, and at some point will disappear altogether. Guidelines provided by competition authorities in both the USA and the UK suggest that there is little likelihood of such effects below the 1000 level on the Herfindahl-Hirschman index²⁹ – a common measure of concentration. This would suggest that it is unlikely that there will be coordination with more than ten firms and that, in general, the lower the number of firms the easier it will be for coordinated effects to arise.

Three broad conditions help to facilitate coordinated effects. First, there must be sufficient information available for firms to be aware of whether each of the others is behaving as expected. Second, there need to be clear disincentives for firms to deviate from the coordinated position. And third, the competitive constraints in the industry need to be low enough that there is not a threat of firms outside the coordinating group taking market share.

The CC report into the acquisition of Safeway looked into these conditions in some detail³⁰. The report found that most of the characteristics facilitating coordination appeared to be present in the market for one-stop shopping in the UK.

²⁹ Herfindahl-Hirschman index levels are calculated by summing the squares of the market share of firms. A level of 10,000 indicates that there is only one supplier in the market; as this figure decreases, so concentration lessens.

³⁰ See paragraphs 5.118 to 5.138 of the Safeway report.

Abbreviations

ACS	Association of Convenience Stores
CC	Competition Commission
GB	Great Britain
GLA	Greater London Authority
LFS	Labour Force Survey
NES	New Earnings Survey
OFT	Office of Fair Trading
ONS	Office for National Statistics
TNS	Taylor Nelson Sofres
UK	United Kingdom
USA	United States of America
VOA	Valuation Office Agency

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Online resources:

GLA Economics

http://www.london.gov.uk/mayor/economic_unit/index

GOAD

<http://www.business-strategies.co.uk/Content.asp?ArticleID=401>

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Greek

Αν θέλετε να αποκτήσετε αντίγραφο του παρόντος εγγράφου στη δική σας γλώσσα, παρακαλείστε να επικοινωνήσετε τηλεφωνικά στον αριθμό αυτό ή ταχυδρομικά στην παρακάτω διεύθυνση.

Turkish

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Punjabi

ਜੇ ਤੁਹਾਨੂੰ ਇਸ ਦਸਤਾਵੇਜ਼ ਦੀ ਕਾਪੀ ਤੁਹਾਡੀ ਆਪਣੀ ਭਾਸ਼ਾ ਵਿਚ ਚਾਹੀਦੀ ਹੈ, ਤਾਂ ਹੇਠ ਲਿਖੇ ਨੰਬਰ 'ਤੇ ਫ਼ੋਨ ਕਰੋ ਜਾਂ ਹੇਠ ਲਿਖੇ ਪਤੇ 'ਤੇ ਰਾਬਤਾ ਕਰੋ:

Hindi

यदि आप इस दस्तावेज की प्रति अपनी भाषा में चाहते हैं, तो कृपया निम्नलिखित नंबर पर फोन करें अथवा नीचे दिये गये पते पर संपर्क करें

Bengali

আপনি যদি আপনার ভাষায় এই দলিলের প্রতিলিপি (কপি) চান, তা হলে নীচের ফোন নম্বরে বা ঠিকানায় অনুগ্রহ করে যোগাযোগ করুন।

Urdu

اگر آپ اس دستاویز کی نقل اپنی زبان میں چاہتے ہیں، تو براہ کرم نیچے دئے گئے نمبر پر فون کریں یا دیئے گئے پتے پر رابطہ کریں

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