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FOREWORD

One of the faintly bizarre aspects of the public policy debate on competition law is the passion aroused by the only left-over remnant of the old Restrictive Practices regime, namely the Groceries Order. Its best known feature is the ban on below invoice price selling (commonly, if somewhat inaccurately, referred to as 'below-cost-selling') and it is this feature which arouses the most controversy. However, as highlighted in particular in Chapter 6 within, some of the other provisions of the Groceries Order (such as those relating to suppliers' terms and conditions and the ban on "hello" money, sometimes referred to as "fair trade" provisions) are also capable of generating controversy.

A further peculiarity of the debate on the Groceries Order is that its legal status is such that it cannot be amended. It can only be either left intact or repealed in its entirety. As explained in Chapter 2 within, this is because the order was made under the Restrictive Practices legislation which was repealed by the Competition Act 1991. The Commencement Order bringing the 1991 Act into force seems to have created an exception in relation to the repeal of the Groceries Order which would otherwise have followed. However, since the parent legislation has been repealed, no variation of the existing Groceries Order can be introduced within the Restrictive Practices framework. Among the arguments canvassed in the within discussion document is the possibility of repealing the Groceries Order but introducing specific legislation to deal with such aspects of the grocery trade as are thought to warrant some form of "fair trade" regulation.

As noted in the conclusion section within, the Review Group was divided on the question of whether or not the Groceries Order should be repealed. This reflects a division which has been apparent for many years in the debate which has taken place within industry and amongst academics on the Groceries Order. Some may find it puzzling as to why prolonged debate among rational, intelligent and well-intentioned persons over the years has been unable to produce a consensus. In part, this may be explained by the fact that, as noted in the independent report by DKM Economic

Consultants Limited (Appendix A), much of the empirical data which would be necessary to pronounce definitively on the issues raised is simply not available. Another explanation proffered in the within discussion is that the Groceries Order is favoured (though not exclusively) by particular and focused interest groups whereas those against the Order have no sharply defined point of opposition. Advocates of its abolition therefore tend to be economists, both academic and in independent practice. Whatever may be the true explanation for the divergence of views on the Groceries Order, it is fair to say that this divergence was mirrored amongst the members of the Review Group.

The Groceries Order is not specifically mentioned in the Review Group's terms of reference. It is only of relevance to the Review Group's work insofar as it bears upon the effectiveness of competition law.

The Groceries Order is the single topic upon which the Review Group received the most submissions. The arguments for and against are canvassed extensively in the within discussion document. While comments and submissions are invited, as set out in the introduction, in accordance with our customary procedure, it would be helpful to the time scale of the work of the Group if further submissions in respect of the within document were restricted to points that have not been adequately ventilated already in the submissions to the Review Group and in the within document, as distinct from merely repeating points which have already been made.

Michael M. Collins
Chairman
Competition and Mergers Review Group
December 1999

1. Introduction

The terms of reference of the Competition and Mergers Review Group are:

to review and make recommendations on:

- the mergers legislation in the context of legislative consolidations;
- the effectiveness of competition legislation and associated regulations;
- cultural matters in the context of the Competition Act, 1991 and in particular Section 4(2) of that Act; and
- appropriate structures for implementing the above legislation.

The Group, chaired by Mr. Michael Collins S.C. is currently made up of the following members:

IBEC	Mr. Owen Killian
	Mr. Myles O'Reilly
ISME	Mr. Robert Berney
ICTU	Mr. Paul Sweeney
The Bar Council	Mr. David Barniville
The Law Society	Mr. Gerald FitzGerald
Consumers Association of Ireland	Mr. Peter Dargan
Department of Enterprise, Trade & Employment	Mr. Barry Harte
Economist	Mr. Moore McDowell
Office of the Attorney General	Mr. Damien Moloney

The Group has published three discussion papers.[1] This discussion paper focuses on the Restrictive Practices (Groceries) Order, 1987 (the "Groceries

1 The first discussion paper, published in July 1998, contained proposals for discussion in relation to mergers. The second discussion paper, published in February 1999, contained proposals for discussion in relation to some recommendations of the Report of the Commission on the newspaper industry. The third discussion document, published in September 1999, contained proposals for discussion in relation to competition law and is primarily concerned with possible legislative changes which might assist in improving the effectiveness of competition law in Ireland.

Order")[2]. The Group's examination of the Groceries Order arises from the context of its review of the "*effectiveness of competition legislation and associated regulations*" in its terms of reference.

The Group published advertisements which called for submissions from the public on issues relevant to its terms of reference. Several submissions were received concerning the Groceries Order. The submissions by number of these interested parties will be referred to and considered later in this paper. Submissions were received on the Groceries Order from the following:

1. IBEC - Competition Council;
2. IBEC - Food, Drink and Tobacco Federation;
3. Irish Co-Operative Organisation Society Limited;
4. Barry Doherty (a member of the European Commission Legal Service but writing in a personal capacity);
5. Irish Farmers Association;
6. RGDATA, IADT and SSRF;
7. An Bord Glas (Horticultural Development Board);
8. A fruit and vegetable distributor;
9. Dr. Patrick Walsh and Ms. Ciara Whelan (Department of Economics, Trinity College, Dublin);
10. Dr. John Fingleton (Department of Economics, Trinity College, Dublin);
11. Competition Authority;
12. William P. Fagan (Former Director of Consumer Affairs).

Following a meeting of the Group in February 1999 it was agreed that the Group should retain an economist to carry out a study on the economic impact of the Groceries Order and to report to the Group with the results of that study. It was agreed that the study should be conducted by an economist who was totally independent and who was not perceived as having previously taken a position in relation to the Groceries Order. DKM Economic Consultants Limited ("DKM") was retained to carry out the study. DKM initially reported

[2] S.I. No. 142 of 1987.

to the Group in August 1999 and presented its final report in October 1999. DKM recommended that the Groceries Order should be repealed in its entirety. The nature and extent of the study by DKM and its conclusions will be addressed later in this paper. A copy of the DKM report is to be found at Appendix A.

Following a meeting of the Group to discuss the Groceries Order, and in particular, the DKM report, a member of the Group, Myles O'Reilly (Secretary to the IBEC Competition Council) agreed to prepare a paper which would set out the arguments in favour of the retention of the Groceries Order. A slightly amended version of Mr. O'Reilly's paper is included as Chapter 6 of the present document. It reflects the IBEC submissions and comments on the DKM report. Chapter 7 contains contrary arguments based largely on the work of two economists, Patrick Walsh and Ciara Whelan who have extensively analysed the Groceries Order and have argued for its abolition. Dr. Walsh and Ms. Whelan also made submissions to the Group.

This discussion document will commence with an examination of the terms of the Groceries Order. It will then refer to and briefly consider previous studies. It will then summarise the submissions made to the Group by various interested parties and bodies. It will then refer to and consider the DKM report. A summary of the arguments for and against retaining the Groceries Order follows as referred to above[3]. The paper concludes with the Group's draft proposals for discussion.

Comments and submissions on the within proposals should be made in writing to the Secretary of the Group, Ms. Grace O'Regan at the Department of Enterprise, Trade and Employment to arrive on or before Monday the 24th of January 2000.

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3 It will be appreciated that Chapters 6 and 7 do not, in themselves, reflect the views of the Group as a whole but rather summarise the respective positions of those for and against retaining the Groceries Order.

2. The Groceries Order - Legal Background

The Groceries Order was made by the then Minister of Industry and Commerce in exercise of powers conferred by Section 8 of the Restrictive Practices Act, 1972 following a review of the operation of the earlier Restrictive Practices (Groceries) Order, 1981 by the Restrictive Practices Commission. Prior to the report of the Restrictive Practices Commission which led to the making of the Groceries Order, 1987, there had been five previous formal enquiries or reviews of the groceries trade in Ireland by the Fair Trade Commission and by the Restrictive Practices Commission. The following reports were published following those enquiries/reviews:

1. Fair Trade Commission: Report of Enquiry into the Conditions which obtain in regard to the Supply and Distribution of Grocery Goods and Provisions (Stationery Office, Dublin 1956) Pr 3722;

2. Fair Trade Commission: Report of a review of the operation of orders relating to the Supply and Distribution of Groceries (Stationery Office, Dublin, 1966) Pr 8896;

3. Fair Trade Commission: Report of Enquiry into the Conditions which obtain in regard to the Supply and Distribution of grocery goods for human consumption (Stationery Office, Dublin, 1972) Prl 2517;

4. Restrictive Practices Commission: Report of Special Review by means of Public Enquiry of the operation of Articles 2 and 3 of the Restrictive Practices (Groceries) Order, 1973, as amended by the Restrictive Practices (Groceries) (Amendment) Order 1973 (Stationery Office, Dublin, 1975) Prl 5274;

5. Restrictive Practices Commission: Report of Enquiry into the Retail Sale of Grocery Goods Below Cost (Stationery Office, Dublin 1980) Prl 9428;

6. Restrictive Practices Commission: Report of review of Restrictive

Practices (Groceries) Order, 1981 (Stationery Office, Dublin 1987) Pl 4678;

7. Fair Trade Commission: Report of review of the Restrictive Practices (Groceries) Order, 1987 (Stationery Office, Dublin, 1991) Pl 8304.

In addition, the OECD in its 1993 Economic Survey of Ireland favoured rescinding the Groceries Order.

The purpose of this discussion document is not to review or consider Orders previously made in relation to the grocery market under the Restrictive Practices Act, 1972 and its predecessors. The report of the Fair Trade Commission on the Groceries Order published in 1991 summarises the results of the earlier enquires and reviews[4]. One or two points however should be made. The prohibition of resale price maintenance was first introduced following the report of the Restrictive Practices Commission in 1956. Advertising of below cost sales of products was first introduced in 1973 following the report of the Restrictive Practices Commission in 1972. Advertising of below cost sale of grocery products was prohibited for the first time following the report of the Restrictive Practices Commission in 1980. However, below cost selling of grocery products was not prohibited until the 1987 Groceries Order. The prohibition on the payment of "hello" money was prohibited for the first time in the 1987 Groceries Order.

1987 Groceries Order

Article 2 is the definition section. "Grocery goods" are defined so as to

[4] FTC1991 Report Paras 1.2-1.11

exclude fresh food, fresh vegetables, fresh and frozen meat, fresh fish and frozen fish which has not been processed. The term includes grocery goods for human consumption (with the exception of those goods just referred to) and intoxicating liquors not for consumption on the premises. It also includes "household necessaries" ordinarily sold in grocery shops.

Article 3 contains the prohibition against resale price maintenance. Suppliers and wholesalers are prohibited from (inter alia) requiring or inducing any person to resell or offer for resale grocery goods at a fixed price or a price not less than a fixed or minimum price or a fixed mark-up or a fixed discount or a mark-up not less than a fixed or minimum mark-up or a discount not greater than a fixed or maximum discount specified by the supplier or wholesaler or established by agreement or otherwise[5]. Article 3(2) makes it clear that there is nothing to prevent a supplier from advertising or otherwise specifying retail prices for grocery goods provided such prices are maximum prices or withholding grocery goods from a wholesaler or retailer in certain cases such as where the wholesaler or retailer has sold grocery goods supplied by the supplier at a price exceeding the maximum retail price specified by the supplier[6].

Article 4 provides that where a supplier indicates or recommends a retail price of grocery goods such a price is not binding on any person as a minimum resale price.

Article 5 prohibits "*arrangements, agreements or understandings*" between suppliers, wholesalers or retailers which have or are likely to have the effect of ensuring that goods will be resold or offered for resale at a fixed price or a price not less than a specified minimum price or at a fixed mark-up or at a mark-up not less than a specified minimum mark-up or at a fixed discount not greater than a specified maximum discount or on any other basis which involves eliminating or limiting competition in price between suppliers or

5 Article 3(1).
6 Article 3(2).

between wholesalers or between retailers.

Article 6 precludes agreements, arrangements or understandings between two or more suppliers or between two or more wholesalers as to prices at which they will supply grocery goods to other persons or as to discounts to be allowed or mark-up to be applied in respect of such goods.

Article 7 prohibits suppliers or wholesalers from withholding grocery goods from any person or from discriminating against any person as to the terms on which such goods are supplied because that person is or is not a member of a trade association or is not approved of by a trade association or because such person's name either appears or does not appear on a list prepared, maintained, published or issued by a trade association or because of representations made concerning the withholding of supplies or the terms on which supplies should be made to such person by or on behalf of a trade association.

Article 8 precludes a trade association or a combination of persons from coercing or inducing a supplier or wholesaler to withhold supplies of grocery goods from any wholesaler or discriminating against any wholesaler or retailer as to the terms on which such groceries may be supplied to them.

Article 9 precludes agreements, arrangements or understandings between suppliers, wholesalers or retailers which have or are likely to have the effect of limiting or restricting entry to trade any grocery goods.

Article 10 prohibits lists or other acts designed to secure a boycott of persons in relation to grocery goods because of prices charged by that person for goods or other terms or conditions on which goods are supplied by that person or which are designed to affect adversely the terms of supply of goods to any person because that person has refused to do any act which he is prohibited from doing by the terms of the Groceries Order.

The prohibition against below cost selling is contained in Article 11. Under

Article 11 a retailer is prohibited from selling grocery goods (except in very limited circumstances in the case of goods whose date of minimum durability has expired) which is less than the net invoice price of the goods (including value added tax) or where charges in respect of carriage, insurance and other costs not included in the relevant invoice have to be paid by the retailer to the supplier to obtain delivery of the goods to his premises. The amount obtained when such charges or costs are added to the <u>net invoice price</u> of the goods (including value added tax)[7].

Article 12 prohibits retailers or wholesalers or other persons acting on behalf of retailers from publishing or displaying or advertising the sale of grocery products at below cost (the cost being determined by the net invoice price of the goods (including value added tax)[8]. Where charges for carriage have to be paid by the retailer, the cost is the amount obtained when such charges or costs are added to the net invoice price of the goods (including value added tax).

Article 13[9] requires suppliers to prepare and maintain a written statement of the terms and conditions on which and subject to which they sell grocery goods. Suppliers are obliged to sell grocery goods to wholesalers and retailers on and subject to those terms and conditions. This requirement does not apply in the case of a sale of goods which have been processed, packed or otherwise prepared to the specification of the purchaser and which are not given the name or brand name of the supplier[10]. Article 13(2) provides that the supplier's terms and conditions may make provision for discounts or rebates having regard to certain criteria. Article 13(3) provides that supplier's terms and conditions may not discriminate unfairly against the purchasers.

Under Article 14 a supplier must, if requested by the Director of Consumer

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7 Article 11(1).

8 Where charges for carriage have to be paid by the retailer, the cost is the amount obtained when such charges or costs are added to the net invoice price of the goods (including value added tax).

9 Articles 13-18 contain the so-called "fair-trade" provisions.

10 Article 13(1)(c). This sub-paragraph appears to obtain a typographical error in that the sub-section refers to the "purchaser" whereas it would appear clearly to be intended to refer to the "supplier".

Affairs, provide a copy of the statement of its terms and conditions. Retailers with more than five grocery outlets and wholesalers are also obliged to furnish to the Director of Consumer Affairs a statement of supplementary terms negotiated with suppliers

Under Article 15 (as amended) a supplier may be obliged by the Director of Consumer Affairs to amend any of its terms and conditions which the Director regards as constituting unfair discrimination in favour of or against any wholesaler or retailer or any section of the grocery trade.

Under Article 16 wholesalers and retailers are precluded from causing whether by the use of threats or inducement or otherwise suppliers to sell grocery goods on terms and conditions other than those contained in the suppliers' statement of terms and conditions. Wholesalers and retailers are required to comply with terms and conditions as to credit which are contained in suppliers' statements prepared under Article 13 of the Groceries Order[11]. However, it is an offence for a person who does not comply with such terms or conditions as to credit that such failure is due to that person's inability to pay for the goods in accordance with those terms or conditions.

Article 17 imposes certain obligations on suppliers, wholesalers or retailers who purchase grocery goods outside the State and import them into the State to furnish the Director of Consumer Affairs a statement of the terms and conditions on which such goods were purchased and imported. Although such obligations do not arise if the goods are the same kind as other goods in respect of such a statement as being furnished to the Director and are purchased and imported on the same terms and conditions.

Article 18 contains the payment by a supplier and the receipt by a retailer or wholesaler of "hello" money. Under Article 18, suppliers are prohibited in paying and retailers and wholesalers are prohibited from receiving payments or allowances or reductions or discounts in prices in consideration of the carrying out by the wholesaler or retailer of advertising in respect of the goods or making available space or additional space on opening a new retail outlet, on extending an existing outlet or after change of ownership of an existing outlet.

Article 19 contains technical provisions governing proof of the net invoice price of goods in proceedings under the Groceries Order.

Finally, Article 20 provides that the provisions of the Groceries Order prohibiting below cost sales of grocery goods and advertising such below cost sales do not apply in respect of "seasonal goods" which is defined in Article 2 as meaning Christmas cakes, Easter eggs and Halloween bracks.

Enforcement of the provisions of the Groceries Order is entrusted to the Director of Consumer Affairs. The contravention of any provision of the Groceries Order is a criminal offence under Section 20 of the Restrictive Practices Act, 1972. The director is empowered to bring summary prosecution for breaches of the Groceries Order[12]. The penalties for breaches of the Groceries Order are contained in Section 23 of the 1972 Act (as amended)[13]. The penalty on summary conviction in the District Court is a fine not exceeding IR£500 (together with in the case of the continuing offence a fine not exceeding IR£50 for every day on which the offence is committed) or at the discretion of the Court imprisonment for a term not exceeding six months or to both a fine and imprisonment. Prosecutions on indictment are brought by the Director of Public Prosecutions. On conviction on indictment a person is liable to a fine not exceeding IR£10,000 (together within the case of the continuing offence a fine not exceeding IR£1,000 for every day on which the offence is committed) or to a period of imprisonment of up to two years or to both fine and imprisonment.

The Director has brought summary proceedings arising out of breaches of the

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11 Article 16(1)(b).

12 Section 24(1) of the Restrictive Practices Act, 1972 as amended by Section 22 of the Restrictive Practices (Amendment) Act, 1987.

13 Section 23 of the Restrictive Practices Act, 1972 as amended by Section 21 of the Restrictive Practices (Amendment) Act, 1987.

Groceries Order. In addition to enforcement by way of criminal proceedings the Director has also commenced civil proceedings seeking interim and interlocutory injunctive relief to restrain breaches of the Groceries Order. This procedure has enabled the Director to obtain urgent relief from the court in relation to breaches or alleged breaches of the Groceries Order. The following table summarises the enforcement actions in relation to the Groceries Order:

Date	Complaints / Investigations	Prosecutions Commenced	Civil Proceedings Commenced
1988	77	-	2
1989	87	-	2
1990	12	2	-
1991	n/a	-	2
1992	12	2	1
1993	n/a	-	-
1994	n/a	1	-
1995	6	-	-
1996	4	-	-
1997	16	-	-
1998	5	-	-

Source: Director of Consumer Affairs

The Current Legal Status of the Groceries Order

It should finally be pointed out that the current legal status of the Groceries Order is somewhat unusual having regard to the provisions of the Competition Act, 1991. These provisions led to the following comments by Ireland's member on the Court of First Instance of the European Communities, Judge John D. Cooke, who writing extra-judicially described the Groceries Order as an anomaly which is:

> *"still hovering like a magician's assistant in the statutory vacuum left by the repeal of [the Restrictive Practice Acts]. It hangs there, unchangeable, suspended on the tenuous thread of a questionable Commencement Order under Section [2] of the 1991 Act,*

notwithstanding the blunt wording of Section 22"[14].

The reason for these doubts concerning the continued existence of the Groceries Order having regard to the 1991 Act arises from a combination of the provisions of Section 2 and Section 22 of the 1991 Act. Under Section 2(1) it was provided that the 1991 Act should come into operation on the day or days as may be fixed by order of the Minister "*either generally or with reference to a particular purpose or provision*" and "*different days may be so fixed for different purposes and different provisions of [the 1991 Act]*". Under Section 22 the provisions of the Restrictive Practices Act, 1972 and "*every order made under that Act*" together with a number of sections in the Restrictive Practices (amendment) Act, 1987 were repealed.

However, Section 2(2) provided that an Order under Section 2(1) could as respects the repeal effected by Section 22 of the provisions of the 1972 Act "*fix different days for the repeal of different provisions of that Act or for the repeal for different purposes for any provision of that Act*". Thus, Section 2(2) did not refer to <u>orders</u> made under the 1972 Act but only <u>provisions</u> of that Act. Since the 1972 Act <u>and all orders made thereunder</u> were repealed by Section 22 of the 1991 Act it was felt in some quarters that notwithstanding that it was the clear intention that the Groceries Order would remain in force[15] the Groceries Order may have been inadvertently repealed. However this argument was made in *Masterfoods Limited v H.B. Ice Cream Limited*[16] and was rejected by Keane J in the High Court. He relied on the fact that Section 2(1) empowered the Minister to provide for the coming into operation of the 1991 Act on such day or dates as he might fix either generally "*or with reference to a particular purpose or provision*". He found that the Minister had made use of that power in the commencement order[17] to bring into force on 1 October 1991 Section 22 for all its purposes other than those specified

14 Judge Cooke was writing in the foreword to Imelda Maher "*Competition Law Alignment and Reform*" Roundhall Sweet & Maxwell (1999) at vii-viii.

15 See for example the comments by the Minister in Dail Eireann - 409 Dail Debates Col. 776.

16 [1993] ILRM 145.

17 Competition Act, 1991 (Commencement) Order, 1991.

and among those specified was the repeal of the 1987 Order. The court held the Minister was clearly entitled to do this. Therefore, it would appear that notwithstanding the doubts about the continued existence of the Groceries Order its existence has received judicial confirmation in the form of the judgement of Keane J in the High Court[18]. The Group has proceeded on the assumption that the Groceries Order is in force.

18 The issue of the status of the Groceries Order was not among the issues which are the subject to the appeal to the Supreme Court.

3. 1991 Fair Trade Commission Report

The most recent review of the Groceries Order was carried out by the Fair Trade Commission in 1991. The Commission furnished its report to the then Minister for Industry and Commerce in August 1991. A majority of the Commission[19] recommended that the Groceries Order should be abolished in its entirety. The minority[20] agreed that certain of the provisions of the Groceries Order would no longer be required when the Competition Act, 1991 came into operation but argued that certain of the provisions in the Groceries Order should be re-enacted in the form of a Fair Trade (Groceries) Act including the prohibition on below cost selling and the provisions governing suppliers' terms and conditions.

The Commission was unanimous in its view that having regard to the enactment of the Competition Act, 1991 and in particular Section 4 of that Act, the provisions of the Groceries Order containing agreements to fix or maintain prices in Articles 3, 4, 5 and 6 of the Groceries Order were no longer necessary and should be repealed. The Commission was satisfied that agreements and practices were covered by Section 4(1) of the Competition Act, 1991 and there was no necessity to prohibit such practices by way of a separate order in the groceries sector.

The Commission was also unanimous in its recommendation having regard to the enactment of Section 4(1) of the Competition Act, 1991 the provisions of Articles 7 to 10 (inclusive) of the Groceries Order should be repealed.

The Commission was divided in relation to the provisions of the Groceries Order governing below cost selling, namely, Articles 11, 12, 19, 20 and (part of) 2 but the majority recommended repeal of those provisions. It concluded that the anti-competitive aspects of below cost selling would adequately be

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19 Patrick M. Lyons (Chairman) and Patrick Massey (now member of the Competition Authority and Director of Competition Enforcement).

20 Mr. Myles O'Reilly, Secretary of IBEC Competition Council and a member of the present

covered by the Competition Act, 1991. It was accepted that in the absence of an agreement or action which might be caught by Section 4 of the 1991 Act below cost selling by a firm which was not in a dominant position and which did not have a predatory object or effect would not be prohibited by the Competition Act. The majority however was of the view that non predatory price competition was no less desirable than other forms of promotion such as advertising, opening hours and free deliveries and a ban on below cost selling which was non predatory and which was not engaged in by a firm in a dominant position in the market was a "*serious restriction upon competition and upon the free play of market forces*"[21]. The majority also considered that there was "*persuasive evidence*" that the prohibition on below cost selling had resulted in higher prices, a decrease in price competition and an increase in margins[22].

The minority (Mr. O'Reilly) argued that the prohibition on below cost selling should be retained and extended and re-enacted in the form of a Fair Trade (Groceries) Act. He recommended that the definition of cost should be changed from the "net invoice price" to the price after taking into account all discounts or rebates related to the goods. He was of the view that the ban on below cost selling should be retained for a number of reasons, principally that the removal of the ban would lead to an increase in concentration and would strengthen the position of multiples at the expense of independents and small firms. He was of the view that an increase in concentration be likely to reduce competition or damage the interests of consumers and independent retailers. The majority did not agree with Mr. O'Reilly's proposals that the ban on below cost selling should be retained as part of a new Fair Trade (Groceries) Act.

The Commission was also divided in its findings and recommendations concerning provisions of the Groceries Order governing terms and conditions of supply at Articles 13 to 18. The majority recommended that Articles 13 to

Review Group.

21 FTC 1991 Report para 7.124.

18 of the Order be repealed. It was of the view that the provisions of Section 4 and 5 of the Competition Act, 1991 were sufficient to address the issues with which these Articles are concerned. With regard to the provisions in Article 16 governing adherence to credit terms, the majority was of the view that whilst non-compliance with credit terms might constitute a breach of Section 4 or Section 5 of the Competition Act, 1991 if a problem should arise which could not be determined by reference to the 1991 Act consideration could be given to the introduction of special legislation on credit terms in the future. The majority was of a similar view in relation to Article 18 which prohibits "hello" money. The majority felt that the Competition Act, 1991 would apply and to the extent that it did not and if problems arose consideration could be given to specific legislation in respect of such payments. On that basis the majority was of the view that Articles 13 to 18 of the Groceries Order should be repealed.

The minority, Mr. O'Reilly, agreed that certain of the Articles could be repealed having regard to the Competition Act, 1991. They were Articles 13(2), 13(3), 13(4), 14(1), 14(2), 14(3) and 14(4), 15, 16(1)(c), 16(2) and 17. However, he was of the view that the matters covered by the remaining Articles should be re-enacted in the form of a Fair Trade (Groceries) Act. The matters which he felt should be re-enacted in that form concerned (1) the requirement to prepare and make available statements of terms and conditions; (2) the provisions regarding a refusal to supply and adherence to credit terms, and (3) the provisions governing threats and inducements, advertising allowances and "hello" money. The majority did not agree that Fair Trade (Groceries) Act legislation was necessary.

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22 FTC 1991 Report para 7.128.

4. Summary Of Submissions On The Groceries Order

The purpose of this section is to summarise briefly the submissions received by the Group on the Groceries Order. The persons and organisations who made submissions to the Group on the Groceries Order have been identified earlier in this paper. Most of the submissions from industries made to the Group favoured retaining the Groceries Order in its current state or by way of new legislation. Economists and the Competition Authority favoured the repeal of the Order.

(1) IBEC: Competition Council and Food, Drink and Tobacco Federation

Detailed and helpful submissions were received by the Group from both the Competition Council and the Food Drink and Tobacco Federation of IBEC.

In its submissions the Competition Council (the "Council") stated that it was "*essential that the provisions of the ban on below cost selling and the requirements in relation to the payment of supplier's accounts be retained*". The Council also considered that the other "*fair trade provisions*" in the Groceries Order be retained. The Council submitted that the Group should recommend to the Minister that a Fair Trade Groceries Act should be introduced. In its submissions, the Council identified what it considered a number of beneficial effects of the Groceries Order. They may be summarised as follows:

(a) A rate of increases in food prices in the five years following the introduction on the ban of below cost selling was lower than in any five year period since 1947;

(b) The rate of increase in the food price index has since 1987 been lower than the increases in the Consumer Price Index;

(c) The rate of increase in the food price index has since 1985 been significantly lower than in the United Kingdom or the rest of the European Union;

(d) The retailer's margin on food sales has not increased;

(e) Since the introduction of the Groceries Order the production of the food and drink industries has increased over fifty per cent and the stability brought about by the Groceries Order has made a "significant contribution" to this;

(f) Since 1990 employment in the food and drink processing industries has increased by three thousand people when compared with a fall in employment between 1981 and 1990. The Competition Council believe that this was partly due to the fair trading environment brought about by the Groceries Order.

The Council identified what it submitted to be the effect of removing the Groceries Order. Those effects may be summarised as follows:

(a) Total employment in the retail sector and associated sectors could be reduced by up to 23,000 people;

(b) Consumer prices would in time increase by more than the "all items" index because greater market concentration would lessen competition;

(c) Irish producers would experience a loss of competitiveness leading to a reduction in exports of food products which would be brought about by unfair trading conditions on the home market;

(d) Other retail sectors would experience harmful effects as multiples would attract customers from outlets such as hardware, gardening and similar outlets by below cost selling of food;

(e) It would facilitate the entry of British multiples which would have further harmful effects for employment in the food processing sectors and in the development of food exports which would seriously disadvantage Irish suppliers and producers.

The Council accepted that the "competition" provisions in the

Groceries Order have been “largely duplicated” by the Competition Act, 1991 but it submitted that it was still important that a number of features of the Groceries Order be retained. Whilst the Council submitted that the two most important provisions which should be retained are the ban on below cost selling and the requirement that suppliers be paid in accordance with their terms, other provisions should also be retained to ensure fairness in the grocery trade.

The Council offered as the preferred solution the retention of the fair trade provisions in the Groceries Order indefinitely in the form of specific legislation providing for fair trade in the grocery trade which it recommended should be enacted. In the alternative, the Council submitted that the Competition Acts should be amended to provide specifically for fair trade in the grocery market. Those provisions which the Council felt should be retained and re-enacted in this manner are Articles 11, 12, 19, 20 and (part of) 2 relating to the ban on below cost selling and Articles 13 to 18 relating to (inter alia) supplier’s terms and conditions and the ban on “hello” money. The Council submitted that the matters dealt with in these Articles are not regulated by the Competition Acts and the retention of such provisions in the form of the fair trade legislation which the Council submitted should be enacted would not have an anti-competitive effect. The Council attached by way of an annex to its submissions proposals for a Fair Trade (Groceries) Act.[23]

The submissions made by the Food, Drink and Tobacco Federation of IBEC (the “Federation”) were to the same effect. The Federation submitted that the Groceries Order was “*fundamental in ensuring fair competition in the Irish grocery market*”. It also submitted that the removal of the Order would have serious consequences and echoed the effects submitted by the Competition Council. The Federation submitted that if the Groceries Order is not retained “*a substantial*

[23] The IBEC Competition Council submissions are to a significant extent reflected in Chapter 6.

number of jobs would be lost both in the retail sector and in the supplying sector" and that it is "*important that the government ensure that fair competition exists in the market place"*.

(2) RGDATA - IADT - SSRF

A joint submission was made to the Group by the Retail Grocery Dairy and Allied Trades Association (RGDATA), the Irish Association of Distributive Trades (IADT) and the Service Station Retailers' Federation (SSRF). RGDATA represents more than 9,000 independent grocery and newsagent retailers in the State. IADT represents 44 food wholesalers who operate more than one hundred cash & carries throughout the State many of which also deliver to retail customers. The SSRF represents 1300 service station / forecourt shop retailers in the State.

In their submission, RGDATA, IADT and SSRF (which shall for ease of reference be referred to together as "RGDATA") advocated the retention and strengthening of a number of provisions of the Groceries Order. RGDATA submitted that the Order has been of "*incalculable importance*" to the retail and wholesale sector since 1987. RGDATA submitted that the ultimate beneficiary of the Groceries Order has been the consumer whom it submitted has benefited from low prices in a competitive market which has benefited from the ban on below cost selling. RGDATA submitted that because of the importance of the grocery sector to consumers daily lives and to the lives of those working in and supported by the groceries sector there are "clear arguments in favour of an element of public regulation of the sector". RGDATA submitted that a minimum legislative framework to discourage unfair and predatory trade practices is necessary to enable the new competition from UK multiples to be met head on. It submitted that if the "*restraining influence*" of the Groceries Order was removed without being replaced the market would descend into "semi chaos". This would lead to a new drive for market share based on loss leading the eventual winner of which would be the company with the greatest resources. It was submitted that this would lead to job losses across all sectors and would be detrimental to the consumer. Standards and investment would also decline.

RGDATA accepted that certain elements of the Groceries Order have been duplicated by the Competition Acts 1991 to 1996. However, until the enforcement provisions in the 1996 Act were introduced it was necessary to retain those provisions of the Groceries Order. RGDATA accepts that Articles 3 to 10 have now been superseded by the Competition Acts, 1991 to 1996 and accept that it is not necessary to retain these Articles of the Groceries Order. However, RGDATA submitted that the Order should not be repealed in its entirety and that the provisions dealing with the ban on below cost selling, the prohibition on "hello" money and on the abusive credit terms and the requirement to retain a statement of terms and conditions should be retained. Failure to do so would, RGDATA submitted, result in a closure of over two thousand independent retailers throughout the State and a consequent loss in employment and services to the public. RGDATA submitted that new legislation should be en-acted providing for the retention of key aspects of the Groceries Order. Those aspects of the Groceries Order which RGDATA submitted should be retained and re-enacted in the form of new legislation are:

(a) The ban on below cost selling.
(b) The ban on "hello" money.
(c) The provisions governing adherence to supplier's credit terms.
(d) The "Fair Trade" provisions in the Order, namely, Articles 13 to 18.

(3) Irish Farmers Association

The Irish Farmers Association (IFA) made a submission to the Group advocating retention of the Groceries Order and the extension of the provisions of the Order to include fresh fruit and vegetables.

The IFA submitted that the retention of the Groceries Order was vital to allow Irish farmers producing milk, meat, fruit, vegetables and potatoes to compete fairly and on an "even plane" with imports. The IFA submitted that in relation to the milk market the Groceries Order has been instrumental in maintaining a high level of door stop sales by ensuring that they would not be undermined by predatory pricing by supermarkets and that this had not been achieved at the expense of the consumer as the retail price of milk has not increased beyond inflation in the past 10 years. The IFA submitted that the abolition of the Groceries Order would encourage a return to price wars between supermarkets in which Irish primary producers, small food processors, consumers and independent retailers would be the "ultimate casualties". It submitted that the only winners in such price wars would be the major supermarket chains.

(4) Irish Co-operative Organisation Society Limited (ICOS)

The ICOS furnished a submission to the Group advocating retention of the Groceries Order. It submitted that it was vital that the ban on below cost sales should be retained *"so that trade can take place in an environment that is fair to all"*.

(5) A Distributor of Fresh Fruit and Vegetables

A detailed submission was made by a firm of solicitors acting for a distributor of fresh fruit and vegetables. The submission was made on the basis that it would be treated as confidential. The identities of the firm and its clients are not disclosed.

It was submitted by the distributor that fresh fruit and vegetables which are excluded from the Groceries Order are repeatedly targeted by multiples for heavily advertised below cost selling. It submitted that such heavily advertised below cost selling causes significant inefficiencies and unnecessary expenses. It favoured retail outlets selling fruit and vegetable products for low cost or on a marginal basis provided this was done (i) for an extended period of time and (ii) for a total or at least a wide range of products which would have stimulated demand without unnecessary costs. However, it submitted that this was rarely the case as such short term below cost selling produces a short term surge and demand requires additional distribution on a non-scheduled and urgent basis which is disruptive and increases costs. It submits that such heavily advertised below cost selling of single product ranges increase inefficiencies in the production and distribution system of suppliers to the retail outlets and would impose unnecessary costs which are of no benefit to the consumer. In summary, the firm submitted that the ban on below cost selling should be retained but should also extend to fruit and vegetable produce. If the ban is not extended to fruit and vegetable the firm submitted that the ban on below cost selling should be removed so that the fruit and vegetable sector would not continue to be the target of all below cost campaigns.

(6) An Bord Glas (The Horticultural Development Board)

An Bord Glas furnished a submission to the Group which advocated the inclusion of horticultural produce within the scope of the Groceries Order so that such produce would not in future be a focus for below cost selling. An Bord Glas referred to a previous submission which it made in similar terms to the Department of Enterprise & Employment in 1994.

(7) Barry Doherty

Barry Doherty, a member of the Legal Service of the European

Commission furnished a submission to the Group in his personal capacity. He pointed out differences between the rules in the Groceries Order and those applied by the Competition Authority under the Competition Acts. He noted that the effectiveness of the Groceries Order might be open to question and referred in particular to the ban on the payment of "hello" money. His submission also noted the practical importance of the Groceries Order had been "greatly reduced" because of the general remedies now available under the Competition Acts. However, his submission states that the Groceries Order is still useful in that it covers areas which are not necessarily covered by "pure" Competition Law. He suggests that it would be possible to incorporate special rules for the grocery sector in a "revised" Competition Act.

(8) <u>Dr. John Fingleton (T.C.D.)</u>

Dr. John Fingleton of the Department of Economics in Trinity College made a submission to the Group part of which concerned the Groceries Order which he described as a "*serious anomaly in our system of competition*".

Dr. Fingleton's views on the effectiveness of the Groceries Order can be seen from the following extract from his submission:

> "*The Groceries Order is a serious anomaly in our system of competition and, very probably, assists anti-competitive behaviour in some of the most concentrated markets in the economy, namely, the distribution and retailing of groceries.*
>
> *The Order prevents retailers selling below cost, where cost is defined as the price on the invoice. However, this is not the true cost, as off invoice discounts are substantial and wide spread. Thus the Order permits a form of resale price maintenance in the groceries sector.*

IBEC has produced various statistics that illustrate that food prices did not rise in real terms between 1987 and 1993. However, margins not final prices, are relevant to the effects of the Order as it affects the distribution and retail business rather than the manufacturer. The price of the raw materials (e.g. food) did not match inflation over the same period.

There is nothing to recommend the retention of the Groceries Order other than the interests of producers in this sector. The Order undoubtedly imposes high costs on the consumer and offers a convincing explanation for the under development of the distribution and retailing sectors in the Irish economy."

(9) Patrick P. Walsh and Ciara Whelan

Patrick P. Walsh of the Department of Economics, Trinity College, Dublin and Ciara Whelan of the London School of Economics[24], made a submission to the Group on the Groceries Order. They generously furnished a copy of two papers which they presented to the Irish Economic Association in May 1995 and the European Association for Research in Industrial Economics in September 1996 entitled respectively *"A Rationale for Repealing the 1987 Groceries Order"* and *"Loss Leading and Price Intervention in Multi-Product Retailing: Welfare Outcomes in a Second Best World."*

In their submission, Dr. Walsh and Ms. Whelan argue that loss leading is a form of competitive price discrimination that processes information for the consumer in the short run and has no effect on structure in the long run. They argue that loss leading is an equilibrium outcome that is socially desirable in

24 Both economists are also of the Centre for Transition Economics, Katholieke Universiteit, Leuven.

an imperfectly competitive market with imperfect consumer information. They argue that the provisions of the Groceries Order may have had the unintended and perverse effect of implementing minimum resale price maintenance resulting in a large proportion of increased consumer expenditure being appropriated upstream to suppliers who were never intended to benefit from the Groceries Order. They argue that this is likely to increase the likelihood of the market becoming more concentrated in the long run. Analysis suggests that since the introduction of the ban on below cost selling in the Groceries Order concentration of the market has continued to rise. They believe there is a possibility that this may in part be attributed to the introduction of the Groceries Order. They argue that the removal of the ban on below cost selling and the exposure of the grocery retail market to the provisions of the Competition Acts would be beneficial for overall welfare and that the Competition Acts are the preferred legislative framework given the possibility that loss leading can be a legitimate reflection of the competitive process. Their arguments are reflected more fully in Chapter 7 below.

(10) Competition Authority

In its second submission to the Group the Competition Authority addressed that part of the Group's terms of reference which was directed to considering the "effectiveness of competition legislation and associated regulations". In this submission the Authority addressed the Groceries Order. The Authority recommended the repeal of the Groceries Order on the basis that it is anomalous and counterproductive.

The Authority noted that prohibition on resale price maintenance, price discrimination and the payment of "hello" money would be prohibited under the Competition Acts where they inhibit competition and submitted that to that extent the Groceries Order is redundant. The Authority submitted that the ban on below cost selling and the ban on refusal to supply in the Groceries Order operate at cross purposes with the Competition Acts.

With respect to the ban on below cost selling, the Authority noted that the Competition Act, 1991 prohibits predatory pricing in the sense of deliberate below cost selling by dominant firms in order to eliminate competitors. However, the Authority noted that many cases of below cost selling are not predatory but may be a "*legitimate means of increasing market share which is the objective of all competitive behaviour*". In its submission the Authority argued that the ban on below cost selling is a "*highly effective mechanism for suppliers to enforce minimum prices*" and that the Authority had received a complaint which "*fully substantiates its use for that purpose by a group of all of the main suppliers of one basic grocery product*".

The Authority addressed some of the arguments for the retention of the Groceries Order put forward by representative bodies of suppliers and independent retailers. Those bodies have argued that the ban on below cost selling has helped to contain food price increase, has preserved employment and enhanced the competitiveness of Irish food processors. However, the Authority argued that such claims are not compatible with "most conventional explanations of causes of inflation". The Authority also disputes the assertion by supporters of the ban on below cost selling that the ban is necessary to ensure the survival of small independent grocery retailers even if true the Authority contends that this merely illustrates the common perception that the purpose of the ban is to protect competitors and not competition. The Authority noted that the numbers of retailers have continued to decline. In response to the contention by supporters of the ban that the ban protects jobs by protecting small retailers and suppliers, the Authority contended that in reality many suppliers to the grocery trade have closed their domestic manufacturing operation since the Groceries Order came into force and now act as distributors of imported goods.

With respect to the prohibition on refusal to supply in Article 13(1) of the Groceries Order (i.e. the obligation on the supplier to sell to wholesalers or retailers in accordance with the supplier's written terms and conditions), the Authority noted that while in some circumstances a refusal to supply would be anti competitive but there are also legitimate reasons why suppliers may refuse to supply on purely commercial grounds and that this distinction is not reflected in the Groceries Order.

The Authority referred to the research of a number of economists and bodies suggesting that the Groceries Order restricts competition and is harmful to consumers. The Authority argued that the only supporters of the retention of the Groceries Order are bodies representing retail grocery interests and suppliers. The Authority recommended the repeal of the Groceries Order on the basis that it is anomalous and counter productive.

(11) William P. Fagan (former Director of Consumer Affairs)

William P. Fagan, former Director of Consumer Affairs furnished the Group with a copy of a paper entitled “Enforcing the Groceries Order Past and Future?” delivered at a conference in February 1997. At the conclusion of his paper Mr. Fagan set out a series of observations which he indicated might help the Group and others considering the future of the Groceries Order. Those observations were as follows:

"1. I have no vested interest one way or another in the continuation of the Order. I have been less active in relation to the Order in recent years because I have received fewer complaints. I have not been proactive in relation to the enforcement of the Order (a) because I see no need for it and (b) because I have a greatly expanded range of functions in other areas which require me to be proactive in those areas.

2. I believe the Order has done no real harm to our economy. I would leave it to food/grocery trade industry representatives to talk about the benefits. I would point to four items only:

   (a) Low food inflation;
   (b) Absence of collapses since H. Williams in the 1980's (whether this is good or bad depends on your point of view);
   (c) Improvement in the standard of retail outlets;
   (d) Growth of high standard single outlets particularly in rural Ireland.

3. I believe Irish and UK price levels are getting closer to one another…

4. The Groceries Order should not be a relevant issue in relation to the expected UK food retail invasion. We have had difficulty in determining the precise inward cost for the purposes of Article 11 of the Order. UK retailers are, however, free to enter the Irish market and may use internal invoicing methods to bring goods from stores in the UK without reference to the Groceries Order. We had a District Court ruling that such internal invoicing was not relevant in the case of Power Import/Quinnsworth Group.

5. The decision on a continuation of the essential features of *the Order will be a political one based on the views of the Review Group. I believe it will boil down to the issue of below cost selling.*

6. *The Groceries Order is an old piece of legislation which cannot be amended. I believe that if it is to continue in some form a new piece of legislation (probably a Groceries Act) will be required. The question also arises as to who should enforce it."*

5. Independent Study On Impact Of Groceries Order

As pointed out in the introduction to this paper the Group decided to engage the services of DKM Economic Consultants Limited to carry out a study on the economic impact of the Groceries Order and to report on the results of its study to the Group. A copy of the DKM report is attached at Appendix A to this document.

In assessing the impact of the Groceries Order, DKM concentrated exclusively on what it regarded as being the most significant and most controversial provision in the Order, namely, the ban on below cost selling. In its report DKM describes the ban on below cost selling as resembling although not identical to resale price maintenance. The DKM report considers the submissions made by the various parties to the Group and the evidence available on the impact of the Groceries Order. In particular, the report looks at the effect of the Groceries Order on trends in food prices relative to the Consumer Price Index, on margins in the grocery trade and on trends in market structure including the overall number of outlets and concentration. DKM express the view that the ban on below cost selling *"is unlikely to have profound effects on any of these three variables"*.

With respect to food prices, DKM note that the consideration of data on food prices relative to the Consumer Price Index from 1976 does not support the view that the Groceries Order has had any discernible effect on food prices and that extraneous factors affecting relative prices in the economy are "*more powerful than any conceivable impact from the Groceries Order*". DKM do not believe that the impact of the Groceries Order on relative prices is capable of being assessed by reference to the CPI and its component series. DKM conclude with the view that none of the submissions succeeded in establishing that the Order had the beneficial impact claimed on food prices.

With respect to margins, DKM express the view that the evidence in the submissions does not support the view that the Groceries Order has had the effect of applying downward pressure on margins in the trade. They suggest that the available evidence, restricted to gross margins and therefore of questionable value, does not show a pattern of decline in margins.

Finally, with respect to the question of market structure, DKM express the view that it is not possible to draw firm conclusions from available data on the influence of the Groceries Order on outlet numbers because of extraneous influences such as demographic change, population decline, urbanisation and rise in car ownership. DKM express the view that none of the submissions established that the Order has had the effect of ensuring a greater number of outlets either nationally or in specific locations than would otherwise have been the case in its absence. With respect to the question of concentration, DKM express the view that from the submissions or otherwise they are unaware of evidence establishing that the Groceries Order has impacted on the degree of concentration in the industry.

The DKM report considers the economic effect of repealing the ban on below cost selling contained in the Groceries Order. DKM argue that the static impact of repeal of the Order would be limited and would not result in any major impact on consumer prices or on margins. The principal impact would be on the composition of promotional activities. They also argue that the dynamic impact of repeal of the Order would be even more limited. They conclude their review of the potential consequences of repealing the ban on below cost selling in the Groceries Order as follows:

> *"Different countries have adopted different approaches to the practice of below cost selling. It is permitted, for example, in the UK, as well as in Germany, Spain and Italy, but restricted in France, Belgium and Portugal.*
>
> *The objectors to repeal of the Groceries Order have failed in their submissions to demonstrate empirically the claimed benefits of the*

Order, or to establish the justification for their predictions of the impact of repeal. The available evidence, as well as considerations of market structure and competitor response lead us to conclude that the impact in Ireland is capable of being exaggerated.

The principal immediate impact of the Order is to facilitate a form of minimum price maintenance, and to channel competition into other avenues. The claims made for the Order include beneficial impact on suppliers of the multiples and on their smaller competitors. The protection of these interests is not a feature of Irish consumer or competition law in other sectors, and the Groceries Order is to that extent an anomaly."

The conclusions and recommendations of the DKM report are contained in Section 6 of the report and are as follows:

"Conclusions, Recommendations

Our conclusions mirror those of the majority report of the Fair Trade Commission in 1991.

They concluded, inter alia, that the ban on below cost selling did not prohibit pricing behaviour by a dominant player which might be predatory in intent or effect.

They concluded that for predatory pricing to be effective, the predator must succeed, not only in eliminating competitors, but also in inhibiting the entry of new ones. They express doubt that these conditions obtain in the Irish grocery market.

> *They consider that:*
>
> *"… promotional, non-predatory, price competition, including below cost selling, is not less desirable than other forms of promotion such as advertising, opening hours, free delivery and so on"*

They expressed scepticism about claims that the Order had resulted in food prices rising by less than the CPI.

They attributed an evident increase in non price competition with the impact of the Groceries Order and concluded that the Order had the effect, particularly in view of the practice of off-invoice discounting, of permitting a form of resale price maintenance.

They did not accept that the majority of consumers were, or would be, fooled by below cost selling, and they expressed doubt as to whether removal of the ban would impact adversely on independent stores.

On the matter of retail chains facing undue pressure on suppliers, they did not consider that any safeguards were required over and above those contained at Section 5 of the Competition Act.

We agree with each of these conclusions and believe that the available evidence from the period since the FTC report was written, including the evidence cited in submissions, does not controvert them.

The majority also concluded (paragraph 7.128) that:

> *"… there is persuasive evidence that the ban on below cost selling has resulted in higher prices, a decrease in price competition and an increase in margins".*

We have concluded that the available evidence is inadequate to support categorical attributions of movements in prices and margins to the impact of the Groceries Order.

The minority report drew radically different conclusions on many points. The most significant were:

- *If there is no prohibition on below cost selling,* *market concentration is likely to increase substantially;*

- *Below cost selling will make it almost impossible for many independents to compete;*
- *A ban on below cost selling can be a significant barrier to predatory conduct.*

We have concluded that the likely impact of a removal of the below cost selling ban would be limited. The third point cited above is in conflict with the know facts. A multiple which cuts prices across the board to the level of cost would be operating at hugely negative net margins, could only chose to do so rationally with some form of predatory intent, but would be operating within the terms of the Groceries Order.

The majority of the FTC recommended the repeal of the Groceries Order in its entirety, and this is also our recommendation."

6. Arguments in Favour of Retaining the Groceries Order.

1. Introduction and Summary of Arguments

This chapter summarises out the arguments in favour of retaining the Groceries Order.[25] The chapter is largely a response to the DKM report from the point of view of those who support the retention of the Order such as IBEC and is based to a large extent on the IBEC submissions. It argues that the conclusions of the DKM report should not be accepted by the Review Group and that the Groceries Order fair trade provisions be maintained.

The Groceries Order came into force eleven years ago. The grocery trade has undergone very substantial change since that time. A review of the statistics shows that food processing activity has grown substantially and the levels of employment in food processing have also grown since the Order was introduced. Similarly, the independent retail trade has been greatly strengthened and provides a credible alternative to the multiples for grocery shopping. Consumers have not been disadvantaged by higher prices and have gained from an increase in choice of product and better grocery stores.

The DKM report found that the Order has not had any significant impact. The report did not consider that its abolition would, therefore, have any negative impact. Thus there is no compelling reason for the order removing the order.

It seems to be significant that nearly all of those who are familiar with the operation of the Order in the grocery trade are not opposed to its continuation. No sector of the grocery trade is arguing that the Order is anti-competitive or has an anti-competitive effect. Opposition to the Order comes from academic and practising economists who, it is believed, have not had the time or the possibility of engaging with the participants

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25 In preparing this chapter, the IBEC Competition Council submission of 31st January 1997, the Food, Drink and Tobacco Federation (FDT) submission and information contained in other submissions to the Review Group have been extensively used. Assistance has also been obtained from members of the IBEC Competition Council involved in the grocery trade and, particularly, from Ms. Ailish Forde, Assistant Director of the FDT and members of the Food Processors and Suppliers Group.

in the grocery trade to assess in detail the implications and realities of competition in the sector. It is believed that, if they did have the opportunity of having extensive discussions and of examining the nature of that competition, they would have less difficulty with the Groceries Order.

This chapter examines the position of suppliers, consumers and retailers. It seeks to establish what effect the Groceries Order has had on each of these categories. It then assesses the likely impact of the abolition of the Order for each category.

The Fair Trade Provisions

There is no conflict between the fair trade provisions of the Groceries Order and the Competition Acts. The Competition Acts can exist comfortably with the fair trade provisions of the Order. Many countries have fair trade laws in addition to their competition legislation. Many of these fair trade laws prohibit below cost selling and loss leading. Ireland is not unique in having such legislation. Many countries also have provisions against price discrimination by suppliers. Among these countries are Germany and the United States (Robinson-Patman Act, 1936). The purpose of the Order is to create fair trading conditions or "a level playing field" between competitors in the grocery market.

Below Cost Selling

The Groceries Order is not designed to stop predatory pricing. Below cost selling is not necessarily a predatory activity. However, one of the effects of the ban on below cost selling is to make it less likely that predatory actions would take place. The Competition Act does not specifically prohibit predatory pricing. Only a company in a dominant position is required to sell at fair prices. As it is possible that a Court would not regard any of the present retailers as being in a dominant position, the Competition Act does not prevent unfair pricing or predatory pricing by grocery retailers. It is necessary, therefore, to have a provision such as the ban on below cost selling if below cost selling activity is to be prevented.

The ban on below cost selling has been in existence for over eleven years. It is an established feature of the grocery trade. Almost none of the grocery trade participants advocate its removal. The DKM report was not able to establish any harmful effect of the Groceries Order. In these circumstances, it would seem that to remove the Order against the advice of those who understand and know competition in the grocery trade would be ill advised.

The harm which the removal of the Order would have on suppliers, consumers and retailers could not readily be undone by a re-imposition of similar provisions at a later date. Businesses would have closed, the extent of concentration would have increased and it would take drastic action to restore the present position in the grocery trade. It would seem a dangerous experiment to abolish the Order with a view to assessing what the effects would be.

Effects of the Order

1. The level of food processing has increased very substantially compared with the ten years prior to the Order. The level of employment in the food processing sector has shown an increase since the Order was introduced compared with a fall prior to the introduction of the Order. It is realised that these changes cannot all be attributed to the Order. There have been many other factors. Nevertheless, suppliers consider that the fair trading environment brought about by the Order has had a significant effect on their ability to increase production and employment in the sector.
2. Consumers have benefited from the investment of independent retailers and multiples in better quality stores, the increased range of products supplied, longer opening hours and services such as delivery by some supermarkets. Consumers have also benefited from the intense competition in the sector. Consumers have not had to travel from one store to another to obtain a reasonably priced shopping basket.
3. Independent retailers are much stronger in 1999 than they were in 1987. The introduction of the ban on below cost selling gave them the confidence to invest in their stores. This has led to a much higher quality of store throughout the country. The share of the market now held by independent retailers, including those who are members of symbol groups, is higher than it was in 1987 prior to the introduction of the order.
4. Employment in the sector has grown. The numbers employed by retailers has

increased. The numbers employed in the food processing sector has also grown.

Effects of removing the Order

1. There would be a loss of competitiveness among Irish suppliers in their home market. This loss of competitiveness in the home market will, in time, result in reduced competitiveness in export markets.
2. After the initial sale of goods below cost, independent retailers will become less competitive and some will cease business altogether. Concentration will increase and the consumer will have less choice of store.
3. The harmful effects of below cost selling will impact on sectors such as off-licences, hardware stores, drapery stores and other areas where the larger retailer will be selling products not generally sold in a grocery store. The large retailers would be able to attract customers by below cost selling of grocery goods. This will have an unfair effect on other retail sectors.
4. The permission to retailers to sell grocery goods below cost will undoubtedly facilitate the entry to the market of foreign multiples. These multiples will have no difficulty in investing large sums of money in selling goods below cost in order to obtain a foothold in the market. By doing so, they will eliminate domestic retailers who have an allegiance and loyalty to Irish suppliers.
5. The removal of the Order will result in reduced service in stores and reduced quality of stores. The reduction in the number of stores will require consumers to spend more time travelling to stores. It will result in increased car usage. It will also result in some villages throughout the country not having any viable grocery shops with resulting social effects.

2. <u>Suppliers</u>

The suppliers to the grocery trade include producers, processors, importers and distributors.

In order to determine what the effect of the Groceries Order has been on suppliers, statistics have been examined for the years 1977, 1987 and 1998. The Order came into force in January 1998 so that the 1977 and 1987 statistics were before the coming into force of the Order.

Production Levels

Category	1977	1987	1998
Slaughtering and Preserving of Meat	80.0	109.8	167.3
Manufacture of Dairy Products	67.1	96.2	109.3
Grain milling and manufacture of animal and poultry food	85.6	105.2	147.4
Bread, biscuit and flour confectionery	103.7	83.4	97.6
Manufacture of sugar and cocoa, chocolate and sugar confectionery	99.9	98.6	125.9
Other foods	86.3	155.6	364.8
Total	**77.1**	**117.4**	**204.3**
1985=100			

Source: CSO

During the ten years from 1977-1987 production increased by 52%. During the eleven years from 1987-1998, production rose by 74%. The changes in the production of "Other foods" is more significant. In the ten years to 1987 these rose by 80% whereas in the eleven years to 1998, they rose by 134%.

Undoubtedly, there are many factors influencing the levels of production. These are changes in the Common Agricultural Policy, currency movements, changes in taxation, reduction of trade barriers, etc. However, one of the important factors for food producers is the ability to trade on a fair basis in their home market. The Groceries Order has provided a fair trading environment. This has enabled suppliers to test market products in the Irish market and then to export them. It is significant that the greatest increase in production has been in the category "other foods". This has been where the development in food processing has taken place.

Employment in the Food and Drink Processing Industries

Numbers of Employees – 000's

Category	1977	1987	1997
Slaughtering and Preserving of Meat	11.7	9.6	12.1
Manufacture of Dairy Products	9.6	8.0	7.5
Grain milling and manufacture of animal and poultry food	4.7	3.6	2.9
Bread, biscuit and flour confectionery	9.9	6.7	5.7
Manufacture of sugar and cocoa, chocolate and sugar confectionery	7.9	43	4.1
Other foods	6.2	4.9	8.2
Total	**50**	**37.1**	**40.5**

Source: CSO

As can be seen from the above table, employment dropped sharply from 1977-1987. Employment increased by 9% between 1987 and 1997 (the latest available figures). Again, there have been many reasons for the changes in the employment levels. One of the factors has been the adoption of the ban on below cost selling.

A comparison of the volume increases for the food sector with employment in the food and drink processing industries shows that there have been very significant gains in productivity over the past ten years. These productivity gains have been a feature of all manufacturing industries. The trading environment in the grocery trade, however, has contributed to productivity improvements in processing. The absence of discontinuity in production and the absence of delisting of products has contributed to improvements in efficiency and productivity

Views of suppliers

In general, suppliers to the grocery trade believe that the ban on below cost selling introduced in the 1987 Order created a fair trading environment which allowed them to expand their businesses and to improve operating and other efficiencies. The ban on below cost selling eliminated the disruptions caused by de-listing and the falls and surges in demand from retailers depending on whether a particular product was being sold below cost or not. This fair trading environment was achieved not only by the ban on below cost selling but by the other fair trade provisions in the Order. These include the provisions in relation to credit, requirements to supply, fair terms and hello money.

The overall effect of the fair trade provisions of the Order allowed the management of processors and suppliers to concentrate their time and energies on the development of the businesses, particularly in relation to export markets and improving the efficiency of their operations. These benefits have resulted in increased exports, increased employment as well as a substantial increase in the productivity of those employed.

While the most talked about provision of the Order is the ban on below cost selling, suppliers believe that the retention of the provisions in relation to credit, the requirement to supply, fair terms and hello money are equally important to them. Suppliers believe that these fair trade provisions have general application to all sectors. Many countries incorporate fair trading provisions of this type.

It was the coupling of these fair trade provisions with the ban on below cost selling in the 1987 Order which brought about the following:

- Economic efficiencies through regulatory of supply and absence of discontinuity;
- A reduction in the increase in the level of concentration and therefore buying power of the major multiples;
- An assurance that a supplier’s brands would not be subject to the whims of retailers.

It must be remembered that Tesco, the largest supermarket group in the United Kingdom with a turnover 18 times larger than any of the Irish multiples, entered the market during the past two years. The Groceries Order ensures that Tesco and other similar market entrants are subject to a set of rules. These rules do not recognise the buying power or the economic power of the entrant but instead concentrate on creating a level playing field and a balance between the interests of suppliers and retailers. Retailers are not disadvantaged by the Groceries Order but have to treat their suppliers in a fair and reasonable way. Ultimately, this is in the interest of retailers as well as of suppliers. Nevertheless, the Order represents a set of fair trading rules with which existing and new market entrants must comply.

The Republic of Ireland market has managed thus far to absorb the entry of Tesco without excessive damage to Irish suppliers. This has been due, in no small part, to the existence of the Order and to the commitments given to the Irish Government by Tesco which were recognised in the EU approval of the Tesco acquisition of Quinnsworth. Hard discounters such as Aldi and Lidl have already established a presence in the Irish market and that trend looks likely to continue in the years to come. Many of these will have economic power, buying power and technical expertise greatly in excess of existing Irish retailers and suppliers. The Groceries Order represents a set of fair trade rules with which they have to conform. If there are no such rules in Ireland, they will employ whatever tactics they need to achieve market power, irrespective of the damage to existing retailers and suppliers.

Importance of Irish Brands

Irish food manufacturers provide both branded and own label products. Branded products are owned by the manufacturers and own label products are owned by the retailers. Supermarket groups are a major channel for manufacturers and suppliers to sell their branded products to consumers. However, supermarket groups are in competition with suppliers in so far as promoting their own label product ranges are concerned. Therefore, there is an unequal relationship between suppliers and retailers in that retailers are both customers and competitors (through their own label brands) of suppliers.

A retailer is certainly in a position where he can use below cost selling to destroy a brand’s worth so that the private label can ultimately triumph.

One of the significant developments in the past ten years has been the development of new Irish branded grocery products. For example, the Irish dairy sector has successfully launched a number of value added consumer brands, as has the prepared consumer food sector which has witnessed significant growth. The grocery trade has been supportive of these brands and companies invested in new product development with confidence knowing that their brands will not be used as loss leaders. In the absence of the ban on below cost selling, no such confidence would exist and suppliers would find themselves in a position where the value of their brands would be undermined by below cost selling.

For a company to penetrate overseas markets, it is important to be able to trade satisfactorily in its domestic market.

The removal of the ban would seriously undermine the economics of producing domestically branded goods and would further damage the overall strategy of test marketing and domestic market launch which normally precedes an export market drive.

The Effects on Suppliers of the Abolition of the ban on below cost selling

The Groceries Order came into force in January 1988. For the previous eight years there had been a ban on below cost advertising which had the effect of reducing below cost selling activity without eliminating it. Due to a court decision, the enforceability of the ban on below cost advertising was called into question after a number of years and the ban became then of little value.

However, prior to 1980, although there was no ban on below cost selling, suppliers were permitted to withhold supplies of goods if the goods were being sold below invoice cost.

Until the ban on below cost selling was introduced in 1988, suppliers generally discontinued supplies if the goods were being sold below cost. This was due to pressure from other retailers as well as their own need to ensure that their brands were not being devalued.

If the ban were now to be removed, the question arises as to whether suppliers would again seek to not supply where goods were being sold below cost. Because they would not have any explicit right to do so, as provided under the Groceries Order, many suppliers might decide that they would continue to supply irrespective of the price levels at which the goods are being sold. However, many other suppliers might believe that the carefully created image of quality and value attaching to their brands was being undermined by sales below cost and that they should cease supplies so as to bring about an end to the below cost selling activity. In addition, retailers who are not selling below cost, will apply pressure through de-listings and other activities on those suppliers whose goods are being sold below cost by other retailers.

The Competition Act 1991, unlike the Groceries Order, does not require a supplier to supply goods to any particular customer. It could be argued that Section 5 of the Act would require a company in a dominant position to supply goods even if they were being sold by the retailer below cost. Undoubtedly, below cost selling activity will create severe disruption to supplies for consumers, retailers and for suppliers. This disruption will reduce economic efficiencies in the supply chain and will increase costs. These costs, in time, will be passed on to consumers. In addition to increased costs of production, there will be the waste of management time and energy in constantly dealing with these issues at the expense of the long-term development of new products and export markets.

The weakening of Irish suppliers will facilitate the entry of overseas suppliers to the Irish market. Thus a greater proportion of the food and groceries on sale in the Irish market will come from overseas markets. This will have consequential effects on processing activity and employment levels.

The grocery trade is presently being affected by the changeover to central distribution. This has an impact on processors, suppliers and importers. It can be argued whether this will lead to an improvement in efficiency or not. The logistical arrangements presently being put in place will be disrupted by the discontinuities of below cost selling if the ban is removed.

Effect on suppliers of the abolition of the remaining provisions of the Order

Suppliers wish to have all of the fair trade provisions retained. The Order requirements in relation to credit and hello money are particularly important. The rules on non-discrimination in terms are of very considerable importance. If these are removed, the effect on concentration in the grocery trade and on suppliers will be significant. The suppliers note that DKM only addressed the ban on below cost selling.

3. Consumers

	Overall Index	**Food**	**% Food: Overall**	**Increases in Food Prices**
1977	131.6	130.0	101.20%	

1987	357.7	316.0	88.30%	143%
1998	470.1	412.5	87.70%	30.5%

Source: CSO

During the ten years from 1977-1987 food prices rose by 143%. However, they rose during that period by less than the overall consumer price index. At the end of 1987 the food price index was 88.3% of the overall index. During the eleven years to 1998, food prices only rose by 30.5%. During that time they rose by slightly less than the overall consumer price index.

Consumer Price Indices Comparisions*

Year	Ireland	UK	E.U.
1985	100.0	100.0	100.0
1990	116.8	125.7	123.5
1991	117.6	132.1	130.6
1992	119.0	135.0	134.7
1993	118.8	137.3	136.1
1994	122.9	142	140.2
***1985 = 100**			

Source: Eurostat

Consumer Price Indices Comparisions*

Year	Ireland	UK	E.U.
1994	95.0	93.4	95.3

1995	98.1	97.0	98.1
1996	100.0	100.0	100.0
1997	101.5	99.9	100.8
1998	105.7	100.9	102.3
1994/98	11.26	8.03	7.34
***1996 = 100**			

Overall Price Changes

1985/98	36.74%	53.78%	50.54%

Source: Eurostat, Note: Eurostat introduced a new index in 1996.

Since 1985 Irish prices rose by 36.74%. This compares with the increases in UK prices of 54% and of EU average prices of 50.4%.

Since 1994, Irish prices have risen faster than those in the UK or the EU average. However, this compares with a much lower rate of increase from 1985 to 1994. Prices in the past few years have been affected by imported inflation as a result of the depreciation of Sterling.

These tables do not show that consumers have been disadvantaged by higher food prices as a result of the ban on below cost selling. There are many factors influencing food prices including the CAP, currency movements, competition levels and others. It is not possible to say precisely what the effect of the Groceries Order ban on below cost selling has been. It is certainly not claimed that the Groceries Order has contributed to lower food prices. However, it is claimed that there is no evidence that the Groceries Order has contributed to higher grocery prices. This result is to be expected because below cost selling does not, in practice, generally mean lower prices. Below cost selling generally means lower prices on some products while other products are increased to recover the money given away on the “known-value items”.

The most important test to be applied in considering the Groceries Order is whether the price levels are higher as a result of the Groceries Order or not. We see below that the consumer is obtaining many other benefits from competition in the grocery trade. However, if it could be shown that the consumer was having to pay more as a result of the ban on below cost selling, then those who advocate the retention of the Order would have an important case to answer.

The tables show that the rate of increase in the price of grocery products has been modest. Undoubtedly, the price of grocery products is affected by many different influences such as currency changes, CAP reform, changes in lifestyle etc. Nevertheless, the relatively low level of increases in food prices since the Order was introduced in 1988 seems to show that the Groceries Order has not contributed to any increase in the prices of grocery goods.

Below cost selling does not contribute to a reduction in the price of grocery goods. Instead below cost selling means a reduction in the price of some goods and increases in the price of other goods. The overall margin to the retailer is unchanged. Therefore, banning below cost selling could not and did not result in any increase in the price of grocery goods to consumers.

The Irish grocery trade has traditionally been extensively supplied with products manufactured in the UK. The increase in the value of Sterling has resulted in continuing pressure on the price of grocery goods in the Irish market in recent years. Price surveys of grocery products show significant differences between prices of many products in Ireland and the UK. Overall, Irish prices, over a basket of goods, tend to be lower than those in the UK. This pertains although below cost selling is permitted in the UK market.

It would be extraordinarily foolish to think that because below cost selling is prohibited in the Irish market that there is no price competition. Price competition is intense. The only area where price competition is not permitted is in relation to the selling below invoice price of grocery goods.

Consumers benefit from competition among retailers as they benefit from price competition. However, consumers in general do not benefit from loss leading or below cost selling which is intended to mislead the customer about the value they can achieve in a particular store.

One of the important areas for consumers is the availability and accessibility of grocery stores. If concentration levels within the grocery trade increase, consumers would have less access to grocery stores. This would result in additional car journeys, traffic disruption etc. Consumers will spend more time travelling from one shop to another. In time, as the effects of below cost selling increase the level of concentration within the trade, consumers will have less choice. Prices will inevitably rise. The drive for efficiency at supplier and retailer level will diminish.

The effect of below cost selling will also be to reduce consumer choice in areas not directly affected by the Groceries Order, for example, hardware, off-licences and other specialised stores.

Both the present Director of Consumer Affairs and her predecessor have publicly stated that the ban on below cost selling should be retained.

4. Retailers

Retailer Share of the trade

	4 Weeks October 1986 %	**12 Weeks September 1990 %**	**48 Weeks December June - 05 %**
Dunnes	24.0	20.4	18.8
Quinnsworth/Tesco	25.0	20.9	21.0
H. Williams	6.0		
Superquinn	6.0	4.2	8.7
L&N/Roches	4.0	4.2	2.3
Other Multiples			1.1
Total Multiples	**65.0**	**49.6**	**51.9**
Superquinn/Centra		14.2	17.9
Spar		4.6	
Mace		2.8	
Other Symbols		4.2	6.9
Total Symbols	**18.0**	**25.7**	**24.8**
Others	**17.0**	**24.7**	**23.3**
	100.0	100.0	100.0

Source: Attwood/Taylor Nelson

N.B.: The product mix in the surveys has changed significantly between 1986 and 1999.

The above table must be treated with considerable caution. The first two set of statistics were contained in the Fair Trade Commission reports of 1987 and 1991. However, the first column related only to 31 products surveyed by Attwood at that time. The second column was in respect of a greater number of products and the third column, a still greater number.

The Commission report of 1987 examined the multiple share in great detail. The conclusion was that the multiple shares were not 65% of the market but in the range of 40-50% if the wider market definition including all sales of food in shops, household products and alcoholic liquor is used. The Commission noted that the share had increased significantly since 1980.

The number of multiple grocery outlets in 1986 was 174. This had risen from 107 multiple outlets in 1970. The number declined from 174 to 154 in 1991.

Given that L&N have been taken over by Musgrave and their stores are now trading as symbol stores, and that Roches Stores are also being supplied by Musgrave, the number of multiple outlets has fallen. This is partly due to the demise of H. Williams.

Without the access to the turnover of each of the companies involved, it is not possible to be certain of the impact of the Groceries Order on the share of the market taken by multiples. Nevertheless, it appears that, since the ban on below cost selling was adopted in 1988, there has been no significant increases in the share of the market enjoyed by multiple companies. In particular, it appears that Dunnes and Quinnsworth/Tesco, whose shares were particularly of concern to the Fair Trade Commission in 1986, have not shown any significant increases in market shares since then. It does not seem unreasonable to attribute the interruption to the rapid growth in multiple market shares, that had taken place in the years prior to 1988, to the adoption of the ban on below cost selling at the beginning of 1988. Undoubtedly, there are other factors such as the growth in competitiveness of Musgrave through its SuperValu and Centra stores and the general resurgence of the independent sector. The independent sector would attribute this partly due to the introduction of the ban on below cost selling which led to confidence that it could sustain profitable businesses in competition with the multiple stores.

One prominent supplier with well-known brands has found that the share of its business to the multiples has declined from 56% in 1987 to 45% in 1999. While it could not be stated that this was due to the ban on below cost selling, the supplier believes that the ban on below cost selling has partly contributed to this effect.

Concentration in the Irish grocery trade

The statistics above show the following market shares in 1998.

	%
Dunnes	18.8
Tesco	21.0
Musgrave/Roches	20.2
Superquinn	8.7

The HHI concentration level is 1279. The four firm concentration level is 68.7%.

In Britain, where concern has been expressed about concentration levels, the equivalent figures for December 1998 were:

	%
Tesco	17.0
Sainsbury	13.0
Asda	9.2
Safeway	8.1

The HHI concentration level is 609. The four firm concentration level is 47.3%.

It is apparent that the Republic of Ireland market is much more concentrated than the British market. This is further illustrated below:

	ROI %	GB %	Diff. %
Largest firm	21.0	17.0	(4.0)
Largest two firms	41.2	30.0	(11.2)
Largest three firms	60.0	39.2	(21.8)

Any measures which might have the effect of increasing the market shares of the largest companies will increase the level of concentration.

The Groceries Order was signed in 1987 although it did not come into force until

January 1988. Since the Order was signed, there have been a number of significant developments. H. Williams went into liquidation and its stores were sold to other market participants. The H. Williams liquidation happened before the ban on below cost selling came into force and arguably might not have happened if the ban had been introduced.

There have been a number of new entrants to the market; Iceland with some stores, CostCutters, and Vivo, a symbol group of Hendersons of Belfast. Tesco took over the Quinnsworth and Crazy Prices stores. Two German companies, Aldi and Lindl are entering the market. Musgrave have absorbed Roches Stores and L&N. It is significant that Musgrave and BWG have expanded to Northern Ireland, the UK and Spain. In addition, the last ten years have seen the continual growth of the forecourt retailers.

The grocery trade is arguably one of the most competitive in Ireland. Irish grocery shops are of an internationally high standard. Irish towns and villages throughout the country are being served by grocery shops. Undoubtedly, over the past ten years, the numbers of independent grocers who are not aligned with any of the symbol groups has continued to decline. Nevertheless, the existence of a number of symbol groups whose stores are owned by independent retailers provides competition to large multiple entities as well as between symbol groups.

Effects on Competition within the Retail Trade if the Order is Removed

The ending of the ban on below cost selling and the revoking of the other fair trade provisions will result in the following.

- More concentration among retailers
- Less competition
- Reduction in the numbers of specialised stores

Trends in Retail Outlet Numbers

Trends in Retail Outlet Numbers 1977 - 1998							
	1977	**1983**	**1988**	**1991**	**1993**	**1996**	**1998**
Grocers	9,042	7,736	6,575	5,909	5,813	5,296	4,808
Grocers with Off-Licence	377	541	598	563	590	626	792
Grocers with Pub	1,933	936	677	615	424	309	250
Garages with Shop	N/A	N/A	673	1,188	979	1,282	1,429
Total	**11,352**	**9,213**	**8,523**	**8,275**	**7,806**	**7,513**	**7,279**

Source: Nielson

The trends in retail outlet numbers cannot be correctly established because Nielson did not have available the numbers of garages with shops in 1977 and 1983. However, on the basis of the above figures, there was a decline of 25% in the numbers of retail outlet numbers selling grocery products between 1977-1988. The decline from 1988-1998 was 15%.

The rate of decline in grocery retail outlet numbers has been reduced. This may be partly attributable to the increase in population since 1988 and the general growth in gross national product. It may also be that the Groceries Order has given confidence to small grocers to continue in business.

It is interesting that the Fair Trade Commission report of 1991 identified only 159 outlets with more than 8,000 square feet.

5. Compatibility of Groceries Order with Competition Acts

Prevention, Restriction or Distortion

The key provision in the Competition Act, 1991 is in section 4. Section 4 prohibits:

> *"all agreements between undertakings, decisions by associations of undertakings and concerted practices which have as their object or effect the prevention, restriction or distortion of competition in trade in any goods or services in the State or in any part of the State."*

It is worthwhile to consider whether the fair trade provisions are in anyway incompatible with the requirements of Section 4. The Groceries Order is a statutory instrument that could be incorporated in separate legislation or in the Competition

Acts. Section 4 refers to agreements between undertakings and decisions by undertakings as well as concerted practices. However, the real issue is whether the Groceries Order prevents, restricts or distorts competition.

No one has argued that the fair trade provisions in relation to credit, hello money, requirement to supply etc are not pro-competitive rather than anti-competitive. The only issue on which any controversy lies is in relation to the ban on below cost selling. However, the ban on below cost selling does not prevent, restrict or distort competition. The ban provides a framework within which competition takes place.

The primary purpose of the Groceries Order is to provide for competition in the grocery trade. The ban focuses competition but does not restrict it. The articles prohibit anti-competition actions in the grocery trade. The Order specifically prohibits price fixing by competitors and prohibits resale price maintenance (whereby manufacturers seek to fix the price at which retailers sell their products). Thus it is incorrect to say the Order restricts competition.

There are many other regulations relating to employment, safety, health etc. which also have the effect of providing a legislative framework within which competition takes place. Retailers are not prevented from competing on price down to their invoice price values. Retailers can import products from other countries and are not prevented by the Order from selling these at the cost of import.

The Competition Acts (as does the existing Order) prohibit resale price maintenance and anti-competitive agreements between competitors. If an unintended effect of the operation of the net invoice price mechanism is to bring about resale price maintenance in some instances, then this can be attacked under the Competition Acts.

There is no reason whatsoever why the fair trade provisions of the Groceries Order could not exist alongside the Competition Acts.

Preservation of Competition

The fair trade provisions have a long-term pro-competitive effect. In order to ensure that the intense competition presently in the grocery trade continues into the future, it is necessary to ensure that there continues to be a sufficient number of competitors and that no companies achieve a position of dominance so that competition is threatened. The fair trade provisions, by ensuring that there is a level playing field for all competitors in the market, make it more likely that there will continue to be competition in the future. If there is no requirement for fairness, then, undoubtedly, the buying power of the major multiples will be used to the greatest possible effect to obtain terms that discriminate in favour of their operations. This, when accompanied by below cost selling, will greatly increase the concentration levels in the market. The Irish market is already concentrated. Any further increase in market share of the principal companies may bring about an oligopoly. In these circumstances, competition is reduced, prices increase and customer service diminishes. It is reasonable, therefore, to see the fair trade provisions of the Groceries Order as having a long-term pro-competitive effect. By preserving the existing level of competition, they ensure that consumers continue to have the benefits of a competitive market. If the provisions are removed, then, the long-term effect may well be to have an uncompetitive grocery market.

Predatory Pricing

The Groceries Order does not prevent predatory pricing. It does, however, make it less likely that predatory pricing will occur.

The Competition Acts do not prevent predatory pricing either. However, section 5 of the Competition Act prevents <u>unfair</u> pricing or other <u>unfair</u> trading conditions. For companies in a dominant position to apply unfair selling prices or other unfair trading conditions would leave them open to an action under section 5 of the Competition Act. However, the definition of unfair may or may not relate to predatory pricing. Predatory pricing means selling at prices that are designed to eliminate a competitor from the market. In general, below cost selling in the grocery trade was seldom used for this purpose. It is a promotional device intended to attract customers to the store and to convince the customers that a particular store has a low price policy for its basket of goods. In practice, below cost selling as used in the grocery trade does not result in price reductions but merely emphasises low prices on some products and high prices on other products. A small proportion of better known items would be sold below cost to attract customers to the retailers. This reduction in the price of some items can be afforded by increasing the prices on less well-known products whose price the customer is unable to remember. Essentially most customers would not benefit from this practice because the overall cost of a shopping basket would remain generally unchanged. Below cost selling, therefore, as ordinarily practised, cannot be considered to be predatory pricing.

However, below cost selling could be used to eliminate competitors in local areas where there may be only one or a small number of competitors to a branch of a multiple store. It would be very easy in such circumstances for a store in a particular town to sell at different prices than in all other outlets so as to eliminate a competitor. Undoubtedly, such an action would be predatory pricing. However, if the multiple store was not in a dominant position in the State or in a substantial part of the State, it would not be possible to take action under Section 5 of the Competition Act. Although, it is sometimes argued that, because of ease of entry to the market, it would not be possible for the multiple to recover the cost of its predatory actions by subsequently raising its prices, in practice it would be able to do so. The fact that it had managed to put a competitor out of business would be a serious deterrent to new entrants to a local market.

Similarly, the Groceries Order would prevent a large multiple from engaging in predatory action by using below cost selling on a national basis. It would not prevent a large multiple from consistently selling below its true costs including its employee remuneration and other overhead costs. However, as the effect of selling below its true cost without the deep price cuts which the ability to sell below cost gives, is less likely to have an impact with consumers, then the ban on below cost selling makes it much less likely that predatory action of this type will take place.

Because of the levels of market shares of the major retailers, it is very likely that the Competition Authority and the courts would not accept that they are in a dominant position. While many in the grocery trade would argue that Tesco, because of its economic power and, in particular, because of its buying power, is in a dominant position, there would be no certainty that the courts would accept this view. Similarly, some of the other companies in the grocery trade have significant market power and could sustain substantial losses for some years in order to ensure that there was less competition in the market in the future. Again, there is uncertainty as to how the courts would interpret such market power and as to whether they would consider unfair actions by such companies as being an abuse of a dominant position.

6. Economic Analysis

Theory

The Competition and Mergers Review Group received a number of submissions on the Groceries Order. An analysis of these submissions shows that none of those who were opposed to the continuation of the Order were involved with the grocery trade. The Tanaiste stated in the Dail in February 1999 that she had not received any submissions looking for the abolition of the Order. Most of the opposition comes from those with a background in economics who are applying economic theory in giving their view on whether the Groceries Order should be retained or not. They conclude that, on the basis of the principles they generally accept, that there is no case for the retention of the ban on below cost selling.

However, the economic theory in relation to competition is a constantly evolving one. There is no clear set of economic principles on which economists agree which can lead to a view as to whether the Groceries Order is good or bad.

Perhaps it is understandable that those who have been trained in or studied economics will be sceptical of the type of provisions contained in the Groceries Order. Economics deals with perfect markets, contestable markets and theories of perfect competition. There are a number of reasons why these theories may not be applicable to today’s modern, sophisticated, grocery trade. It is essential that those who advocate the abolition of the Order should consider the barriers below to the operation of a perfect market in groceries. The existence of these inhibitions on perfect competition creates the necessity for a provision such as a ban on below cost selling.

Barriers to Perfect Competition

1. Restriction of Offer

In theory, if a grocer sells goods below cost, other grocers will purchase those goods because they will be cheaper than the price they have to pay for their products. In these circumstances, no grocer would sell goods below cost. However, under common law, retailers are permitted to restrict the offer they make for the sale of goods. Thus a retailer can sell butter below cost on the basis of one kilo of butter for every £20 of goods sold. A retailer can also simply decide not to sell a particular product to a particular customer. Thus if a retailer realises that another retailer is purchasing the below cost goods, supplies can be refused. In a perfect market situation, retailers selling goods below cost would have to sell them to any purchaser. If this happened, no sales below cost would take place. Thus, it is the interference in the market of the common law permission for a restriction of offer which makes it possible to sell below cost. This, in turn, makes it necessary to prohibit below cost selling.

2. Numbers of products in store

The theory of perfect competition assumes that the purchaser can compare the price of the goods being offered with the prices of goods previously purchased or with the prices of goods offered by other suppliers.

In the modern grocery supermarket, there can be up to 20,000 products. It is not possible for the consumer generally to remember more than the prices of 100 products. Many will not be able to remember the prices of more than a few products.
Irrespective of the method of pricing the products, the consumer could not possibly even remember a small proportion of the prices in the modern supermarket. However, the consumer’s ability to remember prices has been greatly reduced by the development of scanning systems. The price of the product no longer appears on the product itself.
The consumer, in any event, is at present only concerned with the price of the overall shopping basket of goods. The consumer is concerned that the cost of the shopping basket of goods purchased is not greater than the cost of purchasing those goods in other accessible supermarkets. The total cost of the shopping basket is a measurable amount which comes out of the weekly or monthly expenditure of consumers.

If the consumer is unable to remember the prices of the goods being purchased, we have an imperfect market. The purchaser is not able to make a logical and rational decision on price in these circumstances. The consumer can be misled by reductions in the prices of the best known items (those most likely to be remembered by the consumer) and increases in the prices of other products.

Again, this clear distinction between the reality of the modern grocery trade and the economic theory of the perfect market is a reason why a ban on below cost selling is needed.

3. Consumers

The ban on below cost selling assists consumers to make economic choices about the food that they purchase. The absence of sales of goods below cost ensures that the decision to purchase one food rather than another is based on the usefulness or otherwise of that product in their total shopping basket. Where there is a ban on below cost selling, some goods are unfairly discriminated against and others, because the retailer judges that the consumer is likely to remember the prices, will be unfairly lower in price. Thus below cost selling distorts the pattern of consumer behaviour between products and leads to a false allocation of resources and supplies within the supply sector.

4. Balance of Power

The modern supermarket multiple has very considerable market power. Where a multiple is responsible for 20% of the purchases from a supplier, then the decisions of the multiple in relation to the listing of products, shelf positioning, inclusion in advertising and promotion etc. are of major significance to the supplier. If the multiple not only purchases for the Irish market but also for markets in other countries, then the market power of the multiple further increases. In these circumstances, it is necessary to provide fair trading arrangements between buyers with significant market power and suppliers with limited power. The only power of suppliers is in relation to the development of brands through advertising and promotion. If the supplier can, by appealing directly to consumers, generate a demand for the product, it may be difficult for the retailer to not stock the product. However, increasingly, retailers also offer own-brand products which compete directly with the brands of suppliers. Retailers do not need the branded products of suppliers except in very few cases.

If retailers obtain an excess of power, this in turn will have a damaging effect on producers and processors. It must be remembered that retailers do not export products from Ireland. It is the processors who do so. If the processors in Ireland are damaged through the operation of excessive power by the retailers, then Irish exports will suffer.

5. Market Structure

Although European competition law and Irish competition law does not at present recognise the importance of market structure, it is one of the underlying principles of US anti-trust law that "monopolisation" be prevented. It is clear that, in order to ensure that there is competition in the future, it is necessary to have a reasonable number of competitors. The concentration levels in the Irish grocery market are already high. Any action which may inhibit a growth in concentration preserves the existing level of competition.

It must be clearly understood that if concentration were to increase substantially, as it is believed would happen if the ban on below cost selling and the other provisions of the Order were removed, then competition would be reduced and the ability of retailers to collude on prices and margins would be greatly increased. In a non-competitive market, consumer prices will rise and innovation and development within the grocery trade in relation to products and services will diminish.

If concentration levels increase to an unacceptable extent, it will not be possible to bring about a reversal of the situation. It would be necessary for a new law to require the sell off of certain supermarkets by some multiples to reduce their market shares to acceptable proportions. This would be a much greater interference in the market than anything which may take place as a result of the ban on below cost selling.

6. Effects on Other Sectors

The definition of grocery products contained in the Order refers to food products and household necessities normally purchased in a grocery shop. Household necessities includes detergents, bulbs, soaps and some toiletries.

However, it is very important to realise the developments that have taken place in supermarket retailing. The modern grocery store can deal in the following sectors which were not formerly considered to be grocery goods: -

- off-licences
- hardware
- gardening
- newsagents
- toys
- clothing
- toiletries

Thus any action taken by a grocery retailer to reduce the prices of groceries below cost can partly be recovered by increasing the sales of non-food items. Obviously, this ability to reduce the food price below cost, while recovering the losses on increased sales in other products, makes it impossible for those specialising in particular product areas to compete. Thus an off-licence company cannot react to the sales of beer or spirit products being sold below cost. A specialist drapery retailer cannot sell their goods below cost because they have to recover the loss somewhere else in their clothing goods. The permission for grocery multiples to sell food below cost will impact not only on the grocery trade but upon most retailing sectors. The decision as to whether grocers should be allowed to sell grocery products below cost is therefore of a wider significance than for the grocery trade.

Again, the ability of grocers to sell food products below cost, while recovering the losses on other products, is a distortion of the market. It prevents or restricts competition in other trade sectors.

7. Response to the DKM Economic Consultants Limited Report on the Economic Impact of the 1987 Groceries Order

The Groceries Order has been in existence for almost eleven years. It is necessary for those who wish to have the Order abolished or revoked to justify the reasons for so doing. The DKM report states that those who made submissions to the Review Group were not able to demonstrate to the satisfaction of DKM the tangible benefits being achieved. However, DKM was unable to demonstrate any restrictions or distortions in the market arising from the operation of the Groceries Order.

A number of statements contained in the report can be accepted.

> *"We would state….that the ban on below cost selling is unlikely to the grocery trade and trends in market structure including the overall numbers of outlets and concentration." (Pages 23 and 24)*
>
> *"The existing Groceries Order…does not prevent price wars of an across the board type." (Page 29)*
>
> *"We have concluded that the available evidence is inadequate to support categorical attributions of movements in prices and margins to the impact of the Groceries Order." (Page 41)*
>
> *"We have concluded that the likely impact of a removal of the ban on below cost selling would be limited." (Page 41)*

Given that the abolition of the Order would not bring any significant benefits to consumers or to competition it can be reasonably asked why the Order should be abolished.

The IBEC Competition Council and the Food, Drink and Tobacco Federation believes that the abolition of the Order will have harmful effects on small grocers, suppliers to supermarkets and consumers.

This chapter demonstrates elsewhere what these effects are. DKM confined their examination of the issues to the submissions received by the Review Group and previous reports of the Fair Trade Commission and to discussions with IBEC and the Competition Authority. DKM did not discuss the result of competition in the grocery trade to any great extent with individual suppliers or retailers and did not have the benefit of their insights or experience, (save through discussions with IBEC). In addition, no examination was made of the position in Northern Ireland or Britain where below cost selling has been taking place or the United States which has had fair trading provisions for over sixty years.

One of the arguments put forward by DKM (page 35) is that the principal and immediate impact of the Order is to facilitate a form of minimum price maintenance. Nevertheless, on page 21, DKM state that the "it is important to understand that resale price maintenance removes the price discretion from the retailer, channelling competition into non-price areas. A below cost selling ban does not do this, since retailers are free to charge at any level down to a gross margin of zero (ignoring discounts)". It is clear, therefore, that a ban on below cost selling is not a form of resale price maintenance. The Order specifically prohibits resale price maintenance as does the Competition Act of 1991. The Director or the Competition Authority could intervene in any case where the provisions in relation to invoice price are bringing about a form of resale price maintenance.

DKM state that, "the law does not protect consumers against promotional activity by sellers in any general way...". The advocates of the Order are not arguing for protection of the consumer. They argue that, because the consumer cannot remember prices, the grocery market does not operate in the way that economists envisage markets operating. If the consumer cannot remember the prices of the products being purchased and is unable to compare the prices with the prices in other shops, or even the prices of other products then there is market failure.

DKM could find no evidence that the Order is having a harmful effect. Yet, they advocate removal of the Order. Surely the collective view of the grocery trade that the Order should be retained must carry greater weight than a conclusion reached by DKM after a necessarily brief examination of the issue?

8. Employment

The Number of Persons Engaged in the Retail Grocery Trade for 1991:				
	Full-time	**Part-time**	**No. of Proprietors**	**Total**
Retail Sale in Non-Specialised Stores	16,670	13,137	7,875	37,682
Retail Sale in Specialised Stores	4,032	1,923	4,240	10,195
Total	**20,702**	**15,060**	**12,115**	**47,877**

The Number of Persons Engaged in the Retail Grocery Trade for 1997				
	Full-time	**Part-time**	**No. of Proprietors**	**Total**
Retail Sale in Non-Specialised Stores	21,000	33,816	8,600	63,416
Retail Sale in Specialised Stores	4,388	2,374	2,932	9,694
Total	**25,388**	**36,190**	**11,532**	**73,110**

Source: Annual Services Inquiry of CSO

The number of persons employed in the retail grocery trade has grown from 47,877 in 1991 to 73, 110 in 1997.

Regrettably, we do not have access to information under these headings prior to 1991 or for 1998. The numbers employed in non-specialised stores or grocery stores grew by 68% between 1991 and 1997. While a significant part of this growth was of part-time employees, there was also a growth of 26% in full-time employees. The numbers of proprietors and their family members increased as well.

The section on suppliers shows the numbers employed in food processing at the end of 1997. There were 40,500 persons employed in this sector.

In addition, there are employees in importers and distributors and wholesalers serving the grocery trade. The CSO Annual Services Enquiry 1997 shows that there were 11,046 persons engaged in the wholesale of food, beverages and tobacco.

In addition, grocery trade employment must take into account the numbers engaged in developing new retail outlets, new food factories as well as the refurbishment and redevelopment of existing ones. It has not been possible to obtain any statistics on the numbers of persons engaged in such activity. The census of population for 1996 showed that there were a total of 109,798 persons engaged in building and construction. This is compared with 87,661 in 1991. The monthly employment index for 1997 showed an increase of 9.3%. The number employed in the construction industry for 1997 was, therefore, about 120,000.

The total of all construction output in 1996 amounted to £6,138 million. Of this amount, industry accounted for £395 million and commercial £407 million, a total of £802 million. It is not possible to analyse the industry and commercial totals into categories for food processing enterprises or retail grocery outlets. A total of industry and commercial output is 13% of the total in construction output. If this was applied to the number of employees in the construction industry this would be 15,680 employees. However, it is unlikely that food processing and retail developments would be more than 30% of this total. This would leave the numbers employed in the construction industry related to the grocery trade at perhaps 4,700.

If the Order is revoked, the first victim will be the confidence of independent retailers. Independent retailers will cease to invest in their stores until such time as the full impact of below cost selling activity has been assessed. In time, it is believed that many independent retailers will seek to end their involvement in the grocery trade by selling their stores or converting their stores to other uses.

The IBEC Competition Council believes that, if the ban on below cost selling is removed, it will have a significant effect on employment related to the retail grocery trade. Any estimate of the effect can only be based on the experiences of those who have spent a great deal of their lives in the grocery trade. The grocery trade members of the Competition Council believe that the reduction in the numbers of employees would be significant.

Undoubtedly, if the ban on below cost selling was removed, this would not affect the consumption of food or of grocery products. However, the renewed emphasis on price as the major competitive weapon is likely to lead to a reduction in the standards of the stores and the level of service to consumers. For example, a decision by a retailer to pack bags at the checkout will result in a higher number of persons being employed than if bags are not packed. The decision by retailer to have extended opening hours, results in a greater number of persons employed. Arguably, extended opening hours do not increase the total volume of grocery products consumed. However, extended opening hours facilitate consumers. A reduction in the product ranges will reduce costs for retailers and allow for price reductions but will seriously affect the choice which consumers have. If the emphasis is on the price of products only, then it would seem likely that the product ranges will be reduced.

If, as is expected, below cost selling results in many fewer grocery shops, then this may reduce costs in the distribution chain in the narrow sense of the costs from production to retail sale. However, the consumer will have to expend more time in travelling to stores and will also be involved in the cost of travelling as well as the general inconvenience of having to do so.

These are some examples of what might happen if the ban is removed. These examples would result in substantial reductions in employment in the retail grocery sector and the general distribution system.

9. Effects of below cost selling

This section illustrates the consequences of revoking the ban on below cost selling. The information has been provided by a supplier with very many years of experience in the grocery trade.

Retailer "A", a major supermarket multiple, reduces a product or products to below cost and advertises the promotion in the media (national or local) with the objective of attracting more consumers to its stores.

Effects on retailer

Retailer A may increase selling prices on other products within its 10,000-20,000 product range to compensate for the loss of profit on their loss leader promotion.

Retailer A's competitors may react in the following ways:

a) within hours the principal competitors will match or better A's prices and demand a reduced price from their suppliers in order that they may maintain their gross margin while selling at reduced prices;

and/or

b) delist the products involved or reduce support and shelf space of the loss leaders;

and/or

c) Put their support behind a competitive product to the loss leader or a different size of the same brand;

and/or

d) Compete with Retailer A using their discounted brand

Only large retailers can compete in price wars and hope to be successful. They need a large range (10,000-20,000) of products spread across many different categories to maintain their profit objective. Alternatively, if they are part of a multi-national group which can subsidise their Irish operation or a retailer who has significant amounts of business outside the grocery area, they can survive a below cost selling war.

When a serious price war develops, it has the effect of attracting more consumers to the larger retailers to buy the "bargains" and while they are in the store, they are likely to buy the rest of their weekly shopping, of which some items may be at inflated prices. There is then a loss of business to the smaller retailer and speciality store who cannot compete on range or media advertising. This leads to further concentration of trade.

The small retailer cannot buy the below cost products from large retailers for resale because of the ability of retailers to restrict their offer under common law.

The small retailer and symbol group owners will not have the confidence to re-invest in their stores during price wars because of uncertain profits leading to further concentration of trade to the larger multiples.

Effect on Consumers

A consumer can only remember a limited number of product prices. Therefore, if they are attracted to a store by a loss leader, they tend to believe that all products are of good value in that store, which is unlikely to be the case. They will buy their weekly shopping basket – which in total may be about the same price as they pay to their normal retailer.

Below cost selling prices and their attendant delisting and short term pricing tend to reduce consumer choice. Retailers will delist brands and sizes which have been sold at very low prices in other stores. This will add to the confusion of what is good value.

Price wars lead to further concentration of trade and will reduce consumer choice of good quality independent and symbol stores available in their locality.

Effect on suppliers – discontinuity

- Artificial peaks and falls in demand with very short notice leading to disruption to production lines, overstocks, stock outs. These add to suppliers costs. In due course these costs must be passed on to consumers.
- Disgruntled customers who will demand increasingly large discounts.
- Withdrawal of support by customers.
- Delistings
- Long-term increasing concentration of trade and less customers to resell their products.

While a retailer with a 20% market share is not in a dominant position if they de-list or seriously reduce support for a product, the manufacturer or supplier will suddenly lose 20% of their home market business through no fault of their own. This will cause inefficiencies through higher stocks, reduced production and a huge waste of management time. It must be remembered that, while it is 20% of the manufacturers business in Ireland, it is very unlikely to be more than half of a percent of the retailer's business, which they will recover through giving more support to their own label or a competitive product.

Price wars are the classic way for supermarkets to gain market share especially new entrants to the market. For example, Walmart, after taking over Asda, are reducing prices in the UK to compete with Tesco and Sainsbury.

Comment

Other features of below cost selling activity include short term reductions in prices while stocks last, offers which are directed to a number of items per customer, extensive price advertising which has an impact throughout the country and not confined to the areas served by the supermarket reducing prices. In general, consumers do not believe that retailers sell below cost. They believe that the retailers selling above cost are "ripping them off". No retailer wants to be thought to be selling at uncompetitive prices by its customers. This leads in turn to the delisting of the products being advertised.

It must be remembered that below cost selling activity is taking place in the British market for quite a number of years at the same time as British supermarkets have the highest net profit to sales in the Western world.

Consumers are greatly affected by below cost sale offers. If a product normally sells at 40p and it is offered for sale at 10p, consumers will regard those selling at 40p as exploiting them. Consumers will transfer their business from independent stores to multiple supermarkets in these circumstances.

10. British Market

On 8th April 1999 the United Kingdom Director General of Fair Trading announced that he had referred the grocery retailing sector in the United Kingdom to the Competition Commission for investigation.

The Commission has been asked to report within one year on, *inter alia*, whether any facts found by the Commission may be expected to operate against the public interest. The Office of Fair Trading enquiry prior to the referral to the Commission had raised several competition issues. The most important of these were:

- The nature, extent and existence of barriers to entry to the market.
- The extent to which land is increasingly impacting on the structure of competing firms.
- The intensity of price competition at local, regional and national levels.
- The nature of the relationship between the multiples and their suppliers, including agricultural producers and the ways in which buyer power is exerted.

The Director of the Office of Fair Trading stated that he is not satisfied that competition between existing grocery retailers is effective. He stated that he is concerned that grocery prices are often set to match competitors rather to undercut them particularly in catchment areas where consumers have a limited choice of supermarkets.

This investigation by the Competition Commission is of very considerable importance to the grocery trade in the United Kingdom. The findings of the Competition Commission will have an impact on the future law in relation to grocery retailing throughout Europe.

It is noteworthy that the lack of competition, to which the Director refers, has occurred in spite of the ability of the multiple grocers to sell below cost. It is clear that the ability to sell below cost is not in any sense a precondition for vigorous competition in the grocery trade.

It is likely that the Competition Commission will consider the issue of below cost selling and the general decline of the independent sector in Britain. It would seem premature, at the least, to consider any revocation of the Groceries Order until the UK Competition Commission presents its report.

11. Northern Ireland Market

Estimated Market Shares			
	1994%	**1999%**	
Stewarts / CP	25	31	Tesco
Wellworths	18	8	Safeway
Sainsbury	-	12	Sainsbury
Dunnes	8	6	Dunnes
M&S	3	4	M&S
Co-Op	6	6	Co-Op
Iceland	1	4	Iceland
sub Multiple	**61**	**71**	
SuperValu	-	8	
Other Independents	39	21	
sub Independents	**39**	**29**	
TOTAL	**100**	**100**	

It will be seen from the above table that, since 1994, the share of the market held by independent grocers has fallen from 39% to 21%. This has been partly due to the entry to the market of Sainsbury and the building of new stores by Tesco and Safeway. The significant changes have been partly due to the ability to sell below cost in the Northern Ireland market This facility has been availed of by some of the principal participants.

While consumers may have benefited from the building of additional stores, many independent shops have closed or will inevitably close. Thus consumer choice of grocery shop has been curtailed.

The “other independents” total includes symbol stores such as Spar and Mace. SuperValu entered the market by purchasing the smaller Wellworth stores. The larger Wellworth stores were transferred to a joint venture between the Fitzwilton Group and Safeway.

It is interesting that Tesco have gained market share in the Northern Ireland market as compared with the shares previously held by Stewarts/Crazy Prices. This gain in market share is in spite of the entry to the market of Sainsbury and the increase in the number of Iceland stores. This contrasts with the position of Tesco in the Republic of Ireland market.

Chapter 7 Arguments Against Retention of the Groceries Order

1. Summary

1.1 The main case against the Groceries Order is a simple one: it restricts price competition. In doing so, it encourages non-price competition (e.g. stamps, loyalty cards, bonuses, free flights, etc.). Non-price competition in general involves employing scarce economic resources. Hence, by restricting price competition and encouraging non-price competition it damages consumer welfare twice: consumers face higher prices, and resources which could be used for other purposes (and improve consumer welfare in the process) are used up unnecessarily.

1.2 Modern economic theory, (which far from concentrating on perfect competition, expressly grapples with the problems of industrial structure, market power, concentrated markets and imperfect information on the part of all the participants in the market) points to a connection between non-price competition, sunk costs and reduced competition through increased concentration and higher entry costs[26]. Hence, a second problem arising from the Groceries Order is that it is predicted to reduce the intensity of competitive pressure in the groceries sector. It induces increased non-price competition between large retailers. Suppliers and those arguing for the retention of the order highlight this as a positive outcome of the Order. Sutton[27] in case studies of food and drink sectors across seven countries, shows that an escalation in non-price competition (involving sunk cost expenditures) drives markets into a more concentrated structure (see also and Walsh and Whelan, 1999[28]). This mechanism can be observed in the Dublin area

[26] John Sutton: *Sunk Costs and Market Structures,* Cambridge, Mass., and London, MIT Press, 1995.
[27] Op.cit.
[28] Walsh and Whelan (1999), *'Loss-Leading and Price Intervention in Multi-Product Retailing: Welfare Outcomes in a Second Best World',* The International Review of Law and Economics, Vol.19, No.3.

since 1987. Using the Sutton framework, Walsh and Whelan, 1999[28], examine restrictions on loss leading by supermarket retailers and the induced escalations in service expenditures on retail concentration. They predict such a mechanism will lead to higher prices and a more concentrated market structure over-time. Competition between large retailers is only in large urban areas where the density of population can support many competing large firms. Concentration and service (non-price) competition has increased dramatically since the introduction of the Order in 1987. As stated by the OECD,[29], the rescinding of the Order would encourage a shift to price competition that has no associated sunk cost. This would benefit a sector that until recently was not exposed to international retail competition. More entry and price competition would be encouraged in urban areas.

1.3 Arguments advanced to justify retention of the Order on employment and output grounds, using data from the food processing sector, are misleading. Growth in output and employment in that sector since 1987 is capable of being explained convincingly without any resort to the Groceries Order, while no plausible causative mechanism between the Order and the performance of the sector is identified and/or quantified. It is true that economic activity and the level of employment in food processing has grown since 1987. Yet it can also be said that 1987, the year that fiscal stabilisation began, marks the turning point in all of economic performance in Ireland. It is likely that the aggregated business cycle, and not the Groceries Order, led to the growing demand for food products and dictated the evolution of the food processing industry. Having said this, the Groceries Order is likely to have shifted power and rents back upstream to suppliers. While employment has grown, price cost margins are also likely to have been inflated, a point omitted from the analysis in section 2 of Chapter 6.

1.4 Arguments for the retention of the Order as a means of encouraging indigenous suppliers to the grocery sector are unacceptable on two grounds. The first is that even if it could be shown that the Order does indeed encourage indigenous firms,

[29] OECD (1993), Economic Surveys - Ireland 1993.

it is simply bad policy design to weaken competition as a surrogate instrument of industrial policy. Optimal intervention requires that a direct rather than an indirect policy instrument be used. In other words, don't weaken competition: offer direct and transparent encouragement. The second is that policy instruments aimed at encouraging *indigenous* suppliers constitute state aids to industry, and as such at best must be cleared with the EU Commission, and at worst are incompatible with the Treaties of Rome, Maastrict and Amsterdam.

1.5 Arguments advanced to support retention of the Groceries Order based on maintaining the competitive position of independents are confused, to some extent self-condtradictory and in any case unqualified. "Independents" (smaller outlets, whether or not part of a chain) survive in one of two segments of the market. The first is as niche outlets in geographical markets where the large multiple outlets operate. They offer a different but to some extent over-lapping portfolio of goods; they open at different hours; they offer immediate availability (as opposed to having to go to a shopping centre) as convenience stores. As such, they are imperfect substitutes for the services of the multiples and to that extent are protected from the effects of increased competition within the multiples sector. The importance of independent shops for impulse products, in terms of total product sales, can be as high as 80 per cent. Independents tend to be the main market for 'impulse' products, such as Chocolate Countlines, but a fringe market for the 'top-up' items, such as Cat Food. The Multiples operate in the one stop shopping niche whereas the Independents operate in the convenience shopping niche. The second is the supply of grocery retailing services in geographical areas where the population density is insufficient to support the activities of the large multiples. It is true that the independent retail trade had retained a credible market share in the one stop shop grocery trade since 1987. Yet, this is only a feature of rural areas where the clusters of population are not dense enough to attract competition between the big players of the national market. Since 1987 Multiples share of the grocery market in the Dublin are steadily increased to 80 per cent by 1996. Independents and Multiples in the Dublin area have evolved to compete inseparate market niches, as argued in

Walsh and Whelan[30]. The confusion and self-contradictions arise from the argument that they need to be protected from competition because they offer a qualitatively different service from that offered by the multiples. But if, and to the extent that they do this, they are sheltered from competition. If they need regulation to protect them, they do that extent do not offer a qualitatively different service. If in the absence of such regulation the independents lose market share it is precisely because consumers switch from them to the multiples on a volumtary basis, and as a whole enjoy higher consumer welfare. There will, of course, be gainers and losers: a reduced availability of convenience stores or local groceries will reduce the welfare of some consumers, but consumers as a whole have gained if this is due to consumers having swithched to multiples as a result of competition. If there are social (as opposed to private) welfare problems involved in a fall in "local" service availability, the correct response on the part of the Government is not to reduce competition, but to offer subvention to "local" service providers.

1.6 The argument that pressure to abolish the Groceries Order comes in the main from academic economists, while consumers and retailers have not pressed for change betrays a complete failure to understand the political economy of public choice. First, note that it is producer interest groups and unions which are lobbying for retention. That suggests that it is producer interests and union interests which are primarily threatened by an abolition of the Order. Secondly, note that retailers as a group, like any other suppliers, are predicted to favour regulations which discourage price competition between incumbents and entry by potential competitiors, both of whch are predicted consequences of the Groceries Order. Similarly, existing retailers are content that the planning law restrictions on new developments should be enforced. Third, note that it is a universal aspect of lobbying to create and protect rents[31] which arise where the costs are not easily discerned, and are spread thinly over a large number of individuals, while the benefits are concentrated among a relatively small number of beneficiaries. In

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30 Walsh, P.P. and Whelan, C. (1999a),*'A Rationale for Repealing the 1987 Groceries Order'*, The Economic and Social Review, Vol.30, No.1, pp.71-90.

31 A return above that which would be produced by perfect competition.

such circumstances the latter (the suppliers) have stronger incentives to act collectively than the former (the consumers).

1.7 The use of invoices as a basis for regualtion price comptition by retailers offers suppliers a means of reducing price competition between suppliers. It is equivalent in effect to a credible pre-commitment not to engage in price information between suppliers while the regulation implies legal sanction being imposed on reductions in prices not accompanied by reductions in invoice prices. In this respect, the Groceries Order operates in the same way as the Net Book Agreeement did in reducing price competition between publishers as well as between bookstores.

1.8 It is sometimes argued that the Groceries Order fulfils a purpose similar to a ban on price discrimination which, it is argued, can be anti-competitive where it strengthens buyer-seller relationships and may thus raise barriers to entry. Prohibitions on price discrimination (such as that contained in the US Robinson-Patman Act) have been heavily criticised[32]. The Report by the Independent Committee of Inquiry into National Competition Policy in Australia, which reported in 1993, examined among other things the prohibition in Australian law against price discrimination and recommended that it should be repealed on the basis that it was contrary to the objective of economic efficiency and had not been of assistance to small businesses. It stated that "The Committee does not believe that it is the role of the competitive rules to protect any particular sector of society

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32 *"The effect of legislation has been the encouragement of price uniformity, and the discouragement of price competition. The Act has been roundly criticised for its chilling effect on competition, its anti-efficiency objectives, and its damaging restrictions on the freedom of the market. It is often perceived as a measure to protect competitors rather than one to protect competition.".* Frazer, *Monopoly, Competition and the Law* (1992*),* p62. *"Economists contended that, especially in oligopolistic industries, unsystematic price discrimation was an important instrument for upsetting collusive price structures: that preventing discounts to high volume purchasers could inhibit efficiency-enhancing innovations in relation to distribution: and that the other efficiency effects of systematic price discrimination could be positive as well as negative."* Sherer, *Competition Policy for an Integrated World Economy* (1994) p73. *"The Robinson-Patman Act is the purist embodiment of the populist trend in American anti-trust legislation, one which arguably seeks to codify equality of treatment - a "level playing field"- as a goal independent of economic efficiency and consumer welfare."* MacAvoy, *At What Price May Seller Sell? in Legal Aspects of Selling and Buying*, (Philip F. Zeidman ed.,1991) p 85-86.

and does not believe that the competition rules should be used to achieve objectives contrary to economic efficiency"[33].

1.9 Finally, the argument that since there is an absence of hard numbers on the impact of the Groceries Order it would be foolish to abolish it is disingenuous. In the case of the minimum wage, the fact that it is hard to descern the employment cost. It simply means that it is hard to measure, and that for small changes in the minimum wage the incremental employment costs may be small. Few people seriously argue that the absence of clear measures of the costs means that it has no effects, or, even less the case, that a minimun wage actually increases economic welfare by increasing employment. In the case of the Groceries Order, the counter-factual, an Irish groceries market without the Order, cannot be observed. Identifying and precisely quantifying the impact of the Order on consumer prices during a decade of enormous change in the structure of the market may be difficult, but it is not an impossible task. That it has not been done cannot be used as a justification for maintining an Order which is known to have the effects predicted by economic analysis simply because the extent of those effects has not been determined.

33 Report by the Independent Committee of Inquiry into *National Competition Policy*. Australian Government Publishing, August 1993, p74. The report noted that *"In a 1977 review of the Robinson-Patman Act, the US Department of Justice condemned that Act a having failed to achieve any of its aims and as having harmed competition by imposing rigid pricing in oligopolistic markets where firms have used the law to prevent competitors from engaging in price cutting"* (p78-79). The Committee concluded that it did not "*consider that competition policy should be distorted to provide special protection to any interest group, including small business, particularly where this is substantially to the detriment of the welfare of the community as a whole. Sectoral assistance policy of this sort is generally more efficiently implemented by more open and direct assistance, including budgetary and taxation measures of various kinds."* (p79-80)

2. Supplier Analysis

2.1 The analysis of statistics on production and employment levels in Food and Drink Processing Industries undertaken in the IBEC arguments reproduced in Chapter 6 were based on the intervals 1977 through 1987 and 1987 through 1998. On the basis of their findings it was argued that the boom period in these industries came after 1987 and the implementation of the Groceries Order and ban on below cost selling. The business cycle over the period in Ireland is well known. This grouping of time periods does not reveal the true employment cycles across manufacturing sub-sectors. The following table reveals a strong boom period in the period between 1974-79, a very deep recession in the period between 1979-87 and another boom period between 1987-91 and a recession 1991-93.

The Year to Year Employment Growth in Total Irish Manufacturing

Year	**1974**	**1975**	**1976**	**1977**	**1978**	**1979**	**1980**
NET Growth	0.4	-3.6	2.0	2.1	32	4.0	-2.8
Year	**1981**	**1982**	**1983**	**1984**	**1985**	**1986**	**1987**
NET Growth	-1.5	-2.9	-4.7	-3.7	-3.1	-2.1	-3.5
Year	**1988**	**1989**	**1990**	**1991**	**1992**	**1993**	**1994**
NET Growth	1.0	2.6	0.8	-0.3	-0.3	-1.3	3.9

Source: Barry, Strobl and Walsh[34]

Grouping all years from 1979 prior to 1987 and those after 1987 would clearly not capture the true employment cycle. In addition the deep recession period 1979-87 is clearly driven by macroeconomic factors such as ERM entry, the abolition of the common external tariffs, and the fiscal crisis. Such trends in the Food and Drink Processing Industries clearly had nothing to do with the absence of a ban on below cost selling under the Grocery Order. A similar argument follows in relation to the periods after the Groceries Order was introduced. A more interesting analysis would have documented suppliers price cost margins

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34 Barry, F., E. Strobl and P.P. Walsh (1998) *"Aggregate Job Creation and Job Destruction and Job Turnover in the Irish Manufacturing Sector"*, The Economic and Social Review, Vol.29,

before and after the introduction of the Order. Irrespective of the business cycle, were suppliers extracting more rent per unit of sale after 1987?

2.2 It does not seem that the ban on below cost selling introduced in the 1987 Order creates a fair trading environment between suppliers and retailers, but rather that it gives suppliers power over resale pricing. This has most likely shifted rents upstream towards suppliers.

2.3 The impact of international competition on the Irish Grocery market is uncertain. It is certainly going to create an upheaval for Irish consumers, suppliers and retailers. The Irish market size can only accommodate a limited number of stores. Clearly Irish retailers have had the first mover advantage in terms of the store location and the emphasis on the branded nature of the products sold. Mergers and acquisitions will continue to be regulated by the Minister and the Competition Authority. If consumers move towards cheap branded items, which is their right, this is bad news for Irish Suppliers. Yet, if suppliers produce quality goods at the right price and the retail market becomes more competitive this will have an overall positive impact on the welfare of all parties concerned. The forces of globalization on the Irish Grocery market will work themselves through, irrespective of whether or not the Grocery Order remains. Yet laws that protect the interest of suppliers over retailers during such exogenous changes should not be upheld.

2.4 The threat of suppliers to cease distribution to a retailer in an endeavour to bring about an end to the below cost selling activity is not a credible one. This is particularly true in the face of import competition and the potential emergence of own labels. Clearly, a brand that is picked out for loss leading enjoys a free promotion campaign that would be good for the long-term success of the brand. If loss leading is on branded Irish goods and not on own label goods this will be good for the survival of Irish suppliers in the face of international competition.

3. <u>Consumer Analysis</u>

No.1, pp 55-71.

3.1 The examination of trends in CPI or Food indices is largely a waste of time. It can not lead to any conclusions as to the ability of suppliers/retailers to extract increased (decreased) consumer surplus post 1987 in Ireland compared to the UK. Variations in net incomes, composition of food products, retailers costs, population densities, competition in retail markets, exchange rates. VAT taxes make such an exercise very difficult.

3.2 It is agreed that statistical analysis up to this point has not made it possible to quantify the effect of the Groceries Order. That does not mean it has not had an effect. Economic theory predicts as a matter of simple logic that in the presence of increased supplier bargaining power over retailers and in the presence of an escalation in service expenditures, consumers will bear the burden of higher input costs in the form of higher grocery prices.

3.3 A move away from resale price maintenance and non-price competition and towards price competition will result from rescinding the Groceries Order. The loss-leading analysis of Walsh and Whelan[35] predicts such a movement to reduce the overall expenditure by consumers on their grocery baskets of goods. Other non-price means of competing such as parking convenience, advertising and promotions, have associated sunk cost expenditures. Someone has to pay for such expenditures. Economic theory suggests that consumers benefit from these extras, but they also have to pay for the different forms of non-price competition and are worse off overall as a result. Price competition does not carry such baggage.

3.4 The analysis of the evolution of concentration levels within the grocery market in urban versus rural areas in the next section of this Chapter indicates that concentration in the Dublin area can only <u>decrease</u> with a reduction in non-price competition. This will yield more choice and lower prices for consumers.

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[35] Walsh and Whelan (1999b), *'Loss-Leading and Price Intervention in Multi-Product Retailing: Welfare Outcomes in a Second Best World'*, The International Review of Law and Economics, Vol.19, No.3.

3.5 In relation to the proposed negative effects of removing the Order, the reduction in suppliers' mark-ups is likely to be passed on to consumers, as the increased price competition between retailers is intensified. Independents in rural areas should not expect the rescinding of the order to induce entry into their isolated markets. Their focus on smaller consumer segments will shelter them. Independents in urban areas are protected by the fact they have carved out a strategic convenience niche in the market over-time. This will protect them from the effects of increased price competition between the large retailers.

4 Retail Analyis

4.1 Historically the Irish retail grocery market was characterised by a fragmented structure. This sector has experienced mass structured upheaval since the development of supermarkets in the 1970s[36]. In contrast tot he structure of earlier decades, modern grocery retailing is highly concentrated with the top 5% of outlets accounting for almost 70% of total food turnover. Market share data show Multiples, which describe larger supermarkets operating with several branches, dominating in Dublin and other densely populated areas around the country. Symbol Groups and Independents retailers dominate elsewhere. Multiples have not entered many regional areas where the market in the surrounding areas is insufficient to justify their entry. In these areas, Symbols and Independents jointly cater for both "one-stop" and "convenience" shopping.

Figure 1: Retail Food Concentration: 1977-1996

36 Walsh, P.P. and Whelan, C. (199a*), 'A Rationale for Repealing the 1987 Groceries Order'*, The Economic and Social Review, Vol.30, No.1, pp.71-90.

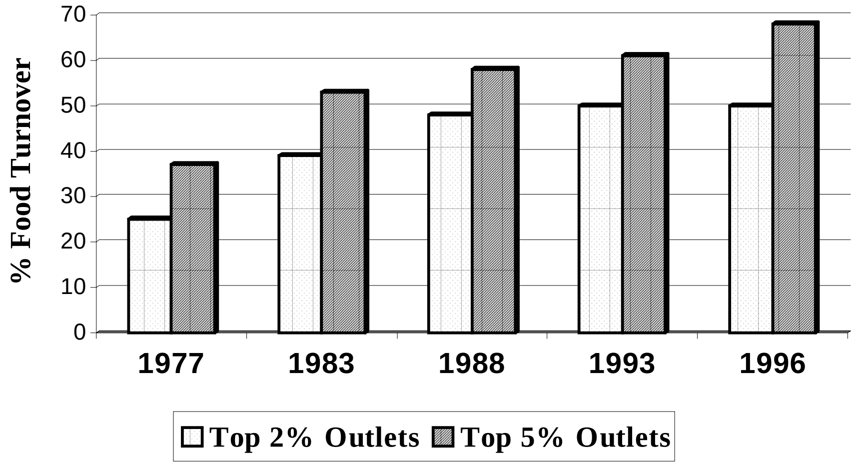

Table 1: Regional Market Share Data

	Total State				Reg. I[1]	Reg. II	Reg. III	Reg. IV
	1990	1994	1995	1996	1996	1996	1996	1996
All Multiples	**49.6**	**57**	**53.8**	**53.7**	**79.6**	**55.2**	**42.0**	**27.3**
Powers [2]	20.9	24.5	25.3	26.6	41.9	29.3	17.8	11.5
Dunnes Stores	20.4	22	21.3	18.3	20.5	18.7	17.8	14.4
Superquinn	4.2	5	5.4	6.5	14.0	7.0	2.2	0.1
Roches	1.7	1.5	1.8	2.3	3.0	0.1	4.1	1.4
L&N	2.5	4						
All Symbols	**25.7**	**24**	**27.5**	**27.3**	**8.8**	**24.9**	**38.4**	**43.9**
Musgraves[3]	14.2	15	18.7	18.6	5.0	20.1	30.0	20.9
Spar	4.6	4	3.6	3.7	1.6	0.9	4.1	10.2
Mace	2.8	2	1.9	1.9	0.1	0.8	3.0	4.7
Other Symbols	4.2	3	3.3	3.0	1.5	3.1	1.3	8.1
Independents	**24.7**	**19**	**18.7**	**19**	**11.6**	**19.9**	**19.6**	**28.8**
All Grocers	**100**	**100**	**100**	**100**	**100**			

1. Regions I to IV refer to Dublin, Rest of Leinster, Munster and Ulster/Connaught respectively

2. Powers own Quinnsworth and Crazy Prices.

3. Musgraves operate Supervalu, Centra and, since its acquisition in 1995, L&N.

Source: Consumer Attwood \ Taylor Nelson AGB

4.2 The observed pattern of rising concentration noticeable inurban areas is noteworthy. By 1996 multiples in the Dublin area have captured 80 per cent of the market. Independent retailing in urban areas has survivd by adopting a role that differs greatly from that traditionally defind. Independent retailers now target a specific "convenience" niche of the market. They provide greater location convenience an specialisation in a range of products whcih can be described as non-routine items purchases on 'impulse', such as confectionery, daily routine purchase items such as newspapers, and other noon-routine 'ttop-up' items bought at irregular hours in small quanitites between supermarket visits. Consumers do not tend to buy a weekly supply of these types of goods ina "one-stop" supermarket shop. Independents are an improtant distributing outlet for 'impulse' commodities, as exemplified by the sale of confectionery where 67% of total confectionery sales are through Independents outlets[37]. A market niche has therefore evolved for the smaller independent outlets in the urban grocery market.

4.3 It is clear that in densely populated areas Multiples offer an entirely different product and target a different consumer base from the Independent sector. As a result, the grocery market in urban areas has evolved to a mature efficient dual structure where competition between Multiples in the “one-stop-trolley” market is largely separable from the smaller independent retail outlets who operate in their own “convenience” niche. This approach differs greatly from proponents of the ban who base their arguments on the assumption that both Multiples and Independents compete within the same market segments. In any analysis of the impact of removing the ban one should note that the Independents have largely survived by targeting one stop and convenience shopping in less populated areas. Rural location or horizontal product differentiation shelters them from the evolution of competition between Multiples. Independents in populated areas shelter from Multiple competition by targeting a convenience niche, or adopting a strategy of vertical product differentiation.

4.4 Based on the economic theories outlined in section 6 of this chapter, the escalation in non-price competition in urban areas as a result of the Groceries Order has had a significant impact on the share of the market taken by multiples.

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[37] Checkout, 1996

The rapid growth in multiple market share, that had taken place in the period prior to 1987, did not discontinue with the adoption of the ban in urban area. Market Share analysis undertaken at the national level in section 4 of Chapter 6 is misleading. The four-firm concentration level in urban areas is far greater than 68.7%.

4.5 The comparison with market structure in Britain and Northern Ireland without normalising for population size and the number of large pockets of population clusters renders such an exercise void. It says nothing about the nature of competition in the different segment and regional pockets of the market.

4.6 Given the regional and sub-market structures outlined above economic theory (outlined in Section 6 below) predicts the ending of the ban will result in the following:

- Less concentration among multiple retailers in urban areas
- More price and less non-price competition among multiple retailers
- Very little impact on Independents sheltered by horizontal or vertical product attributes

4.7 The analysis above clearly undermines the points outlined in section 8, 10 and 11 in the analysis in Chapter 6 that are developed from the analysis in section 4 of that Chapter.

5. <u>Compatibility of Groceries Order with Competition Acts</u>

5.1 Those who argue for the repeal of the Groceries Order strongly contend that the

Groceries Order does prevent, restrict and distort competition. It induces a focus on non-price competition between large retailers. The associated sunk cost expenditures are deemed to create barriers to entry and drive the market to a more concentrated structure with higher, on average, consumer prices. In addition it gives power to suppliers to set resale prices and extract the increased rents paid out of consumer surpluses. The Competition Acts prohibit resale price maintenance and anti-competitive barriers to entry into the industry. It is not consistent to allow the Groceries Order to exist alongside the Competition Act.

5.2 The removal of the ban will not make predatory pricing more likely to occur. In fact economic theory finds it very hard to write conditions where predatory options that can exist in markets can be predatory in effect. Predatory pricing is defined as the use of a temporary price reduction by a firm with the intent of altering the evolution of market structure to increase longer-term profits. This is achieved through inducing exit, deterring entry, or restricting rivals to relatively small market shares. The conventional, and in anti-trust cases the most prevalent, test of the existence predatory pricing was developed by Areeda and Turner.[38] Accordingly, prices below marginal cost (usually proxied by average variable cost) indicate predatory pricing. However, ina competitive equilibrum analysis where ther is free entyr, exti, and full information a theoretical reationa fo optimal predatory pricing is difficult to derive[39]

The new game-theoretic models provide valuable lessons for anti-trust authorities. *They conclude no simple rule for the detection of predatory pricing.*[40] Pricing below-cost in imperfectly competitive markets in order to exploit endogenous learning economies can be beneficial to welfare.[41] Pricing above cost in the presence of imperfect capital markets can allow a prey with a financial advantage

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38 Areeda, P. and D. Turner (1975*), 'Predatory Pricing and Related Practices under Section 2 of the Sherman Act'*, Harvard Law Review, vol. 88, pp.697-733.

39 McGee, J. (1980*). 'Predatory Pricing Revisited.'* Journal of Law and Economics, vol.23, pp. 289-330.

40 As argued by Klevorick A. (1993), *'The Current State of Law and Economics of Predatory Pricing.'* American Economic Review, vol. 83, pp. 162-167. this is one of the primary reasons why new game-theoretic models on predatory pricing have had so little impact on the development of anti-trust in the United States.

41 Cabral, L. and H. Riordan (1994*). 'The Learning Curve, Market Dominance, and Predatory*

to successfully predate through manipulating this imperfection.[42]

The central issue surrounding the desirability or otherwise of loss leading, whcih may involve below-cost selling, is wheter such a strategy distorts price comptition, influences market structure, and redusces welfare in th long run. Only if the equilibrium loss leading lond run welfare outcome under imperfect information diverges from that obtained in the full information framework with no loss leading, is there a rationale for intervention through price controls in the market. In light of the lessons derived from the mew game-theoretic models on predatory options and competitive price discriminations, Walsh and Whelan present a model of loss leading in multi-product retail pricing by. It illustrates the welfare improving proprieties of loss leading in retain markets that are imperfectly competitive and host consumers.

5.3 Given the structure of the market where Independents protect themselves with either horizontal (operate in rural areas) or vertical (operate convenience niches in densely populated areas) product differentiation from multiples, predatory actions against the Independent sector will be unlikely. Both large and small retailers are able to protect themselves against potential predatory actions without the help of government legislation.

Pricing.' Econometrica, vol.62, pp. 1115-1140.

42 Bolton, P. and Scharfstein, D. (1988*). 'Agency Problems, Financial Contracting, and Predation.'* Working Paper 1986-8, Sloan School of Management, MIT.

6. Comments on the Critique of Economic Theory

6.1 A point made in the arguments in Chapter 6 is that Economic Theory is not rich enough to correctly model the nature of the Grocery Market. This makes the incorrect assumption that the theories used to study the impact of loss leading in retail pricing are neo-classical in nature: models of perfect competition and consumer information, free entry and perfect price competition. It is fully agreed that such theories are not applicable to today's modern, sophisticated, grocery trade. IBEC lists the core requirements that should be in any theory representing the real life grocery trade. These are summarised below.

- In the modern grocery supermarket, there can be up to 20,000 products. It is not possible for the consumer to compare prices among retailers. The consumer may only compare outlets on the basis of the best known items. This imperfect information can be used by retailers to traffic build.
- The modern supermarket multiple has very considerable market power. Markets should be modelled with strategic behaviour in price and non-price actions taken between a small group of players.
- Spillovers between food and non-food items should also be taken into account. The ability of grocers to sell food products below cost, while recovering the losses on other products, should be modelled to see does it prevent or restricts competition in the market.

6.2 The Walsh and Whelan[43] paper published in the *International Review of Law and Economics* works developed economic theory on the basis of the above assumptions using modern game theoretic frameworks stylised to the conditions of the modern day grocery market. The following is a summary of that paper.

[43] Walsh and Whelan (1999b), *'Loss-Leading and Price Intervention in Multi-Product Retailing: Welfare Outcomes in a Second Best World'*, The International Review of Law and Economics, Vol.19, No.3.

6.3 The paper examines whether loss leading pricing strategies in multi-product retailing should be a target of anti-trust policy.we may define the retail product sold by supermarkets zas a basket of goods bought as a package. As a result, the cross-price elasticities of demad are negative among countless combinations of goods, food annd non-food product lines aliike, *wihtin a supermarket..*. In supermarket retailing one cannot charge consumers different prices for the same product, but it is possible to price discriminate across the range of products. Products that are more important to the consumer, such as staples or frequently purchased items, can be used as “traffic builders”, as consumers tend to be attracted to an outlet by the pricing of this core subset of products. This creates incentives for multi-product retailers to price close to or below cost on such Known-Value-Items (KVIs) to attract consumers into their outlet, with the intention of extracting rents on other items sold therein. In the case of a monopoly store, loss leading on KVIs can be considered a form of monopolistic price discrimination that reduces welfare. Under the assumption of full consumer information, loss leading is not an equilibrium outcome that one should expect.

6.4 Yet, loss leading is an observed phenomenon of multi-product retail pricing that is not confined to supermarket retailing. In restaurants, the main meal can be good value but the extras can be expensive. This can also be observed in the sale of cars - the basic car model can be priced competitively but the extras can be expensive. Retailers seem to compete on core products and try to earn rents on the additional products or extras they provide. The question is whether this is an equilibrium outcome observed under conditions of imperfect competition between firms and imperfect consumer information over products. The pertinent issue is whether loss leading on KVIs justifies intervention in the form of price controls. Is it a form of predatory pricing or price discrimination that reduces long-run welfare, or is it an outcome driven by strategic competition between rivals that leaves welfare outcomes at their full information levels?

6.5 In a model of a model multi-product retail pricing in imperfectly competitive markets predatory options, in the guise of loss leading, materialise in the presence of imperfect consumer information. However, these predatory options may not be predatory in effect. Strategic responses from rival retailers ensure that the market is self-correcting. Long run welfare and equilibrium concentration outcomes remain equivalent to *laissez faire* full consumer information levels. Thus price controls are not justified as a means of improving welfare to *laissez faire* full information levels. The use of price constraints as a second best policy instrument actually creates distortions that reduce welfare to a third best outcome. A blanket prohibition of below-cost pricing in multi-product retailing is clearly undesirable in imperfectly competitive markets with imperfect information. Price intervention imposes a distortion on the market that adversely alters long run structure and welfare. One should not use price controls unless one understands how this instrument will interact with the imperfections of the second best world.

8. Conclusions and Proposals

The debate about the Groceries Order is part of the debate about whether the purpose of competition law is to protect competition rather than competitors.[44] Fundamentally, the debate is about the power or the perceived power of multiple chain stores in the groceries sector vis-à-vis suppliers and the knock on effects on small independent grocery retailers and, ultimately, the consumer. If the Groceries Order is to avoid the charge of protecting sectoral interests rather than serving the interests of the consumer, it is not sufficient to argue that abolishing the Groceries Order will have adverse consequences for suppliers and/or small independent retailers. It is the ultimate effect on consumers which matters from the perspective of the effectiveness of competition law.[45]

Thus, in considering the Robinson-Patman Act[46] the US Supreme Court has stated:

> *"That below-cost pricing may impose painful losses on its target is of no moment to the anti-trust laws if competition is not injured: it is axiomatic that the anti-trust laws were passed for 'the protection of competition, not competitors.'"*[47]

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44 See the Review Group's discussion document on competition law, chapter 2.

45 There may be social or cultural reasons as to why, for example, small independent retailers should be protected. It is not to decry those reasons to say that those reasons do not count when looking at the matter from the perspective of competition law and its effectiveness.

46 The US Robinson Patman Act (now to be found at 15 U.S.C. 13-13b (1988)) is in fact an amendment to section 2 of the Clayton Act and was introduced in 1936 on the basis of Congressional concern about the ability of large chain stores to obtain lower prices than their small, retail competitors and the fear that such large chain stores would therefore drive the local "mom and pop" stores out of business. The Act prohibits price discrimination through the use of certain types of discounts granted by sellers to select customers where the effect of such discrimination may be substantially to lessen competition or tend to create a monopoly in any line of commerce or to injure, destroy or prevent competitionThe US case law on the Robinson-Patman Act is divided into two categories based on the injured competitor's position in the product's chain of distribution. Primary line violations are discriminatory pricing policies that injure a competitor. Secondary line violations are discriminatory pricing policies that injure a seller's customers. Most of the case law concerns the latter category.

47 *Brook Group -v- Brown & Williamson Tobacco* 113 S. Ct. 2578 (1993), quoting *Brown Shoe Company -v- United States*, 370 U.S. 294 at 320 (1962). In *Brook Group*, the court pointed out that because low prices benefit consumers, so long as the pricing strategies of the defendant are above predatory levels there is no threat to competition and thus no violation of the Act (see page 223). More recently, in *Wal-Mart Stores Inc. -v- American Drugs Inc.,* 891 S. W. 2d 30 (Ark. 1995) three local pharmacists sued the world's largest retailer (Wal-Mart) for below cost selling. The Arkansas Supreme Court, in reversing the trial court, held that the use of below cost pricing as "loss leaders" (i.e. pricing select items at a lower than average cost to entice people into a store and increase traffic) without a sustained effort to destroy competition did not violate the Arkansas Unfair Practices Act. The court noted that the pricing strategy employed by Wal-Mart was *"a tool to foster competition and to gain a competitive edge as opposed to simply being viewed as a strategem to eliminate rivals altogether"* (page 35). See generally, Kelley, *Case Note: Wal-Mart Stores Inc. -v- American Drugs Inc.: Drawing the Line Between Predatory and Competitive Pricing* 50 Arkansas Law Review 103 (1997).

Laws regulating commercial terms of trading which are not expressly designed to serve the objectives of competition policy are sometimes called "fair trade" laws. Such laws reflect different policy objectives, usually having to do with perceived imbalance in power in a market place as between manufacturers, suppliers, retailers and consumers. Of necessity, since competition laws and "fair trade" laws serve different (though sometimes overlapping) policy objectives, there can be a tension between them. However, such fair trade laws in one form or another do exist in a number of jurisdictions and their supporters argue that they can co-exist satisfactorily with competition laws.

The so called ban on below cost selling contained in the Groceries Order is argued by its opponents to be an interference with the ordinary principle that in the absence of some harmful action by a dominant firm and in the absence of some form of anti-competitive agreement or arrangement between firms, parties in trade must be free to set their price levels as they see fit. This, it is argued, is the essence of competition and any interference with the process requires a specific justification. It is further argued that since the ban is in any event a ban on selling below the invoice price, it is not in fact a ban on below cost selling as such because the invoice price does not represent the true cost of the product to the retailer for a variety of reasons such as off-invoice discounting, etc.[48]

If the Groceries Order is to be justified from the perspective of competition law rather than as a fair trade measure, it must protect the consumer from some adverse consequence deriving from some form of business behaviour which does not constitute a breach of section 4 and 5 of the Competition Act and yet is harmful to consumers in a way that can generally be regarded as “wrong” or “unfair”. The supporters of the Groceries Order argue that such adverse consequences for consumers occur in one of three different ways.

First, it is said that while selling certain products “below cost” may appear favourable

[48] It is also argued that foreign suppliers can, by means of transfer pricing within their own organisations, legitimately create an invoice price which enables the retailer to sell at the desired promotional level without involving any infringement of the Groceries Order.

to the consumer because the consumer is able to buy such products more cheaply, the consumer is in fact being duped. It is argued that the consumer is being lured into the large retail store by the attraction of the specific promotion in question (where the amount of goods available for sale at such an attractive price may be limited or may be in a relatively inaccessible part of the store). The consumer will end up buying other goods as well, some of which will be priced higher than would otherwise be the case so that the store recoups the loss it may otherwise be suffering on the items the subject of the promotion. This may have the effect that the consumer ends up paying more for the basket of goods which he purchases in the store than would otherwise be the case. It is argued that consumers may not realise this is happening because they cannot realistically be expected to remember the prices usually charged for the variety of goods on sale or the prices charged in competing supermarkets.

Opponents of the Groceries Order reply that this underestimates consumers. Consumers may well not remember many or even most of the prices of individual products but price conscious shoppers do know the cost of their standard basket of goods which they purchase in the supermarket. If the price of that basket is increased for any reason, then insofar as consumers are concerned about such costs (where the sensitivity to such changes in costs depends in part on the income of the shopper and whether the differential in cost is worth the time and trouble to go to another store), the consumer will respond accordingly. Opponents of the Groceries Order thus argue that the ban on below cost selling is not necessary to protect consumers in this way and that if and insofar as below cost selling might otherwise occur, it merely deprives the consumer of an opportunity to buy certain goods, on occasion, at very cheap prices.

The other two mechanism through which it is argued by supporters of the Groceries Order that the interests of consumers are adversely affected is through the knock on effects of below cost selling on suppliers and independent retailers. If a supplier finds his goods are being sold by the retailer below the invoice price, then aside from any damage this may do to the brand image of the product in question as a quality good (and that argument clearly applies only to premium type products), the supplier may find that competing retail stores who do not wish or cannot afford to price these products in the same way decline to stock the products at all (either because it is pointless in that consumers will not buy them or because they do not want to be perceived as selling some product at a higher price than the price which its competitor is loudly advertising). The supplier thus finds that his sales of the product are adversely affected, at least for so long as the "below cost" promotion continues.

It is argued that such circumstances may ultimately drive the supplier out of business (which it is argued will be bad for consumers because the range of products for sale is thus diminished) or, alternatively, the fact that competing stores may not stock the product if it is the subject of a promotion in another store deprives the consumers of access to those products in the stores which decline to stock them.

Opponents of the Groceries Order argue in response that the non-availability of the product is not an issue. It will be available in the store offering the discounted price for so long as those stocks last even if competing suppliers cease to stock the product temporarily. It is argued that they will resume stocking the product once the special promotion ceases in the competing store. Thus it is argued that the consumer is not in fact deprifed of access to the products inquestion. More fundamentally, it is argued that the response of the competing store will be to launch a promotion of a different type perhaps in relation to different products. That, it is said, is the essence of competition which tends to drive prices downwards and is therefore beneficial for consumers.

Insofar as such practices make life more difficult for suppliers, it is argued that the protection of such sectoral interests is not a legitimate objective of competition law.[49] The argument is also conducted in terms of the possible adverse effects on small independent retailers where it is argued that the continuing existence of such independent retailers is a benefit to the consumers. Supporters of the Groceries Order

49 Some supporters of the Groceries Order put the matter on a different and non-competition basis. It is said that the grocery trade will become increasingly dominated by giant international retailers and that one cannot necessarily apply the pure principles of competition to a small economy such as Ireland's. Some measure of balance and protection is required for indigenous industry and it is argued hat the Groceries Order (both in its ban on below cost selling and its fair trade provisions) represents some small measure by which the power of large multiple retailers can be curbed vis a vis suppliers. This may well be a fair point from the perspective of the indigenous suppliers but it is a different criterion to that used in analysing the issue from the perspective of the effectiveness of competition law. The retailers, even the large multiples, of course, do not necessarily see themselves as having this type of power. In particular, they stress that they are locked in very extreme competition with each other and point out that none of

argue that below cost selling will result in the demise of many independent retailers and "symbols" stores (i.e. independent stores trading under a common symbol or brand franchise) thus increasing concentration in the retail sector and therefore reducing competition to the detriment of consumers. In essence, the argument revolves around whether small independent retailers are truly engaged in price competition with the large multiples or whether they are in fact selling a somewhat different product i.e. service, convenience, late opening hours and so forth so that they will not necessarily lose business even if (as is generally the case) their prices are higher than those of the large multiples. It is also pointed out that many small independent retailers have come together to give themselves both brand image and purchasing power through branded franchises.

Although it is sometimes argued that the Groceries Order has a role in preventing predatory pricing (deliberate low cost selling to drive a competitor with less resources out of business), both opponents and supporters of the Groceries Order agreed that the Order does not in fact prevent predatory pricing defined by competition law cases. The available evidence in relation to supermarket margins indicates that if large multiples wish to cut prices significantly on selected lines (perhaps provoking a “price war” with other multiples, but severely affecting small independent grocery outlets in the process) they can do so without the necessity to lower the price below the net invoice price. Equally, even below cost selling may not, in and of itself, be predatory in either intent or effect. In other words, the presence or absence of predatory pricing has no necessary link with below cost selling and the Groceries Order in itself does not prevent predatory pricing occurring. Supporters of the Groceries Order argue however that the Groceries Order does prevent loss-leading which they argue to be an undesirable practice.

Aside from the below cost selling issue, supporters of the Groceries Order also argue that the fair trade provisions of the Groceries Order (particularly the obligation on retailers to pay in accordance with suppliers’ terms and conditions, especially in

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them are dominant in the Irish market place.

relation to credit and the ban on “hello money”) are equally vital to some measure of balance between retailers and suppliers and that this balance is ultimately beneficial for consumers.

Members of the Review Group were divided over these issues. All agreed that quite a number of provisions of the Groceries Order (such as Articles 1-10 save for some definitions relevant to the below cost selling issue) no longer had any useful function in light of the Competition Acts 1991-1996. Since the Groceries Order cannot be amended, all were agreed that it should be repealed but a substantial minority were of the view that it should only be repealed if something was put in its place which both included a ban on below cost selling and at least some of the fair trade provisions currently in the Groceries Order if not others.

By a slim majority, most members favoured abolishing the ban on below cost selling. While the requirement to adhere to suppliers’ terms and conditions could be argued to be nothing more than ensuring that people abide by their contracts, most members did not consider that to introduce a specific provision which would enable compliance with such contractual terms to be easily and immediately enforced was anti-competitive in itself. For that reason, most members agree that insofar as any regulation of the grocery trade be introduced which would replace the Groceries Order, such a regulation would include a provision which would require retailers to abide by suppliers’ agreed terms and conditions, particularly those terms in relation to credit.

While “hello money” may be regarded as a disguised pricing issue and from the perspective of a competition purist it might be argued that people should be free to come to such arrangements if they see fit, those members of the Group who were in favour of repealing the Groceries Order and who opposed any reintroduction of a ban on below cost selling, regarded this issue as of much less significance. It is certainly arguable that if “hello money” is indeed a pricing issue, then it is preferable that such price competition be conducted in a more transparent fashion through the ordinary mechanism of setting prices rather than disguising the true prices and costs through the payment of “hello money”.

The Review Group attempted to see if some other solution to these problems was possible or if some consensus recommendation could be arrived at. While a consensus recommendation does not seem to be possible, there is one suggestion which, if introduced, would at least diminish the significance of the ban on below cost selling in the eyes of those members of the Group who support the ban, even though those members would still prefer to see the ban remain in place. The suggestion is that a provision be introduced which would prohibit retailers from restricting offers of sale of products below cost to any particular class or classes of customers. In other words, if products are being sold by a large multiple at below cost (whether through volume discounts or otherwise), an independent retailer should be entitled to purchase those products as much as the domestic shopper[50]. If the removal of the ban on below cost selling might have the adverse effects on independent consumers feared by the supporters of the ban, the opportunity for independent retailers to buy from the large multiples would go a long way to resolving that issue. If on the other hand opponents of the ban are correct and removal of the ban will have little or no adverse effects on independent retailers and consumers, then a clarification that independent retailers can purchase from the large retailers if they so wish may have little or no consequences.

While it is true to say that the minority of the Review Group who seek to preserve the ban on below cost selling still maintain that position, it is also fair to say that they hold that position with somewhat less fervour if a provision along the lines just discussed were introduced.

The Group was of the view that insofar as any regulations governing the groceries trade may be introduced in lieu of the Groceries Order, the responsibility for enforcement of such regulations should rest with, as at present, the Director of Consumer Affairs through the mechanism of prosecutions in the District Court.

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50 At least some members of the Group would favour a further provision whereby the large multiple retailer could not make offers which would be restricted in terms of the absolute number of goods which could be purchased (i.e. that an offer restricted to, say, one only per customer, would be prohibited). The argument for such a prohibition is that the independent retailer will not in practice be able purchase enough of such special offers to stock his own shelves. However, the draft recommendation put forward at the end of this Chapter does not include such a prohibition on the basis of the majority view that it is in the interests of price competition that retailers should be allowed to structure their offers in whatever way they see fit (subject only to the prohibition against discriminating between classes of customers mentioned in the text).

Accordingly, the Review Group puts forward the following recommendation for discussion.

Recommendation

(a) The Group as a whole recognises that a number of features of the Groceries Order as it currently stands are redundant as having been overtaken by the provisions of the Competition Acts, 1991-1996. To that extent, the Group as a whole agrees that the Groceries Order should be repealed but a number of members do not favour its repeal unless and until it is clear that it is going to be replaced by either legislation or regulations which would (i) include a ban on below cost selling and (ii) include at least a number of the so called fair trade provisions of the Groceries Order.

(b) A slim majority of the members of the Group are of the view that in any legislation or regulations which are introduced to replace the Groceries Order, a ban on below cost selling should not be introduced.

(c) Some of the members of the Group who favour retaining the ban on below cost selling stress the importance of some of the so called fair trade provisions of the Groceries Order and in particular stress the importance of the following provisions:

- The obligation on retailers to abide by suppliers' terms and conditions particularly in relation to credit;
- The ban on "hello money".

(d) At least some members of the Group who favour retaining the ban on below cost selling would regard the ban as less important if a provision were introduced which would prohibit retailers from restricting their offers to any specified class of customer so that if a retailer was selling products at below cost, other (perhaps smaller) retailers could purchase those products at that price from the larger retailer.

(e) The Group therefore invites submissions on a proposal that:

- the Groceries Order be repealed;
- any legislation or regulation introduced in relation to the grocery trade would not include a ban on below cost selling;
- some form of regulation be introduced in relation to the grocery trade which would in particular require retailers to honour the credit terms on which suppliers are prepared to trade with them, would ban "hello money", and would require retailers not to discriminate between classes of customers in respect of the products which they sell.

Appendix A

Economic Impact of the 1987 Groceries Order

Report for the Competition and Mergers Review Group

October 1999

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Section 1 Background

1.1 The Review Group

In September 1996, the Minister established the Competition and Mergers Review Group.

The group consists of members drawn from the Irish Business and Employers Confederation (IBEC), Irish Small and Medium Enterprises Association (ISME), Irish Congress of Trade Unions (ICTU), the Bar Council, the Law Society, Consumers Association of Ireland, the Attorney General's Office, the Department of Enterprise, Trade and Employment, and economist Moore McDowell from UCD.

The group was asked to review and make recommendations concerning the effectiveness of competition legislation and associated regulations. The group has decided to examine the 1987 Groceries Order.

1.2 The Groceries Order

The Restrictive Practices (Groceries) Order (SI No 142 of 1987) is designed to regulate the behaviour of participants in the grocery trade.

It prohibits resale price maintenance, and price agreements between suppliers.

Goods may not be withheld from retailers, and entry restrictions to trade associations, or collective boycotts, are banned.

With some exceptions, such as fresh fruit and vegetables and certain meat and fish products, selling below cost is prohibited as is the advertising of such sale.
Suppliers to the grocery trade are required to prepare and maintain, and to

comply with, a statement of their terms and conditions of supply.

Payment of “hello money” by a supplier to a retailer (also a wholesaler) is prohibited, and the order contains a number of other provisions relating to the conduct of trade and certain requirements regarding the furnishing of information to the Director of Consumer Affairs.

1.3 The Competition Acts

The Competition Act 1991 was designed to introduce into Irish law the principles enshrined in Articles 85 and 86 of the Treaty of Rome. The Act prohibits the prevention, restriction, or distortion of competition and the abuse of a dominant position.

The Act covers the economy at large, including the grocery sector. It establishes the Competition Authority, and empowers it to grant licences which permit exemptions from the prohibitions listed in certain circumstances.

Section 4 of the Act prohibits anti-competitive agreements between undertakings and concerted practices which have as their object or effect the prevention restriction or distortion of competition in trade in any goods or services in the state or in any part of the state.

Section 5 prohibits the “…abuse by one or more undertakings of a dominant position in trade for any goods or services in the state or in a substantial part of the state…”.

At the time of enactment, it was anticipated that civil action by aggrieved parties would be the principal means of giving effect to the Act’s various provisions. However, an enforcement dimension was added in a subsequent Act, in 1996, and the office of Director of Competition Enforcement was created. The Director is a member of the Authority.

Section 2 The Grocery Market

The 1991 report of the Fair Trade Commission contains a discussion of the extent of the grocery market and notes that a working definition would cover items not included in the scope of the 1987 Order, such as fresh produce. It concludes that every member of the community is a customer and that over a quarter of all household expenditure goes on grocery items.

At the time of the FTC report, population had been declining, since net emigration had exceeded the natural increase (excess of births over deaths) for several years in the late 1980's. This trend has however been decisively reversed. In 1999, the population, we estimate, is about 3.725 million, an increase of 5.6% on the figure revealed by the 1991 census.

The proportion of total consumer spending devoted to grocery items tends to fall over time. The table shows the figures from the National Accounts for the food category.

Table 2.1 Overall Food Spend, £m (in current money).

Year	Food Category	Total Consumer Spend	Food as %
1985	2408.9	10597.6	22.7
1986	2498.1	11305.5	22.1
1987	2587.7	12022.4	21.5
1988	2624.3	12898.5	20.3
1989	2738.3	13885.6	19.7
1990	3118.9	17227.4	18.1
1991	3205.7	18017.2	17.8
1992	3387.2	19085.3	17.7
1993	3550.4	20063.4	17.7
1994	3586.7	21509.2	16.7
1995	3608.4	22933.7	15.7
1996	3915	25058.7	15.6
1997	3998	27555	14.5
1998	4282	30689	14.0

Notwithstanding the tendency for the budget share to fall with rising real income, the buoyancy of the Irish economy in recent years has raised total consumer spend at quite rapid rates, and this has boosted total spend on what we might regard as grocery items.

Table 2.2 Rates of Volume Growth, % per annum

Year	Food & Non-Alcoholic Beverages	Alcohol & Tobacco
1991	1.3	3.3
1992	6.3	0.7
1993	3.1	-1.5
1994	-1.7	4.5
1995	-2.9	4.7
1996	6.7	4.2
1997	3.3	6.3
1998	4.4	2.9

The FTC report notes a tendency for supermarkets to offer a rising range of products to consumers. It mentions in-house bakeries, butchery departments and healthcare/ cosmetics products previously the preserve of specialist retailers.

This trend has continued in the period since 1991. Many supermarkets now sell newspapers and magazines as well as low-ticket household durable items. The main supermarket chains have also been consolidating their position in the off-license trade, which they now dominate in the urban centres.

2.1 Trends in Market Structure

The basis of collection of official statistics on the various retail trades has altered over the years. The CSO now conduct an annual services inquiry, which is a replacement for less frequent inquiries in the past such as the Census of Distribution. The improvement in frequency has been accompanied by changes in coverage and definition, with the result that long-term trends in certain indicators can no longer be readily calculated.

Figures are available for the years 1966, 1971, 1977, 1988 and 1991 on a consistent basis for a category called Grocery including Supermarkets.

The level of aggregation used in the new annual surveys up the year 1994 was too great to identify a category close to what would be deemed grocery outlets for our purposes. But from 1995 onwards, figures are available for a new category called "Retail Sale in Non-specialised Stores" and for a category called "Retail Sale of Food, Beverages and Tobacco in Specialised Stores".

The sum of these two categories includes all the principal outlets for groceries, but is not co-terminous with the categorisation used in the surveys up to the year 1991. There is thus a discontinuity in the available official statistics.

The figures for total numbers of outlets since 1966 are as follows:

Table 2.3 Grocery Outlets

YEAR	NUMBER OF OUTLETS
1966*	10,811
1971*	9,642
1977*	7,555
1988*	5,743
1991*	5,429
---------	--------
1995**	8,441
1996**	8,579
1997**	8,651

* *Definition is: "Grocery Including Supermarket"*

** *Definition is: The sum of Retail Sale in Non-specialised Stores plus Retail Sale of Food, Beverages and Tobacco in Specialised Stores.*

Between 1966 and 1991, there was a steady decline in the total number of outlets, but the number of outlets lost on average each year peaked in the 1970's.

Table 2.4 Average Closures of Outlets per Annum

Period	Average No. of Closures	% of Avg. No of Outlets
1966 to 1971	234	2.3
1971 to 1977	348	4.0
1977 to 1988	165	2.5
1988 to 1991	105	1.9

The figures in the final column show the average number of closures in each period as a percentage of the average number of outlets over the period. Closures were still significant in the 1988 to 1991 period but the pace had slackened considerably.

There is then an unavoidable discontinuity in the series, and from 1995 onwards we are dealing with a different aggregate. It is clear that it is a broader definition, and that it includes some retail outlets whose principal activity is not necessarily grocery. (Note that it does not include the recently expanding forecourt stores at filling stations: it thus *includes* some stores, which may not be grocery, and *excludes* some outlets which are involved, at least to some extent, in grocery).

This aggregate, which is the closest we can get to a category corresponding to grocery outlets, has been growing in recent years. From 1995 to 1997, the number of outlets grew by 2.5%, or 210 outlets.   The statistical discontinuity makes it difficult to draw definitive conclusions about trends in the overall number of outlets operating in the grocery trade.

However it would be reasonable we believe, to conclude that the pattern of decline in the overall number of outlets has ceased in recent years in a context of resumption in population growth and the boom in consumer expenditure. The total number of retail outlets in the state grew from 30454 in 1995 to 33 094 in 1997, an increase of 8.7%, so the growth in grocery outlets during this period was notably slower than in the other categories.

2.2 Market Shares

There have been a number of significant events in the evolution of market structure in the industry over the years. The demise of the H. Williams Group in 1987 resulted in its 32 stores ending up as follows:

Table 2.5 Fate of H. Williams Stores

	No. of Stores
Went to Super Valu	14
Went to Dunnes	10
Went to Quinnsworth	5
Went to Londis	1
Closed	2
Total	32

In the period since, the Super Valu Group, which includes Musgraves as wholesaler and stores which are owner-operated, has absorbed L and N as well as Roches Stores grocery operations, while Quinnsworth (including Crazy Prices) has been taken over by the UK-based Tesco group. Superquinn has opened several new stores but remains a less-than-national group in terms of coverage.

The principal national players are Dunnes and Tesco, which operate larger supermarkets in most or all of the main urban centres; Super Valu whose stores include many smaller outlets as well as larger outlets; and Superquinn which operates a chain of larger outlets mainly in Leinster.

In addition, there are some smaller chains of regional supermarkets and national groupings of independent stores operating under the aegis of symbol groups. These include Spar, Centra and Mace, whose members operate smaller mini-supermarkets in the main.

The four main national players are Dunnes and Tesco, with market shares which each fluctuate around the range 19 to 22%, the Super Valu grouping (including Roches Stores) with about 16 to 17%, and Superquinn, with a national market share of somewhere around 8 to 9%. The latter group would have a higher share in those parts of the country where it operates.

The remaining share of the market, about one-third of the total, is divided between the symbol groups, smaller local supermarket groups and independents including specialist outlets such as butchers and greengrocers.

The percentage of the total market accounted for by the four largest groupings (Dunnes, Tesco, Super Valu and Superquinn) is about two-thirds, with a large number of operators dividing the balance. This overall picture of market structure has not changed substantially since the demise of H. Williams, although the Super Valu group has made some acquisitions and has succeeded in recruiting more independent operators.

2.3 Prices and Margins

The 1991 FTC report, and several of the submissions, consider the data or trends over time in food prices and in the overall consumer Price Index. The figures are as follows

Table 2.6 Trends in Price Indices, Nov.75 =100

	Overall CPI	**Food**	**Food Relative to CPI%**
1976	114.4	113.1	98.9
1977	130.0	131.6	101.2
1978	139.9	144.8	103.5
1979	158.4	166.2	104.9
1980	187.3	183.9	98.2
1981	225.5	211.5	93.8
1982	264.2	239.4	90.6
1983	291.8	258.5	88.6
1984	316.9	283.9	89.6
1985	334.2	294.7	88.2
1986	346.8	307.7	88.7
1987	357.7	316.0	88.3
1988	365.4	325.1	89.0
1989	380.3	340.3	89.5
1990	393.0	346.1	88.1
1991	405.5	351.1	86.6
1992	418.1	357.0	85.4
1993	424.0	358.0	84.4
1994	433.9	370.5	85.4
1995	444.9	381.8	85.8
1996	452.5	389.2	86.0
1997	459.0	396.0	86.3
1998	470.1	412.5	87.7
1999*	473.0	423.0	89.4

* *First five months only*

The final column shows the food price index relative to the overall all-items consumer price index. When this figure is rising, it means that food price inflation is faster than overall inflation, and conversely.

In the late seventies, this was indeed the case, but food prices fell relative to prices in general, up to 1985. There then followed a period of stability up to 1990 when food price inflation was pretty much in line with overall CPI inflation.

Food price inflation then fell relatiove to the CPI up to 1993, but has since exceeded overall inflation. By the early nomthes of 1999, the relative price index for food was back up to the level of the mid-1980's.

It has been argued that trends in food prices, relative to prices in general, will reflect the degree of competition in the grocery trade as well as the impact of policy measures such as the Groceries Order. We will return to this matter in section 4 below. At this stage, we would observe that a wide range of factors influences trends in aggregate price indices over time. In the case of food prices, relative to overall prices, these factors include:

- Changes in VAT rates, which do not apply to most food items. There have been many changes in VAT rates over the period in question.
- Changes in support prices for farm produce under the EU's Common Agricultural Policy, which have also been frequent
- Changes in exchange rates, and in the Monetary Compensation Amounts ("Green" exchange rates) under the CAP.
- Changes in the character of the products covered over time.

All of these factors have been present over the period covered and have influenced relative food prices.

Gross profit margins can be computed, for the aggregate grocery sector as defined in the Central Statistics Office Surveys. These are available for the same years as the figures for outlet numbers, from 1977.

Table 2.7 Gross Margin in Grocery

Year	Gross Margin
1977	14.94
1988	15.77
1991	19.52
-------	-------
1995	21.55
1996	22.67
1997	24.18

Note: The definitions of outlets covered are the same as for Table 2.3 above.

There is again a discontinuity after 1991, and the figures need to be interpreted with care.

Between 1977 and 1991, there was a significant increase in gross margin, and a similar trend is evident for a different definition of the sector, between 1995 and 1997. We can say nothing about the trend in gross margin between 1991 and 1995, due to the data discontinuity.

These upward trends in gross margin do not tell us anything about the net profitability of the grocery retailing business over this period. Gross margins are comprised of turnover less cost of goods for resale, and take no account of operating expense. Net profitability, on which no direct data is available, need bear no necessary relationship to gross margin, and will fluctuate in line with wage costs, nonwage operating expense and other items, including financial charges and rent.

The general upgrading of the retail sector, which has occurred in recent decades, must have resulted in heavier charges for nonwage expense in particular, reflecting higher premises costs and greater use of in-store refrigeration and other equipment.

In so far as these figures are relevant at all, they tell us no more than that gross margin in the industry has been rising, with no discernible impact that could be associated with the Groceries Order. They tell us nothing about profits.

Section 3 Studies and Submissions

Over the years, a number of reports and studies of the retail grocery market have been prepared, and the review group has also received a range of submissions, on the topic of the Groceries Order.

Reports were prepared by the Fair Trade Commission, in 1956, 1966 and 1972, dealing with various aspects of the grocery trade, and the Restrictive Practices Commission also reported in 1973, 1980 and 1986.

The latter body prepared a report dealing specifically with below-cost selling in 1980. This report recommended the introduction of a prohibition on below-cost selling of grocery items including liquor and own-label goods. It however excluded fruit and vegetables (unprocessed) from this recommendation.

The Commission gave a number of reasons for these recommendations,

- The increasing market share of multiples
- The increased role of own brand and generics
- Below cost selling was seen by the Commission as an unfair practice
- Below cost selling creates various practical difficulties for suppliers
- Frequent price charges hinder consumers, who cease to remember more than a small number of prices

The Fair Trade Commission reviewed the position again in 1991. They noted that the 1987 Order was the first to actually prohibit below cost selling. The FTC conclusions included the following:

(i) No single operator in the retail grocery trade could be deemed to have a dominant position nationally since the market shares of the two largest multiples do not exceed about 20%.

(ii) The picture varies regionally. The major operators (Dunnes, Tesco/Quinnsworth and Superquinn) enjoying a combined share of over

70% in Dublin, for example. Despite this, they felt that the “grocery market remains competitive in Dublin”.

(iii) Based on survey of suppliers, they concluded that “… The results indicate that, overall, suppliers would not appear to be unduly dependent on particular retailers”. They also noted that concentration on the supplier side of the market had been increasing.

(iv) Entry to the grocery trade would not appear to entail large sunk costs.

(v) Barriers to entry are not such as to prevent new entrants to the trade.

The FTC made a number of unanimous recommendations regarding repeal of Articles 3 to 10 of the Groceries Order. These deal with agreements on prices and with exclusivity and discriminatory practices, and the Commission felt that they were adequately covered in the Competition Act.

The Commission did not however agree on its recommendations regarding below-cost selling.

Two members recommended repeal (Messrs. Lyons and Massey) while Mr O’Reillly felt the ban should be retained.

The majority concluded that below-cost selling could be predatory, but expressed the view that only a dominant firm would be likely to embark on such a strategy. They also note that pricing which is not actually below cost could nonetheless be predatory in certain circumstances. (para. 7.147).

They argue that below-cost selling which is predatory neither in intent nor in effect is just another weapon in the armoury of competition, and is no “… less desirable than other forms of promotion, such as advertising, opening hours, free deliveries and so on”.

They describe the ban on below-cost selling as a “…serious restriction on competition and upon the free play of market forces”.

Trends towards increasing concentration in the grocery trade, were such to emerge, could be dealt with through merger control, and anti-competitive practices through the provisions of the Competition Act.

Amongst the other observations by the FTC majority is that off-invoice discounts have ranged up to 25% and 30%, and that this practice amounts to resale price maintenance by suppliers.

Given that predatory below-cost pricing would be prohibited, under the Competition legislation, they argue for repeal also of the prohibition on advertising of below-cost prices. They did not consider that arguments about the pressures placed on suppliers by the large multiples were an adequate justification for the ban on below-cost selling.

One member of the Commission, Mr O'Reilly, argued that the ban be retained and extended. He felt that the ban had proved beneficial for consumers, grocers and suppliers.

He notes that, while below-cost selling can be predatory, it is generally a promotional device, and also observes that none of the grocers are dominant in the sense of Section 5 of the Competition Act.

Mr O'Reilly recommended changes to the definition of net invoice price, and that excluded products (fruit and vegetables, fresh and frozen meat and fish) should also be covered by the ban.

Mr O'Reilly's principal argument for the ban on below-cost selling is that its removal would encourage greater concentration in the industry with consequent reduction of competition. This would make life more difficult for suppliers. He also argues that below-cost selling is "…an artifice, a trick or a gimmick" designed to mislead consumers. Shoppers will not know the prices of most items, and will be induced to patronise outlets selling a small range of items below cost, even though the general level of margin in that store may be no lower than elsewhere.
Mr O'Reilly was also of the view that his preferred arrangements would best be achieved through the enactment of a new Fair Trade (Groceries) Bill.

3.2 Summaries of Submissions

Dr John Fingleton (TCD)

Dr Fingleton argues that the Order permits a form of resale price maintenance in the groceries market. As such, it is in the interests of producers in this sector, and imposes high costs on consumers. He regards the Order as "…a serious anomaly in our system of competition", and he favours its repeal.

Dr Barry Doherty (TCD and EU Legal Service)

Dr Doherty notes that the Order explicitly provides that suppliers can set minimum prices, and that this conflicts with the conclusion of the Competition Authority in its decision in the Musgraves case (Decision 354, 19 September 1994). He notes that the Order's "… practical importance is greatly reduced because of the more general remedies now available under the Competition Acts".

He concludes that it would be possible to incorporate special rules for the groceries sector within a revised Competition Act.

RGDATA – IADT – SSRF

RGDATA (the Retail Grocery, Dairy and Allied Trades Association), IADT (Irish Association of Distributive Trades) and the SSDF (Service Station Retailers' Federation), made a joint submission.

RGDATA represents independent retailers, including those in membership of Group or Franchise networks including Mace, Spar, Super Valu, Centra, Vivo and Londis.

IADT represents wholesalers who operate cash and carry outlets and which supply symbol groups.

SSRF represents the owners/operators of filling stations/forecourt shops.

RGDATA-IADT-SSRF argue that the effects of the Groceries Order have been positive. The consumer has benefited from "…genuinely low prices, in a fiercely competitive market…" and from "…the abolition of the nefarious practice of below cost selling which was a cynical and crude marketing device occasionally used as an instrument of predatory pricing but also used as a means of creating perceptions of illusory value for consumers".

They argue that repeal of the Order could presage a resumption of intense and, as they would see it, destructive competition in the market, with consequent threat of closures and job losses, amongst independent retailers and suppliers.

They specifically reject the contention that the Competition Acts provide an adequate substitute for the Groceries Order and argue that the grocery sector is of such importance nationally, to consumers, retailers and their suppliers, that it requires some form of industry – specific regulation over and above the provisions of the more general competition legislation.

They conclude by arguing for the retention of the Groceries Order regulations regarding

- below cost selling
- hello money
- credit terms for suppliers.

RGDATA-IADT-SSRF note (on page 22 of their submission) that "… the discounts not shown on the invoice would aggregate at an estimated 3% to 4%", a point to which we return in Section 4.

Irish Farmers Association

The IFA represents producers of fruit and vegetables not covered by the Order, and of milk, which is covered.

They argue that the order should be extended to cover fruit and vegetables and that its applicability to milk has helped to sustain the home delivery system in Ireland.

They criticise the behaviour of supermarkets regarding low-price promotions of potatoes, and also the downward pressure on the price of vegetables, instancing cases of "… ridiculously low prices…" below the level of production cost.

The fact that the Order does not apply to fruit and vegetables has worsened the position of primary producers.

An Bord Glas

An Bord Glas is the State body responsible for the development of horticulture.

Its submission argues that the Order should be extended to cover horticulture produce, on the grounds that below cost-selling and advertising has a detrimental effect on the industry and on the confidence of producers.

Fyffes Group Ireland

Fyffes Group Ireland, a subsidiary of the publicly-quoted Fyffes plc, is the leading distributor of fresh fruit and vegetables to the Irish market.

Their submission notes that most fruit sold on the Irish market is imported while most vegetables are locally grown. It argues that both fruit and vegetables should be included in the ban on below cost selling contained in the Groceries Order.

Below cost selling causes problems for distributors such as Fyffes.

Short term promotions at below cost produce an immediate surge in demand with consequent need for extra deliveries of perishable produce. Demand from outlets not selling below cost may fall and the overall effect is disruptive and cost-increasing. Independent retailers may even purchase stock from the supermarket thus by-passing Fyffes or other suppliers.

Below-cost selling which is maintained for an extended period is less damaging, according to Fyffes.

They recommend that fruit and vegetables should be included in the ban on below-cost selling. Failing that the ban should be scrapped altogether, since it would remove the pressure of occasional promotions from their sector and spread the effect across the full range of grocery goods.

Irish Business and Employers Confederation (IBEC): Competition Council

IBEC is the principal business representative body in Ireland.
In its submission, IBEC's Competition Council argues that

1. The rate of increase in food prices in the first five years after the ban on below cost selling was introduced was lower than in any five-year period since 1947.
2. The rate of increase in the food price index has been lower than the increases in the CPI since 1987.
3. The rate of increase in the food price index has been significantly lower than in the UK or the average EU since 1985.
4. The retailers margin on sales of food has not increased.
5. Since the order was introduced the production of the food and drinks industries has increased by over 50%.
6. Employment in the food and drink processing industries has increased since 1990, having fallen during the 1980's.

They predict that the removal of the order would reduce employment in the retail and associated sectors by 23,000.

Removal of the order would also result in higher inflation, a loss of competitiveness for Irish producers, harmful impacts on the retail sector, and damage to Irish suppliers and producers through the attraction to Ireland of

British multiples.

The IBEC Competition Council concludes that the Groceries Order should be retained. Alternatively it believes that the Competition Act should be amended to provide for “fair trade provisions” in the grocery trade.

They argue that the removal of the ban on below cost selling will stimulate the UK multiples entry into the Irish market. They calculate that off-invoice discounts may be of the order of 5% across the range of products.

IBEC – Food Processors and Suppliers Group

A second submission from IBEC makes many of the same points. It stresses that below cost selling is only a problem in the Grocery Trade, because stores can drop prices on a narrow range of items, thus creating a low price image while maintaining margins across the full basket of goods. They also warn of damage to Irish suppliers consequent on the entry of UK multiples.

Section 4 Impact of the Groceries Order

4.1 Economic Considerations

The most significant, and the most controversial, element in the Order is the ban on below-cost selling, and we will focus exclusively on that provision in the remaining sections. The report of the Fair Trade Commission, it will be recalled, was divided in its recommendations on the below-cost selling issue. The submissions to the Review Group have also concentrated on this particular issue.

The Objects of Policy

The first question which needs to be considered is the clarification of policy objectives. It is clear from the submissions and from the official reports that policy has, or in the eyes of protagonists ought to have, policy objectives of three kinds:

- The promotion of consumer interests, in particular efficient production and distribution of grocery products at lowest possible prices.
- The promotion of fair trade ensuring that those engaged in production and distribution of grocery goods are protected from unfair or discriminatory practices on the part of their competitors, customers, or suppliers.
- Broader economic policy objectives dealing with matters such as employment, and the development of indigenous food production and processing.

Nature of the Order

The principal provision of the Order is the ban on below-cost selling.

This is in the nature of a provision which resembles resale price maintenance. It is not however identical to resale price maintenance, which is in any event specifically prohibited by the Order. Under the latter, suppliers can indicate the selling price of their product (as they still do for products such as cigarettes or newspapers). These indicated prices are above the invoice price to the retailer, ignoring for the moment the question of off-invoice discounts, and retailers are bound by them under RSM.

In the absence of discounts, resale price maintenance would have the effect of setting minimum prices which included the retailers gross margin. In the case of those goods where uniform prices are charged in Ireland, such as newspapers and cigarettes, these margins are the subject of regular disputes between the producers/suppliers and the bodies representing retailers. The latter sell at prices which exceed the invoice price, in line with the agreed retail margin.

Thus if off-invoice discounts could be ignored, the ban on below-cost selling would permit retail prices for particular goods which would be below those possible under RSM. It also permits each retailer to choose the level of gross margin which they wish to earn. There is no such discretion to the retailer under RSM. Accordingly it would be unreasonable to assert or to suggest that the Groceries Order creates a situation akin to a thorough going RSM regime.

The prevalence of off-invoice discounts complicates the picture. The extent and prevalence of these discounts is difficult to ascertain and appears to vary across product categories and possibly over time.

In earlier sections, estimates of the extent of off-invoice discounts were quoted. Figures of 3,4 or 5% were mentioned but also much higher figures, up to 25%. Off-invoice discounts bring the system obtaining under the Groceries Order closer to an RSM regime. The two would be closest to one another were the general level of off-invoice discounts for the various products equal to the retail gross margin which would emerge under RSM.

However it is important to understand that RSM removes pricing discretion from the retailer, channelling competition into non-price areas. A below-cost selling ban does not do this, since retailers are free to charge at any level down to a gross margin of zero (ignoring discounts).

4.2 Potential Impacts of the Order

At a static level, the ban on below-cost selling could be expected to manifest itself in the form of a general level of margin in the trade equal to, or higher than, that which would prevail in its absence.

Any regime of this kind may have dynamic effects too, impacting on the structure of the industry and on such matters as concentration, the relative position of multiples and independents, and the relations between suppliers and retailers. There could also be effects on employment in the retail sector itself, and amongst suppliers. These could differ from the static effects.

4.3 Impacts Suggested in Submissions

The various submissions and official reports devote considerable attention to the question of the impact of the below-cost selling prohibition in the Groceries Order.

The submission from the **IFA** suggested that

- the ban helped to sustain doorstep milk delivery
- the absence of a ban on below-cost selling for fruit and vegetable producers imposes pressure on their selling prices
- the repeal of the Order would impact adversely on independent stores in rural areas.

An Bord Glas also expressed concern that the absence of a ban on selling fruit and vegetables below cost hurt producers of these products.

Fyffes argued that below-cost selling of fruit and vegetables created disruption and extra cost for distributors of these products.

The Food Processors and Suppliers Group of **IBEC** argued that the Order had restrained food price inflation, and that Irish grocery products had achieved success in international markets since 1987.

The removal of the Order would

- cause job losses of up to 23,000
- damage the food and drink processing industry
- cause food price increases
- reduce investment
- facilitate the entry of UK multiples, thus reducing employment and consumer choice.

The Competition Council of **IBEC** supported these points, arguing in addition that

- retailer margins had not increased as a result of the Order.
- The Order's removal would quicken concentration and cause consumer price increases.
- Irish producers would lose competitiveness, and exports would suffer.

The submission from **RGDATA-IADT-SSRF** argued that the Order had

- helped to check food price inflation
- restrained the dominance of the leading multiple retailers

In the absence of the Order, the market would "descend into semi-chaos". The winner would most likely be the company with the greatest resources, and the costs of the struggle for the market would include high job losses.

The consumer would lose shopping options, and investment would decline.

4.4 Assessment of Available Evidence

In so far as the various submissions make assertions about trends since 1987, it must first be understood that aggregate national data have limited power to discriminate between competing hypotheses. This limitation is excaberated by the discontinuities in data definitions in the official series collected by the CSO.

There is evidence available since 1987 on three aspects, discussed in Section 2. These are trends in food prices relative to CPI, margins in the grocery trade, and trends in market structure including the overall number of outlets and concentration.

We would state at the outset that the principal provision of the Order, namely the ban on below-cost selling, is unlikely to have profound effects on any of these three variables in our view.

We have already listed the myriad factors which impact on aggregate food prices. Unless below-cost selling in the grocery trade were both widespread and persistent prior to the Order coming into effect, the impact of the Order would be small relative to these other factors. The Fair Trade Commission in its 1991 Report, did not document evidence of such widespread and persistent selling below cost prior to the coming into effect of the Order, nor is it documented in any of the submissions.

The data on food prices relative to the CPI contained in the submissions relate to periods excluding the most recent years. A full run of data from 1976, containing long periods both before and after the coming into effect of the order, is shown in Section 2. These figures do not support the view that any discernible effect can be attributed to the Groceries Order. An apparent fall in food prices relative to CPI in the early 1990's has since been reversed.

However we would not be convinced either way by an alternative historical pattern in the data. The various extraneous factors driving relative prices in the economy are more powerful than any conceivable impact from the Groceries

Order, and we do not believe that the impact of the Order on relative prices is capable of being assessed by reference to the CPI and its component series.

We conclude that none of the submissions have succeeded in establishing that the Order has had the beneficial impact claimed on food prices.

Margins in the grocery trade as measured from time to time by the CSO, were also discussed in Section 2.

The margins in question are gross margins, and there have been definitional changes in the scope of retail outlet covered.

The trend in margins would appear to be steadily upward until 1991, and also from 1995 to 1997. The data discontinuity inhibits any conclusions being drawn about developments between 1991 and 1995.

But just as with relative prices, there are many extraneous factors which impact on gross margin. It is entirely conceivable that rising gross margins could coincide with static or even declining margins of net profit.

To give just two examples, a store which moved to in-house bakery would need higher gross margins in order to maintain net profit. The reverse would be the case with a store which shifted warehousing and stockholding costs onto suppliers.

In order to draw conclusions about any impact which the Groceries Order may have had on the degree of competition in the industry, information on net profit and on return on capital would be necessary. Such information is not readily available, and is not deployed in support of the contentions on this matter in the various submissions.

On the matter of margins, we conclude that the evidence contained in certain submissions does not support the view that the Order has had the effect of applying downward pressure on margins in the trade. The available evidence, which is restricted to gross margins and hence of questionable value, does not in any event show a pattern of decline.

Finally, the question of market structure was raised in submissions with several suggesting that the ban on below-cost selling helps to maintain independent retailers and to dampen trends toward greater concentration.

The CSO series on the total number of retail outlets in the grocery trade is again discontinuous. Up to 1991, there had been a steady decline in outlet numbers with no discernible acceleration associated with the advent of the ban on below-cost selling from 1987. Indeed the fastest rate of loss in total outlet numbers would appear to have been in the 1970's.

The new series, not comparable with the figures available up to 1991, shows that the number of outlets in those categories approximating to the grocery sector has actually risen during the years 1995 to 1997, although at a slower pace than for other types of retail outlet.

There are many influences on the trends in total outlet numbers, including in particular demographic change and factors such as rural population decline, urbanisation and the rise in car ownership. The consumer boom of the last few years is a further influence.

It is not possible to draw firm conclusions from the available data about the influence of the Groceries Orders on outlet numbers, because of these extraneous influences. None of the submissions, in our view, has established that the Order has succeeded in ensuring a greater number of outlets either nationally or in specific locations, than would have arisen in the absence of the Order.

There is finally the issue of concentration. We have found it impossible to assemble a consistent data series on the market shares of the different categories of outlet. The definition of the grocery sector is itself problematic, as is clear from the changing categorisations used by the CSO in the surveys which are undertaken by that body.

The major changes which have taken place in the sector in recent years have been

(i) The expansion of the Musgraves organisation through its links to the owner-operated Super Valu chain of stores, and the recruitment of some smaller store chains

(ii) The takeover of Quinnsworth/Crazy Prices by the UK-based Tesco Group

(iii) The opening of some stores outside its traditional Dublin and North Leinster area by Superquinn.

We believe that, defining the market in terms of the totality of outlets selling grocery items (and thus including greengrocers, butchers, and all other food outlets) the four main groupings of Dunnes, Tesco, Super Valu and Superquinn have about two-thirds of the national market. Their share in Dublin would be higher and in provincial areas lower. The Super Valu grouping is not a multiple in the conventional sense, but its participating stores are effectively branded nationally.

We are not aware, from the submissions or otherwise, of evidence which established that the Groceries Order post 1987 has impacted on the degree of concentration in the industry. The last major event which affected concentration ratios was the demise of H. Williams, and developments since then, while they have seen some changes in market shares, are not capable in our view of attribution to unique causes, such as the ban on below-cost selling.

There is a general difficulty regarding post 1987 developments in

- food prices relative to CPI
- gross (or other) retailer margins
- outlet numbers
- concentration ratios

and attempts to attribute these developments to the ban on below-cost selling, or indeed to any other causative factor or factors.

The difficulty is methodological. If we let food prices relative to CPI be denoted by the symbol F, we can write a relationship

F= f (VAT, CAP, XRT, BAN, OTHER)

which says that food prices relative to CPI are a function of

VAT = changes in VAT rates

CAP = changes in the common agricultural policy

XRT = exchange rate effects

BAN = the ban on below-cost selling

OTHER = other known factors

Only if the relationship above can be articulated in detail and the various effects calibrated in some way, does it become possible to estimate what would have happened in the absence of the below-cost selling ban. The course of F, the relative price of food, could then be plotted under this Counterfactual Hypothesis, that is the situation where there was no such ban. A comparison of what actually happened to F, with what would have happened under the Counterfactual Hypothesis, can then be undertaken, and conclusions drawn about the impact of the ban.

The same procedure, involving a full modelling of all known causative influences would be necessary in order to draw conclusions about the influence of the ban on margins, outlet numbers, concentration ratios or on other magnitudes of interest, such as employment or exports.

Modelling of this kind, taking full account of known causative factors has not been undertaken in support of the contentions about the impact of the below-cost selling ban in the various submissions, and in its absence, we believe that the pre and post 1987 historical patterns cannot be conclusive or even informative, about the impact.

We would add that the available Irish data are such that satisfactory modelling of the kind necessary would be very difficult, and may well be impossible for all practical purposes.

4.5 Prospective Impact of Repealing the Ban on Below-Cost Selling

The static impact of a repeal of the ban would be the facilitation of those outlets which would wish to avail of the opportunity to offer goods at prices below cost. The extent of below-cost selling which would actually occur is difficult to predict.

Besides the Groceries Order, all forms of resale price maintenance are prohibited in Ireland, with a few exceptions. Thus retailers of virtually all non-food items are free to sell them below cost if they so desire. Instances of widespread and persistent discounting below cost by retailers in non-food sectors are not plentiful.

The most common example is in the clothing, footwear and household goods sectors, where a cycle of "Sales" has long been established, with post-Christmas and Summer sales the most common. The seasonal nature of clothing lines, and perishability due to fashion changes may create "distressed inventory", analogous to the fruit and vegetable trade. However these features do not apply to many of the items included in these sales, and it seems clear that retailers use them as a promotional tool, as well as to dispose of distressed inventory. Items included in these sales may or may not be priced below cost – it is known, for example, that certain lines are stocked exclusively for sales by some retailers.

In the grocery trade, fruit and vegetables, as well as fresh and chilled meat and fish products, are exempted from the ban on below-cost selling, and it is clear that some retailers have chosen to sell below cost from time to time. This appears to happen more often in the fruit and vegetable sector, particularly in the case of potatoes.
The incidence of below-cost selling in these areas is, in the view of the authors of some of the submissions, greater because of the ban in the mainstream grocery area, and this seems plausible.

The static impact of an end to the ban on food prices would depend on two factors.

The first is the extent to which retailers would actually cut prices below cost, the second the extent to which they would compensate by raising prices for the other items in the shopping basket, not the subject of below-cost promotions. The 1991 minority (Mr O'Reilly) report of the Fair Trade Commission drew attention to this latter possibility.

It was noted in Section 2 that gross margins in the trade were over 20% in recent years, on the current CSO definition of the two sectors involved. On the earlier (up to 1991) definition margins had been below 20%. For the sake of illustration, let us assume that gross margins are 20% and the rate of net profit is 5%.

The effect of the ban on below cost selling is thus to prohibit the conduct of trade at prices 20% below those currently charged, which would amount to a ban on operating at a net profit margin lower than –15%. Clearly no operator could contemplate price-cutting across the board even to the extent currently permitted, given the catastrophic losses which would result. Under the current regime, therefore, operators who felt in a strong financial position are perfectly free to operate at loss for as long as their finances permit. The existing Groceries Order regime, it appears to us, does not prevent price wars of an across-the-board type.

Should the Order be repealed it would become possible for operators to discount a small number of items very severely, while leaving the overall average margin unaffected, or affected very little. But in this scenario, the static impact of repeal of the Order would be limited, and would not result in any major impact on consumer prices or on margins.
The principal impact would be on the composition of promotional activities. Operators would be likely to divert budgets currently devoted to advertising, loyalty cards, cheap flights, and offers of discounted crockery based on accumulating stamps from regular purchase. An additional promotional weapon, namely the offer of particular items at below-cost, would become available, and it is likely that it would be used.

The dynamic impact of below-cost selling could, it has been suggested, adversely impact on

- smaller, independent grocers, and or
- indigenous suppliers

The impact, according to one submission, could be enough to cause the loss of 23,000 jobs.

If we are right in suggesting that the static impact would be limited, it is more difficult to argue the case for major dynamic effects.

Those who argue that repeal of the Order would not result in widespread price-cutting by the major chains also argue, in some cases, that there would nonetheless be substantial long-term effects.

Many of the submissions use the term "predatory pricing" to describe the behaviour they expect to result from repeal of the ban on below-cost selling.

A deliberate campaign of predatory pricing by a large multiple would involve

- a pricing strategy which risked major short-term losses, but
- which gained market share through the permanent elimination of at least some competitors, thus permitting
- recoupment of the losses, and the generation of additional long-run profits, in the less competitive marketplace which subsequently emerged.

A nationwide predatory pricing campaign by one of the large multiples would appear to be one of the hypothesis giving rise to the fears of job losses, and increased concentration.

It should first be noted that a collusive predatory pricing campaign by two or more of the major groups would be illegal under the 1990 Competition Act. The largest Irish groups enjoy market shares of about 20% of the grocery market broadly defined.

If such a group were to embark on a campaign of short-term loss, in the hope of ultimate gain, it would face a number of risks. These include

- Immediate retaliation by another major chain or by the trade generally, which would result in early abandonment of the strategy, and pointless losses
- Failure to achieve sufficient market share gains to justify the expense.
- The free-rider problem created by the existence of other large chains, which sit out the costly price war against smaller players, and then seek a share of the gains when they withdraw
- Regulatory or legal action against predatory pricing, which would cause legal costs and adverse publicity even if it failed.
- The long-run limits to profit created by ease of entry. The grocery trade is not characterised by substantial natural barriers to entry, so pricing which eliminated some players could fail to deliver long-term profit, due to the subsequent entry of new competitors.

This is a formidable list of risks, and the economics literature on this topic has tended to the view that predatory pricing strategies are not promising for players in the circumstances described.

Successful prosecutions for predatory pricing are rare. There are obvious difficulties in distinguishing the impact of predatory pricing from that of aggressive competition, which public policy in most countries seeks to promote.

One of the more celebrated European cases was Akzo (Official Journal, L374, 31 December 1985), when the EU Commission fined the Dutch chemical group for predatory abuse of a dominant position. But even in this case, it has been argued that the evidence presented did not establish predation, and that "… the story told is one of active competition…" rather than of predation[51].

In the United States, actions for predation are infrequent and successful ones are quite rare. In our view, it is extremely unlikely that a firm with the market share of the larger Irish grocery multiples could mount a successful campaign of

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[51] See Phlips and Moras: "The Akzo Decision: A Case of Predatory Pricing?", Journal of Industrial Economics, September 1993.

predation, at least on a national level.

Of course, there can be no guarantee that some firm might not attempt such a campaign, but it is difficult to rationalise any public policy designed to prevent unsuccessful campaigns.

If the major chains were free to sell below cost, this would add to the range of promotional weapons at their disposal. Their capacity to raise the tempo of competition against one another, and against symbol groups and other independents, would be enhanced. It is conceivable that some stores would suffer in this scenario. But this should be seen as a consequence of active competition, and not necessarily of predation. A large and diverse market such as grocery with numerous players, will see regular casualties, in any regime where competition is encouraged.

A recent article on the Irish grocery market draws attention to a dual structure which has emerged.[52] They argue that, in urban areas, the larger outlets provide a one-stop service, relied upon for weekly shopping for example, while the smaller independents and symbol groups offer a convenience product. They offer a greater range of locations, better opening hours, and a somewhat different product range. They argue that this distinction is important, and develop a model which has the feature that loss-leading, that is selling below cost, is an equilibrium outcome. The strategic response of rivals ensures that welfare and market structure are optimal in the long run, and there is no case for the prevention of loss-leading behaviour.

The ban on below cost selling is defended in the submissions by groups which represent suppliers and primary producers. They argue that the ban inhibits the major retail groups from exploitation of their potential market power vis-à-vis suppliers.

The majority report of the Fair Trade Commission makes the point that some firms supplying the retail grocery trade are substantial undertakings, and that

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[52] Walsh and Whelan: "A Rationale for Repealing the 1987 Groceries Order", Economic and

there has been an increase in concentration. We would make the further point that the Irish agri-business sector is a major exporter, and the available market is not restricted to Republic of Ireland outlets.

The difficulties of small suppliers, for example in gaining initial access to retail distribution for new products, are cited in submissions. These difficulties are general, and affect small firms in all sectors. It is not clear that policy towards small and medium enterprises in the food sector should have features over and above those provided for in general competition law, and in the laws and policies regarding relations between businesses, and small business development.

If it is unlikely that repeal of the ban on below-cost selling would have major impacts on prices, margins or concentration in the grocery trade, beyond the consequences of active competition, it is unclear how the balance between suppliers and outlets could be materially altered. The submissions on this point assert that removal of the ban would have widespread impact, but the evidence in support of the asserted effects is not convincing.

The two principal arguments in favour of the retention of the below-cost selling ban in the minority report of the Fair Trade Commission (1991) were, it appears to us, the risk of greater concentration and damage to suppliers, discussed above, and also the direct criticism of below-cost selling as an unfair practice, undesirable from the consumer standpoint. The concern is expressed that the purpose is essentially to mislead the consumer. This is advanced as an argument against the practice, independently of the issue of dynamic effects on industry structure.

The law does not protect consumers against promotional activity by sellers in any general way, beyond the laws and regulatory arrangements dealing with misleading or untruthful advertising. The sale of goods at price below cost is itself a transparent transaction, from which consumers (as distinct from competitors or suppliers) hardly need to be protected. The burden of the argument in the minority report is that the overall level of prices in the outlet concerned would not be reduced, but only the prices of a few known value items, perhaps bread, milk or other high volume lines.

Consumers would be conned into believing that prices in the store were lower than in competing stores, and would mistakenly transfer their custom for this reason.

There is a policy question here about the extent to which laws should protect consumers in markets where all price information is transparent. The use of promotional gimmicks is in any event widespread in advertising and product promotion, without falling foul of the laws dealing with those areas.

The argument is also silent about the reaction of competitors. If one firm were to discount a few lines steeply, and to compensate by enhanced margin elsewhere, competing sellers can be expected to react, either by matching behaviour, or by advertising the price of the representative shopping basket across stores.

4.6 Competition Outside Main Urban Centres

The IFA submission expressed concern about the impact of repeal of the Groceries Order on the retail networks outside urban areas.

The main cities and the larger provincial towns have branches, in most cases, of more than one of the major multiple chains. Towns such as Carlow, Kilkenny or Clonmel, with populations of 14,000, 19,000 and 16,000 respectively have branches of Dunnes, Tesco and Superquinn, as well as SuperValu stores and outlets of other symbol groups. Superquinn does not however operate in several other towns of this size.

Smaller towns, with populations of 4,000 to 6,000, often have both a Dunnes and a Tesco, as well as representatives of symbol groups and of the regional supermarket chains which operate in some parts of the country.

Towns below this size may not have any branch of a national multiple, or in some cases just one such branch. In the main, these smaller towns and villages are served by the symbol groups and independents.

A regime in which below-cost selling was permitted could result in a form of predatory pricing at local level, where a store which was the dominant player in a local geographical market could seek to target the smaller stores in the town and in outlying areas. There may be areas of the country where a selective strategy of this type would have better prospects of success than it would have at national level. However, there would still be strategies of response available to competitors. In the next section we discuss the provisions of the Competition Acts in this context.

4.7 Conclusions

Different countries have adopted different approaches to the practice of below-cost selling. It is permitted, for example, in the UK, as well as in Germany, Spain and Italy, but restricted in France, Belgium and Portugal.

The objectors to repeal of the Groceries Order have failed in their submissions to demonstrate empirically the claimed benefits of the Order, or to establish the justification for their predictions of the impact of repeal. The available evidence, as well as considerations of market structure and competitor response lead us to conclude that the impact in Ireland is capable of being exaggerated.

The principal immediate impact of the Order is to facilitate a form of minimum price maintenance for certain products, and to channel competition into other avenues. The claims made for the Order include beneficial impacts on suppliers of the multiples and on their smaller competitors. The protection of these interests is not a feature of Irish consumer or competition law in other sectors, and the Groceries Order is to that extent an anomaly.

Section 5 The Groceries Order and the Competition Acts

A key issue in considering repeal of the Groceries Order is the adequacy of the Competition Acts to deal with abuses which might arise in its absence. In Section 1, we noted that Sections 4 and 5 of the 1990 Act render illegal a wide range of collusive anti-competitive behaviour and abuses of dominant position.

The Acts would not prohibit below-cost selling per se, which exists in several areas outside the grocery trade. But the use of below-cost selling for anti-competitive purposes, in particular predatory pricing, is the source of many of the concerns expressed in the submissions to the Review Group, and the adequacy of the Acts to cope with predatory pricing, should it emerge, needs to be considered.

The standard test of predatory pricing by a dominant firm recommended in the economics literature dates back to the proposal of Areeda and Turner[53]. They suggested that short-run marginal cost be the test, while acknowledging that there were measurement difficulties and that surrogates might have to be used. Since that date, the literature has focussed in addition on the strategic nature of the predatory pricing issue, and specifically on the dynamic and long-run issues involved. A simple assessment of price-cost relationships may not be adequate to establish predatory intent or likely predatory impact on market structure given the uncertainties about the behaviour of the predator's actual or potential competitors, amongst other matters.[54]

Klevorick concludes that "…if the policy objective is to design a test to distinguish predatory price cuts from aggressive competitive price reductions,

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53 Areeda and Turner: "Predatory Pricing and Related Practice under Section 2 of the Sherman Act", Harvard Law Review, February 1975.

54 These issues are discussed in Klevorick, "The Current State of the Law and Economics of Predatory Pricing", American Economic Review, Vol. 83 (2), 1993.

that test ought to be articulated in the context of situations where one believes predation may be rational for the predator and harmful for society".

Predatory Pricing campaigns which are irrational do not need to be prohibited, since they will fail. A further implication is that behaviour which might fail the Areeda/Turner test may not, in certain circumstances, constitute predatory pricing.

Thus a policy regime which sought to exclude predatory pricing need not ban below-cost selling.

There are two key contexts for judging the adequacy of the Competition Acts, in particular Section 5, to deal with predatory pricing. These are

(i) a national campaign by a predator

(ii) a local campaign by a predator

We have already expressed the view that, given the disposition of market shares amongst the various players in the Irish grocery market, it is unlikely that any one of them could engage in a national campaign with any confidence of success.

However should such fears emerge, we feel that Section 5 as it stands is adequate to deal with the situation, since any firm which was in a position to mount such a campaign would be deemed to be in a dominant position, and hence subject to the Section. It is difficult to conceive of a situation where a firm could simultaneously

- be deemed not to be dominant and
- be deemed to be engaged in predatory behaviour

given the nature of the market.

A local campaign of predation is more problematic.

The relevant Section of the Act refers to the state, or a "substantial part" of the state.

The most germane Irish case would appear to the ***Blemings v. David Patton Ltd*** (High Court 1994 No. 2881P).

In that case, Shanley J. held that a geographic market with fifteen radius miles was the relevant one for the purpose of assessing dominant position, in a case taken against an alleged monopsonist (sole buyer) by a group of suppliers.

The analogy is imperfect in the present context, but the judgement would appear to have established that dominance in relatively small geographic areas could satisfy the Irish courts for the purposes of Section 5 of the 1991 Act.

Thus if a grocery retailer chose to discount heavily in a small geographic market and if competitors felt that the intent and probable effect was predatory it would be open to them to seek redress under the Competition Acts.

Whether they would succeed would of course depend on the facts of the matter, and it would be for the plaintiffs (or the competition enforcement arm) to establish dominance and abuse of that dominance, in the context of a given geographical market.

Section 6 Conclusions, Recommendations

Our conclusions mirror those of the majority report of the Fair Trade Commission in 1991.

They concluded, inter alia, that the ban on below-cost selling did not prohibit pricing behaviour by a dominant player which might be predatory in intent or in effect.

They concluded that for predatory pricing to the effective, the predator must succeed, not only in eliminating competitors, but also in inhibiting the entry of new ones. They express doubt that these conditions obtain in the Irish grocery market.

They consider that

"…promotional, non-predatory, price competition, including below-cost selling, is not less desirable than other forms of promotion such as advertising, opening hours, free delivery and so on".

They expressed scepticism about claims that the Order had resulted in food prices rising by less than the CPI.

They attributed an evident increase in non-price competition to the impact of the Groceries Order, and concluded that the Order had the effect, particularly in view of the practice of off-invoice discounting, of permitting a form of resale price maintenance.

They did not accept that the majority of consumers were, or would be, fooled by below-cost selling, and they expressed doubt as to whether removal of the ban would impact adversely on independent stores.

On the matter of retail chains placing undue pressure on suppliers, they did not consider that any safeguards were required over and above those contained in Section 5 of the Competition Act.

We agree with each of these conclusions, and believe that the available evidence from the period since the FTC report was written, including the evidence cited in submissions, does not controvert them.

The majority also concluded (para 7.128) that

" … there is persuasive evidence that the ban on below cost selling has resulted in higher prices, a decrease in price competition and an increase in margins".

We have concluded that the available evidence is inadequate to support categorical attributions of movements in prices and margins to the impact of the Groceries Order.

The minority report drew radically different conclusions on many points. The most significant were:

- If there is no prohibition on below cost selling, market concentration is likely to increase substantially
- Below-cost selling will make it almost impossible for many independents to compete
- A ban on below cost selling can be a significant barrier to predatory conduct.

We have concluded that the likely impact of a removal of the below-cost selling ban would be limited. The third point cited above is not persuasive. A multiple which cut prices across the board to the level of cost would be operating at hugely negative net margins, could only choose to do so rationally with some form of predatory intent, but would be operating within the terms of the Groceries Order.

The majority of the FTC recommended the repeal of the Groceries Order in its entirety, and this is also our recommendation.