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Submission

By

Musgrave Group

to the

Competition Authority

on the

Retail Related Import/Distribution Sector

Introduction and Background

At the request of the Tánaiste and Minister for Enterprise, Trade and Employment, Ms. Mary Coughlan T.D., the Competition Authority is to carry out a study of the retail related import/distribution sector.

The terms of reference of the study are as follows. To examine:

- How the retail related import/distribution sector operates and how competition works in that sector;
- Whether any practice or method of competition affects the supply and distribution of goods within that sector; and
- The impact on competition within the sector of direct importation from source countries, rather than indirectly through the UK.

The Tánaiste has requested that the Competition Authority deliver its report by 30th April 2009. The Authority has invited submissions from all interested parties such as consumers, retailers, importers, distributors and manufacturers.

The Tánaiste called for the study in response to public concerns over the pricing differential between goods north and south of the border and following on from the recommendations of the Forfas study, *The Cost of Running Retail Operations in Ireland* (Dec 2008).

Musgrave Who We Are

Musgrave is partner to entrepreneurial food retailers and foodservice professionals across Ireland, the UK and Spain. In Ireland we operate the retail brands SuperValu, Centra, Daybreak and DayToday. The retail stores are owned by local entrepreneurs embedded in the communities they serve. Musgrave, together with its retail partners, employs more than 35,000 people in communities across Ireland. Last year these entrepreneurial food retailers invested some €200 million in existing and new retail developments, creating more than 2,000 new jobs in towns and communities nationwide. In excess of 75% of all products in SuperValu or Centra stores are sourced from Irish producers, processors and distributors. This represents total purchases from Irish suppliers in excess of €2.9 billion at retail level. All of our fresh meat including beef, lamb, chicken and pork is 100% Irish.

Competition in the Irish Grocery Market

The Irish grocery market is highly competitive with consumers well served by a choice of local retailers and overseas multinationals. 40% of the market is made up of independent retailers who own their own stores while the other 60% is comprised of chains including overseas organisations who have expanded their operations into Ireland. Over the last six months the Irish grocery market has gone through substantial change. As the impact of the economic downturn has intensified, consumers have become increasingly focused on value and price.

North/South Pricing Differences

The National Consumer Agency is one of a number of organisations that has highlighted price differentials between Northern Ireland and the Republic of Ireland as having contributed to an increase in shoppers from the Republic going to the North in search of bargains. The continued existence of these significant price differences is no more in the interest of Musgrave Group and its associated retailers, than it is in the interests of Irish consumers. Indeed, many of our retail partners in the border regions have seen a decline of 20% in their turnover over the last number of months.

There will always be some price difference between branded goods north and south of the border for the following reasons;

- **First** there are structural differences between the two markets. Retailers in Northern Ireland benefit from the economies of scale associated with being part of the massive UK market with its 60 million consumers. These economies of scale are not available to retailers in the south.
- **Second** is the cost of doing business, that is the operating costs associated with running a store in terms of insurance, wages, light, heat, etc. We estimate that it is in the order of 30% more expensive to do business in the south when compared to the north. Key input costs for Irish business have been well ahead of overall inflation and food inflation for some time now. For example, from January 2000 to February 2008, water supply and refuse charges grew by **257.7%**, electricity charges grew by **62.6%,** gas prices by **68.7%.** Between 2002 and 2008 Local Authority Rates increased by **42%**[1]. Many of these increases have been in areas controlled or regulated by Government.
- **Third,** the single largest cost to a food retailer is the cost of product. The cost of goods bought for resale accounts for **75% to 80%** of any retailer's cost base. Food retailers in Ireland negotiating with large multinational food suppliers have limited market power to negotiate better prices.

[1] Source ISME

- **Fourth,** VAT and excise duties are higher in ROI than they are in the UK.

Although much attention has been paid by the media to retail price differences between Northern Ireland and the Republic of Ireland, it is noteworthy that very significant price differences exist between say Germany and the Republic of Ireland with respect to products sold by Aldi and Lidl. Indeed, it appears that these products are sold in the UK at prices that are also significantly lower than in the Republic of Ireland but significantly higher than in Germany (So how low do they really go? Irish Times, Monday 2nd March 2009). This further demonstrates that the fundamental cause of retail price differences is cost differences and not profiteering by Irish retailers and/or wholesalers.

Obviously, two different currencies operate across the common land border between Northern Ireland and the Republic of Ireland. However, and crucially, very significant currency fluctuations have occurred recently. For example, there was a change of approximately 35% in the euro-sterling exchange rate in the 12 months up to December 2008. This did not occur gradually but in surges, one of which was particularly significant and recent (i.e. December 2008 itself). Only in a textbook world of perfect competition would prices (both wholesale and retail) be expected to adjust instantaneously to reflect such an appreciation (or depreciation) in the value of the euro.

The impact of fluctuating oil prices on petrol and aviation fuel prices and so-called fuel surcharges provides a useful analogy with respect to the issue of lagged changes in retail grocery prices. Petrol pump prices in Ireland and elsewhere in the EU are determined not just by crude oil prices (and of course retail costs and government taxes) but by the dollar-euro exchange rate. In addition, petrol prices inevitably follow crude oil prices and currency fluctuations with a lag. Within the context of aviation fuel, further complications and significant lags are caused by the desire and ability of major airlines to hedge with respect to their fuel costs. Significant lags, both negative and positive, can also occur in the grocery sector when there are sudden changes in exchange rates.

Musgrave believes that similar experiences with respect to lagged changes in wholesale and retail prices are likely to have occurred in other countries. Although Musgrave has no direct experience in, or knowledge of, international price differentiation it recommends that the Competition Authority research the impact of significant currency fluctuations between the Eurozone and other countries. The research could include Denmark and Germany for example or possibly between various Scandinavian countries.

Within the context of the relative bargaining strength of suppliers and retailers in the Irish grocery sector, it is clear from the Competition Authority's recent decision in Kerry/Breeo (M/08/009) that the Authority recognises the powerful bargaining strength of large domestically-based suppliers of branded consumer foods. It is also apparent that Irish retailers have even less bargaining strength relative to the internationally-based suppliers of branded consumer foods. Musgrave's position is that Irish wholesalers and retailers are not responsible in any way for the current price differences between the UK and Ireland.

North/South Pricing Differences Our Response

Musgrave has responded to these market conditions with deep discounts and promotions which have led to lower prices for consumers. Where suppliers have reduced their cost price as a result of the weakness of sterling, these reductions have been passed on to the consumer in reduced retail prices. For example, the recent National Consumer Agency price survey showed that the cost of a basket of goods in SuperValu had dropped from €215.57 to €194.24 since September 2008. In addition, we are looking at reducing our cost base and are working hard with suppliers to reduce the supply chain costs so as to pass on the benefits of the strong euro to the consumer. However, the Irish food sector is now facing a very challenging environment with major changes in consumer behaviour, increasing competition from Northern Ireland due to the weakening of sterling relative to the euro, the lowering of VAT rates in the UK and the steadily increasing cost of doing business in Ireland. The recent economic changes have further widened the price gap with Northern Ireland and the NCA's explicit support for shopping north of the border hasn't helped. There is now a very real danger of job losses, not only in the retail sector but in Ireland's consumer food industry if Government does not take urgent action to address some of the structural challenges faced by the sector.

Government Action to Prevent Job Losses

Musgrave suggests that it would be instructive for the Competition Authority to examine other situations in which two countries share a land border and where significant exchange rate fluctuations have occurred. It would be very surprising if retail prices adjusted without a significant lag in such settings. However, Government must also take urgent action or it is almost certain that we will see significant job losses, both in the retail and Irish food sector. Government should look at;

- Tackling the duty and VAT differentials with the UK;
- Providing financial support for small and medium sized enterprises through the establishment of a Government backed Small Business Operational Fund;
- Ensuring that Government Agencies adopt a supportive rather than confrontational attitude to the Irish food retail sector;

- Assisting in the availability of funds from banks for local entrepreneurial retailers to continue investing in the development of their stores and product ranges;
- Reducing the costs of doing business directly controlled by the state, such as commercial rates, electricity and waste disposal;
- Ensuring the public are aware of the importance of supporting Irish companies, not just for reasons of patriotism but on the basis of rational self interest, as these companies provide local jobs for local people and make a huge contribution to local communities and to the exchequer which helps to pay for public services such as health and education.

While Musgrave welcomes this investigation and is willing and open to engage with the Competition Authority. It must be recognised that the timescale for the review is very short and therefore it may not fully reflect the dynamics of the market. We are committed to doing everything in our power to ensure that our retail partners and their consumers get the best value products available. Anything that this investigation can do to help this will be of value to our retail partners and to Irish consumers.

The issues that are being raised are complex. Comprehensive analysis and widespread consultation will be required to come up with a balanced result that fairly reflects the commercial realities between wholesalers, retailers, national and international suppliers and the effect these relationships have on retail pricing to consumers. In particular serious thought will need to be given to any conclusions or recommendations that might negatively impact on the Irish economy, Irish consumers, or Irish jobs.

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