



# **Economic Impact of New Entry in the Retail Sector by a Large Supermarket Competitor**

**Advice to the Minister for Economic Development under  
Article 6(4) of the Competition Regulatory Authority (Jersey)  
Law 2001  
PUBLIC VERSION**

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## *EXECUTIVE SUMMARY*

In September 2007, the Minister for Economic Development (the ‘Minister’) asked the Jersey Competition Regulatory Authority (‘JCRA’) to advise on the economic impact of new entry into the retail sector by a large supermarket competitor in terms of the impact on consumer welfare, productive efficiency and the Jersey economy overall. He asked that the JCRA base its findings on the most recent information and evidence, with particular reference to other small economies.

The grocery retail sector in Jersey is largely comprised of two supermarket chains (Sandpiper which owns and operates three ‘Checkers’ supermarkets and the ‘Marks & Spencer’ food franchise; and the Channel Island Co-operative which owns and operates two ‘Co-op Grande Marchés’) and numerous convenience stores (either independent or belonging to Sandpiper, Co-op, or the ‘Spar’ and ‘rStore’ chains). In addition there are a number of specialist retailers operating out of St Helier’s Central Market and farm shops.

Although entry is possible economically, institutional barriers to entry are created by the need to seek permissions under the Regulation of Undertakings and Development Law (‘RUDL’) and from the Planning and Environment Department. However, States policy in relation to retailing is to promote vigorous competition in the interests of maximizing consumer welfare, productivity and economic growth.

The JCRA went out to consultation in November 2007. A number of issues were raised in relation to the entry of a third supermarket including freedom of entry, effect on price levels, effect on range of groceries available, flow-on effects to other retailers, effects on local suppliers, appropriate benchmarks to make comparisons, whether incumbents would exit the market, effect on efficiency of incumbents, and the overall effect on Jersey.

The JCRA adopted an economic framework to analyse the information and evidence it received. This is due to the Minister’s terms of reference, which focuses on the economic effects of new entry in terms of consumer welfare, productive efficiency, and overall impact. In terms of economics, empirical evidence demonstrates that the richest and most productive economies in the world invariably rely on competition in markets to deliver consumer welfare and economic wealth. Evidence also demonstrates that the benefits of competition are deliverable in small economies like that of Jersey as well as the larger economies, particularly in the retail sector where economic barriers to entry are relatively low.

The Isle of Man is considered an appropriate benchmark to Jersey given the similar populations, demographics, and standards of living (indeed, Jersey emerges slightly higher on all three factors). However, there is one relevant distinction: in the Isle of Man there are three independent supermarket chains compared to two in Jersey. The JCRA’s inquiries in the Isle of Man found that, in general, grocery prices were lower, and they have remained lower, since the JCRA first did a price comparison in 2005.

Although correlations do not necessarily imply causation, the JCRA considers – on the basis largely of comments made to it by industry participants in the Isle of Man – that the greater number of supermarket competitors is a significant contributing factor to the lower grocery prices in that island. It is also consistent with the general evidence that competition delivers economic benefits to consumers in terms of lower prices, in economies small as well as large.

As detailed in this report, our analysis of retail price comparisons between Jersey and the Isle of Man considers freight and labour costs. Based on the JCRA’s prior work in this area, we understand the increased freight and labour costs are commonly cited as reasons for why food prices in Jersey exceed those in the UK. Based on the evidence we have received during this current analysis, however, these factors would not appear to be the primary reason between relatively higher food prices in Jersey compared to the Isle of Man.

In relation to consumer choice – an important factor in improving consumer welfare – there is evidence from the UK that consumer choice is adequately safeguarded when three or more supermarkets compete in a particular locality. Given that Jersey would be comparable to many localities in the UK, it is considered appropriate to conclude in relation to Jersey that less than three supermarkets is not optimal from a consumer choice perspective.

As to the effect on incumbent retailers, the evidence we have received does not suggest that the entry of a third supermarket would have negative effects on the productive efficiency of existing retailers. In fact, new entry, and the increased competition that should ensue there from, should have the opposite effect in forcing existing competitors to ‘up their game’ and improve their efficiency. Market inquiries in the Isle of Man, combined with publicly available information, support this view.

A significant competitive strategy adopted by the major supermarket chains in the Isle of Man is to ‘buy-local’. It is also supported by the evidence of case studies conducted in various industries around the world, including in retailing, that globalization does not lead to standardization of supply – retailers still have to factor in local preferences and demand if they are to remain competitive.

In conclusion, after considering the evidence and taking into account comments made in submissions, the JCRA, on balance, advises the Minister that the economic impact of new entry into the retail sector by a large supermarket competitor would be economically beneficial in terms of increasing:

- consumer welfare;
- the productive efficiency of existing retailers; and
- the Jersey economy overall.

We note, however, that the terms of reference for this report were limited to determining the economic impact of new entry – consistent with the JCRA’s role and expertise. Other considerations, such as planning, population growth, and environmental impact, also are undoubtedly important, but were beyond the scope of our inquiry. Thus, this report does not purport to be the final word in this debate, but aims to contribute positively to it, and help the Minister make as fully informed decision as possible.

## 1. INTRODUCTION

### *Terms of Reference*

The Minister requested on 24 September 2007 that the JCRA advise him under Article 6(4) of the Competition Regulatory Authority (Jersey) Law 2001 on the economic impact of new entry into the retail sector by a large supermarket competitor.<sup>1</sup>

In providing its advice, the Minister asked the JCRA to take into account the likely impact on:

- consumer welfare (in terms of prices, quality, innovation and choice available to consumers);
- the productive efficiency of existing retailers (in terms of their costs and revenues); and
- the Jersey economy overall.

The Minister also asked that the JCRA advise on the basis of the most recent and relevant information available and it should consider empirical evidence which may be relevant to circumstances in Jersey. In this regard, he mentioned that experience from other small economies may be particularly relevant.

This report comprises the JCRA's advice to the Minister.

### *Economic perspective of advice*

As stated above in the terms of reference, the Minister requested the JCRA to examine solely the *economic impact* of new entry into Jersey's retail sector by a large supermarket competitor. Hence, in light of this request, and in line with the role of the JCRA, the focus of this advice is on economic issues. There are other important policy issues that may be raised concerning retailing in Jersey including, but not necessarily limited to, environmental, population growth, or planning issues. Such issues are undoubtedly important but they do not fall within the remit of the JCRA.

### *Benefits of increased competition*

The creation of a more competitive commercial environment on the Island is a key economic policy of the States of Jersey.<sup>2</sup> The purpose behind the States' goal of promoting competition is worth re-stating:

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<sup>1</sup> Article 6(4) of the Competition Regulatory Authority (Jersey) Law 2001 enables the Minister to request the advice of the JCRA on any matter concerning 'competition, monopolies, utilities or any matter connected with the provision of goods or services' to which the JCRA's functions relate.

<sup>2</sup> *A Competition Law for Jersey*, report presented to the States of Jersey on 8 January 2002, para 1.

*The potential benefits of competition can be summarised into 3 main areas. Firstly, competition forces undertakings to keep costs down, as a failure to maintain competitive prices will result in a loss of customers to their competitors. From the consumer's point of view, this results in the twin benefits of lower prices and increased choice. Secondly, competition forces undertakings to reduce their cost structure and allocate resources efficiently and productively into activities that consumers want. This will benefit Jersey's economy because resources, and the vital factor of labour resources, are focused on goods and services for which there is demand at a profitable price. Thirdly, competition forces undertakings to innovate, to develop new products and use new technology to gain a competitive advantage.*

*All of these factors combine to produce tangible benefits, such as the ability to keep the Retail Price Index down, to achieve a level playing field for those who want to trade in Jersey, and to change people's attitudes to the manner in which businesses will compete in the future. If undertakings have been involved in prohibited practices to stifle competition, then opportunities will arise for individuals and entrepreneurs wishing to enter a market. An opportunity for one business presents a threat to another faced with increased competition. In this environment, there is a better chance of prices to the consumer being reduced.<sup>3</sup>*

As the statement of purpose indicates, competition is not an end in itself. It is ultimately for the benefit of consumers in terms of encouraging lower prices, higher quality, more innovative services and greater choice – otherwise called ‘consumer welfare’, the first impact on which advice is sought.

Consumers benefit because competition forces firms to work harder, reduce costs, and provide the types of products necessary to win and keep customers. In economic parlance, it is called raising productive efficiency – the second impact on which advice is sought.

Competition also makes the economy as a whole work more efficiently as resources in a supply-constrained economy are efficiently allocated to those activities where there is consumer demand. With resources allocated efficiently, the overall Jersey economy benefits – the third impact on which advice is sought.

### ***Small size of Jersey economy***

Jersey is a small island economy with a population approaching 90,000. A critical feature of small island economies is the concentrated nature of many of their markets arising from economies of scale.<sup>4</sup>

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<sup>3</sup> *Draft Competition (Jersey) Law 200-*, report of Economic Development Committee lodged with the States of Jersey on 9 March 2004, p 1.

<sup>4</sup> Economies of scale occur when costs of production fall with increasing output. When scale economies and relatively small demand co-exist, it may well become more efficient for markets to be supplied by a limited number of suppliers (or only one) so that they can reap the economies of scale and achieve lower production costs (ie, increase their productive efficiency). If new entry occurs, suppliers (both new and existing) may have to operate at inefficient production levels, ultimately leading to consolidation or exit

Where economies of scale prevail, the scope for competition (particularly in terms of the number of competitors) may be limited because the markets in which they occur can be more efficiently supplied by fewer rather than more competitors. At the extreme is a monopoly, followed by a duopoly where there are only two competitors.

Other features commonly found in small island economies are higher barriers to entry and expansion, compared to larger economies. These barriers may stem in part from the small size of the markets (and, hence, a limited ability to reap economies of scale), but also from other factors such as increased transport costs and a limited labour force, factors that may be particularly relevant on an island economy like that of Jersey.

Under circumstances such as these:

*... the benefits that competition policy may offer to small economies are much greater, relatively, than those to be gained in larger, less concentrated markets.<sup>5</sup>*

Thus, in small economies like Jersey:

*... [c]ompetition policy must focus particularly on deterring the ... maintenance of artificial barriers to entry in order to permit new firms to enter and expand in monopolistic industries and increase competition.<sup>6</sup>*

And, where competition is limited, there may be adverse economic consequences for Jersey and its consumers. Accordingly, a key area of inquiry for the JCRA has been the state of competition in retailing in Jersey and whether the competition that exists is yielding economic benefits for Jersey consumers and the economy.

## **2. RETAILING STRUCTURE AND POLICY IN JERSEY**

### ***Number and types of grocery retailers***

The retailing sector in Jersey can be broadly split into the supermarket and convenience store sectors. There is also a burgeoning ‘farm store’ sector. For the purposes of its advice, the JCRA sees no need to break it further down into store sizes, range of goods offered, location, operating hours, etc.

#### **(i) Supermarkets**

There are two supermarket chains currently operating in Jersey:

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from the market. For the effect on competition of economies of scale in small markets like those of Jersey, see *Competition Policy for Small Market Economies*, Michal S. Gal, Harvard University Press, 2003.

<sup>5</sup> *Competition Policy for Small Market Economies*, op.cit., p 7.

<sup>6</sup> *ibid.*, p 55.

- **Le Riche**, which operates three supermarkets – Checkers at Rue de Pres, Checkers at Red Houses and the third supermarket, Safeway in St Helier. They are owned by SandpiperCI Limited (‘Sandpiper’), a private equity concern; and
- **Co-op Grande Marché**, which operates two supermarkets – one in St Helier and one in St Peter. They are owned by The Channel Islands’ Co-operative Society Limited (the ‘Co-op’).

In addition to these two, **Marks & Spencer** (‘M&S’) retails ‘up-market’ grocery products in its high street department store in St Helier. Further, M&S has a food hall in its Red Houses outlet and ‘Simply Food’ outlets in St Clement, St John and St Peter. The latter two have opened within the last six months.

M&S is operated by Sandpiper under a franchise from M&S in the UK, and tends to be differentiated from Le Riche and Co-op for the following reasons:

- the majority of products on offer are ‘own-brand’;
- only offers a sub-set of products that are on offer by supermarkets; and
- prices are usually charged at a premium.

**(ii) Convenience stores**

Convenience stores in Jersey fall into three broad categories:

- the large convenience stores operated by Sandpiper (twelve stores under the name ‘Checkers Express’ and one store under the name ‘Benests’ at Millbrook) and by the Co-op (under the name ‘Co-op Locale’);
- the smaller Spar (eleven stores) and rStore (thirteen stores) chains;<sup>7</sup> and
- small independent stores (about thirty stores) which are commonly operated by individual owners, although there are two independent owners who operate two stores each.

Spar is ultimately wholly-owned by the Lodestar Group which also wholly-owns the Channel Island Wholesale Company, which is a major wholesaler of foods and beverages in Jersey.

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<sup>7</sup> In 2007 the JCRA approved the acquisition of rStore by Spar, subject to conditions. See *Proposed Acquisition by Spar (Channel Islands) Limited of several stores from C.I. Newsagents Limited*, Decision M 114/07, JCRA, 19 September 2007.

Convenience stores are generally open for longer hours than supermarkets, are open on Sundays and only offer a sub-set of products that are offered by supermarkets.

In addition, there are a number of local retailers or specialists shops which either, in whole or in part, engage in grocery retailing. These include farm shops and the merchants at the Central Market in St Helier. These outlets, like convenience stores, offer a sub-set of products to those sold in supermarkets.

### ***Barriers to entry***

Generally speaking, a barrier to entry is something that impedes entry by a firm into a market that is at least as efficient as the incumbents in that market. Noted above is the fact that high barriers to entry are common in small island economies like that of Jersey. As noted, these barriers may stem in part from the small size of the markets (and, hence, a limited ability to reap economies of scale), but also from other factors such as high transport costs and a limited labour force.

Moreover, in Jersey there are a number of ‘institutional’ barriers to entry into the retailing market, including:

- the requirement under the Regulation of Undertakings and Development (Jersey) Law 1973 that no new undertaking can operate without obtaining a licence; and
- the requirement that those new undertakings must be granted permission by the Planning and Environment Department.

### ***States policy in relation to retailing – competition***

The evidence is almost indisputable, and the acceptance is virtually universal, that market economies and competition between producers and suppliers within open markets (ie, where entry is not restricted) is the best economic model for delivering consumer welfare and economic wealth. For example, the noted economist John Kay has commented that the defining characteristic of the nineteen world’s richest and most productive economies is pluralism; both in its political and economic dimensions. In the economic dimension, pluralism translates as competition.<sup>8</sup>

Kay noted that the desire to break and prevent economic concentrations of power was behind the adoption of both the United States antitrust and European Union competition laws:

*The world’s largest economy had chosen pluralism over monopoly in its market structure. ... The founders of the European Union were clear that*

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<sup>8</sup> *The Truth About Markets: Why Some Nations are Rich but Most Remain Poor*, John Kay, Penguin Books, 2004, pp 38-39, 50-51, 69-70.

*competition and pluralism, not consolidation, was to be the basis of economic integration.*<sup>9</sup>

In Jersey, the States of Jersey have re-affirmed that competition is a vital ingredient in maximising productivity and economic growth:

*For an Island economy aiming to maximise productivity and economic growth, vigorous competition is a vital ingredient for success.*<sup>10</sup>

This approach also has been adopted in other small economies, as was recently reaffirmed in Jamaica:

*The competitive process favours firms which offer goods that are valued by consumers and which are able to sustain production of those goods at the lowest possible production costs. Through this mechanism, the competitive process ensures that the economy will continue to produce goods using the minimum level of scarce productive resources.*<sup>11</sup>

### 3. ISSUES RAISED IN CONSULTATION

To assist in the preparation of the JCRA's advice to the Minister, the JCRA issued a consultation paper on 12 November 2007 seeking comments from interested parties on the impact of a large supermarket competitor on the retailing sector in Jersey. During the consultation period, eleven responses were received, and these were from:

<b>Submitter</b>	<b>Affiliation</b>
A T J O'Neill	Sandpiper
Ann-Marie Gallery	None (consumer)
Brian Curtis	None (consumer)
Clive Spears	Jersey Chamber of Commerce
David Dodge	Vienna Bakeries
Eamon Fenlon	Jersey Dairy
Gaucho Rasmussen	Tesco
J Cohen	None (consumer)
Jim Hopley	Co-Op
John Jackson	States Rural Economy Policy Group
Lanette Woo	None (consumer)
Mark Le Lay	G J Growers Ltd
Neville Moore	A. de Gruchy & Co Ltd.
Sheila MacRae	None (consumer)

<sup>9</sup> *ibid.*, pp 69-70.

<sup>10</sup> *A framework for managing the development of the retail sector in Jersey*, States of Jersey, 2 June 2006.

<sup>11</sup> *The Fare of Fearing Competition*, Kevin Harriott, Competition Matters, Jamaican Fair Trading Commission, December 2007.

In addition to the above, several comments were posted on the BBC Jersey website in response to the article, *A third supermarket?*<sup>12</sup> There were also several articles in the *Jersey Evening Post* and responses to the *Jersey Consumer Council's Price Watch* in their December 2007 newsletter.

A number of issues were raised in the various responses. These issues are now outlined before discussing them in the following Analysis section of the report.

### ***Free entry into markets***

In its submission, Tesco emphasised the importance of freedom of entry and quoted from the report of the Economic Development Committee on the need for a competition law in Jersey:

*If undertakings have been involved in prohibited practices to stifle competition, then opportunities will arise for individuals and entrepreneurs wishing to enter a market. An opportunity for one business presents a threat to another faced with increased competition. In this environment, there is a better chance of prices to the consumer being reduced.*<sup>13</sup>

On the other hand, other submissions – mostly from existing competitors and the Jersey Chamber of Commerce and Industry (the ‘Chamber’) – argued that entry should be restricted. The Chamber’s submission is representative of the arguments why entry should be restricted:

*Chamber is opposed to the Government sponsored introduction of a third supermarket, being a major multiple, into the Island economy on the grounds that it believes such an introduction will be damaging to small business at two levels. Most specifically small convenience food retailers and farm shops, of which there are many in the local economy, will suffer and run the risk of closure, which will be damaging not only to the actual businesses but to those communities they service. Furthermore given the intense pressure for labour resources on the Island, and the difficulty experienced by small business generally in securing additional staff, there is little doubt that the entrance of a major new player in the service industry would further impact on an already very difficult position, hampering the ability of small business to sustain itself generally. There is little doubt in Chamber’s view, that such an introduction would have a corrosive effect on small business if not the social fabric of the Island as a whole.*<sup>14</sup>

Others suggested that conditions be imposed on entry. For example, the Co-op submitted that, in the presence of free entry, any land that is identified as suitable should be allocated by way of tender. This submission argues that both potential entrants and incumbents should be allowed to tender for land so as to guarantee the maximum price

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<sup>12</sup> *A third Supermarket*, Ryan Morrison, BBC Jersey Talking, 23 January 2008.

<sup>13</sup> *Draft Competition (Jersey) Law 200-*, op. cit., p 1.

<sup>14</sup> Submission of the Jersey Chamber of Commerce and Industry Incorporated (the ‘Chamber’), 7 January 2008, p 1.

for that land. Furthermore, both the Chamber and Vienna Bakeries expressed the view that:

*The States should preserve a level playing field and not favour a new entrant with opportunities unavailable to local partners through Planning and RUDL [Regulation of Undertakings Law] consents.<sup>15</sup>*

We note that issues such as land allocation (or a tender for land) or the granting of consents are beyond the scope of the JCRA's current examination, as per the terms of reference received from the Minister. As stated above, the terms of reference focus on the economic impact of new entry, without taking into account of *how* that entry is achieved (ie, how suitable land is acquired or the manner in which required consents are obtained). We note further, however, that under Article 57 of the Competition (Jersey) Law 2005, the JCRA retains the discretion to advise on the effect a government enactment is having, or is likely to have, on competition in Jersey. Thus, such issues could be subject to further consideration, should they arise.

### ***Price effects***

Evidence was submitted by Tesco to show that open competitive markets deliver real benefits to customers, particularly in terms of significant price reductions, but also in terms of non-price aspects of the offer, such as quality, range and service.

The Co-op submitted that it may be the case that a UK multiple can offer lower prices, however, these will not be on par with UK prices owing to the higher cost structure in Jersey. As is detailed below, this is consistent with the JCRA's own finding that new entry may have the effect of reducing grocery prices, although likely not to UK levels.

### ***Range of groceries available***

Many submissions pointed out that there is already a substantial range of goods in Jersey. Several submissions suggested that M&S and farm shops provide viable alternatives to Checkers and Co-op supermarkets and hence, a third operator is not needed as choice is already sufficient in Jersey.

As is noted above, however, such outlets only provide a sub-set of the products that are on offer by supermarkets. [CONFIDENTIAL REDACTED] Also, as noted above, ultimately M&S in Jersey is not an independent competitor, but is owned by Sandpiper (the owner and operator of Checkers supermarkets). Concerning farm shops, a letter to the Editor of the *Jersey Evening Post* suggests that they:

*... serve a good purpose, and most of their produce is organic by nature, but they command a different shopper from those looking for the more commercial products.<sup>16</sup>*

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<sup>15</sup> Chamber submission, p 3; and submission of David Dodge, Vienna Bakery, 12 December 2007, p 1.

Tesco pointed to the rapid increase in the range of products available to consumers in the UK in line with the greater intensity of competition in that country. In its submission, Tesco drew comparisons with increases in the range of goods and services offered in other industries following the introduction of competition.

### ***Flow-on effects to other retailers***

Tesco stated, supported by its experience, that the opening of a new supermarket in a given locality can attract customers to that local area it operates in, thus increasing the commercial viability of other retailers in the area, including newsagents, convenience stores and speciality traders.

### ***Effect on local suppliers***

A particular concern expressed by the Chamber is that if Jersey allows a UK supermarket to enter into the local market, then there will be a decline in locally sourced produce which will eventually lead to the decline of the local agriculture sector. This view is based on the assumption that UK supermarkets will be able to source fresh produce through less expensive producers in the UK and the EU and hence, local producers will see a fall in demand for their products. This point shall be discussed further in the analysis below.

### ***Benchmarks***

No responding party offered a more appropriate benchmark, as an alternative to the Isle of Man, to help assess the likely economic impact of new entry in Jersey by a large supermarket competitor.

Using the Isle of Man as a benchmark, submissions which commented on this issue highlighted the fact that the populations of the Isle of Man and Jersey are comparable in size but that the more intense degree of competition brought about by the freedom of entry for grocery retail operators onto the Isle of Man might be a significant factor behind the generally lower level of prices there.

On the other hand, other submissions stated that simplistic comparisons of market places are naïve, and that the Isle of Man is not an appropriate benchmark because of the different infrastructures of the islands. Some submissions pointed to the higher cost structure of retailers in Jersey face compared with other jurisdictions. This point shall be discussed further in the analysis below.

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<sup>16</sup> *Come on, Tesco! Help us to break up this cosy supermarket cartel*, letter from David Forde, Jersey Evening Post, 11 January 2008.

### ***Market exit***

Evidence submitted by Tesco also showed that the new entry of an additional grocery retail operator does not necessarily lead to a net exit from the market of grocery retailers. The evidence is confidential but it has been analysed and is supported by the JCRA's own evidence on the price effects of new entry (see Analysis section below, under 'Isle of Man experience').

### ***Empirical evidence on effect of third supermarket***

Most submissions acknowledged that it was difficult to measure the effect of a third supermarket competitor on incumbent supermarkets and other retailers with any level of confidence. This was because of the ex ante nature of the exercise – trying to measure future effects without any empirical evidence in Jersey to support those conclusions.

As a consequence, it was submitted that the effects should be measured after any additional supermarket has entered the market. As mentioned above, Tesco has provided confidential empirical evidence that there was no net effect on the number of grocery retailers with the entry of an additional retail grocery operator.

However, the Chamber commented that it is a dangerous approach to introduce competition and simply 'see how it goes' because of the economic disruption it could cause. The Chamber also went beyond the economic and commercial perspective and claimed that the entry of a third supermarket was most likely to have a 'corrosive effect' on the 'social fabric' of Jersey as a whole.

As mentioned, the focus of the JCRA's inquiry and advice is on economic issues in line with both the Minister's terms of reference for this study and the JCRA's core role of promoting competition for the economic benefit of Jersey and its consumers. Thus, broader, subjective consideration of the 'social fabric' of Jersey, are beyond the scope of this report.

However, the JCRA does note that, should it conclude in this inquiry that the entry of a third supermarket is economically beneficial, then rejecting entry on the basis of a hypothetical and subjective adverse social impact will come at a cost to consumer welfare and the economy generally. And the economic cost is likely to be that much greater because, on the basis of evidence from the Isle of Man, the entry of a third supermarket on that island did not have a detrimental effect on that island's 'social fabric'. On the contrary, several parties interviewed on the island claimed that entry had beneficial social effects because of the need to cater for local consumer buying patterns and preferences (discussed below).

### ***Efficiency of incumbents (productive efficiency)***

It was submitted by Tesco that allowing entry of additional grocery retail operators would have a beneficial effect on the efficiency of the two incumbent supermarkets as well as on the convenience stores and the grocery retailer sector as a whole, in the long term.

On the other hand, the Chamber submitted that the recent internal ‘modernization’ by the two incumbents of their operations will achieve the desired efficiencies without the need to introduce a new competitor.

### ***Overall effect on Jersey economy (allocative efficiency)***

Some submissions argue that the entry of an additional supermarket competitor would have a beneficial effect on the overall Jersey economy. Tesco commented that new entry can enhance the efficiency and productivity of the overall economy in two ways:

- new entry can immediately reduce the ‘cost base’ of an economy if the new entrant is more efficient than the incumbents; and
- new entry can reduce the ‘cost base’ of an economy in the long term if it stimulates greater competition, which tends to increase the on-going incentives for companies to reduce their costs.

The Chamber considers that what may be short term gain will be a long term reduction in choice, will detract from the social fabric of local communities and increase transport movement. As noted above, the Chamber submitted that the introduction of a third supermarket would damage small business at two levels:

- it would damage the businesses of the small convenience food retailers and farm shops; and
- it would make it more difficult for small businesses to secure labour in an already tight situation.

In addition to small business, the Chamber considered that the introduction of a third supermarket would also have a detrimental effect on:

- farm shops;
- local food producers;
- labour market;
- population policy;
- the Island plan;
- the Zero/Ten tax framework;
- the social fabric of the Island;
- transport; and
- the sustainability of supply in the event of market failure.

#### 4. ANALYSIS

To provide a framework for the analysis of the issues raised in the consultation and the empirical evidence, the analysis will commence with an outline of the theory of competition and its *raison d'être*: consumer welfare and economic growth. Consumer welfare manifests itself in lower prices, higher quality, more innovative services and greater choice. The benefits of economic growth are manifest: higher standards of living.

Following this outline, the theory will be put to the test of empirical evidence, both from Jersey and from appropriate benchmarks.

##### *The theoretical framework*

This report has previously commented on the virtually universal view that competition in free and open markets is the best model for delivering consumer welfare and economic growth. The previously quoted economist, John Kay, referenced the nineteen richest and most productive economies in the world. However, the benefits of competition are not confined to the large and wealthy. The benefits of promoting competition have also been recognized in a number of far smaller economies through the introduction of various competition laws. Jersey is one example. Others are Barbados, Cyprus, the Faroe Islands, Greenland, Iceland, Trinidad & Tobago, Jamaica (as cited above) and Malta.

There are numerous studies that have empirically demonstrated the economic benefits of competition, almost creating a presumption that competition should be allowed to prevail unless it can be empirically demonstrated that competition has an adverse effect on consumer welfare and economic wealth.

The logic is forceful: firms facing competition will work harder to achieve lower costs and to provide the goods and services that a consumer wants. This is to win customers and to prevent losing customers to competitors. The act of working harder is termed productive efficiency and, in theory, this is said to increase through competition.

The evidence is emphatic: most recently, the UK Office of Fair Trading (the 'OFT') released in 2007 a paper on 'Productivity and Competition' which concluded that, after extensively reviewing over twenty studies, there was a strong link between the degree of competition and productivity.<sup>17</sup> The paper noted that competition drives productivity in three main ways:

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<sup>17</sup> These observations echo the findings in other publications on this issue. For example, a 1995 article by Blundell, Griffith and Van Reenen shows that increased competitive pressure '...has a positive impact on firm efficiency and productivity growth rates' and a 2000 article by Barnes and Haskell attributes '...30-50% of productivity growth in the UK and US to the entry and exit of firms in their markets.' Refer *Productivity in the 1990s: Evidence from British Plants*, draft paper, Queen Mary College, University of London, 2000. Also refer [http://www.ofit.gov.uk/shared\\_ofit/economic\\_research/ofit887.pdf](http://www.ofit.gov.uk/shared_ofit/economic_research/ofit887.pdf) The importance of the freedom of entry and exit is also illustrated by a 2004 paper *Raising UK Productivity – Developing the Evidence Base for Policy* by the DTI, which shows that '...entry and exit and the reallocation of market share accounted for 50 per cent of labour productivity growth and 90 per cent of total factor productivity growth. Logically therefore, barriers to entry and to exit must hinder productivity

- ‘*a within firm effect*’ – competition penalises poor management and so it tends to be less prevalent in competitive markets;
- ‘*a between firm effect*’ – competition replaces inefficient firms with efficient firms; and
- ‘*an innovation effect*’ – competition can increase the rate of innovation in a market.

Most relevantly, the OFT paper provides evidence which indicates that barriers to entry into a market, whether regulatory or administrative, can have detrimental effects on productivity. While some of the studies tended to focus on evidence in relation to the manufacturing industries (largely because of data availability), it is considered that similar productivity contributions to consumer welfare and an economy would arise by opening up the retail sector to competition by removing ‘institutional’ barriers to entry.

### *The evidence*

Having summarized the theory, what is the evidence? Can consumer welfare be increased by allowing competitors into the Island? As mentioned, the Minister has asked that the JCRA base its advice on the most recent and relevant information available and that it should consider empirical evidence which may be relevant to circumstances in Jersey. In this regard, he mentioned that experience from other small economies may be particularly relevant.

#### *(i) Isle of Man experience*

The Isle of Man has many similarities to Jersey which can be summarized as follows:

- they are both small island economies which are Crown Dependencies of the UK;
- they have similar populations and a similar settlement pattern: The population of Jersey was 88,200 in 2005, of which 32.5 per cent reside in the capital, St Helier; whilst the population of the Isle of Man was 80,058 in 2006, of which 32.7 per cent reside in the capital, Douglas;<sup>18</sup> and

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growth, and so their presence and causes has begun to feature significantly in this literature review as accounting for differences in productivity growth within an industry’. The quote is taken from an article in 2000 by Disney, Haskel and Heden (2000). Refer <http://www.berr.gov.uk/files/file14765.pdf>

<sup>18</sup> *Digest of Economic & Social Statistics 2007*, Economic Affairs Division, the Treasury, Isle of Man, p 14; and *Jersey in Figures 2006*, States of Jersey Statistics Unit, p v.

- both islands are relatively affluent compared to the UK: average weekly earnings in 2006 were £540 in Jersey and £536 in the Isle of Man, which compares to £457 in the UK.<sup>19</sup>

In light of the above, the JCRA considers the Isle of Man an appropriate benchmark for comparison to Jersey. In fact, considering that the Isle of Man:

- is geographically bigger than Jersey (572 sq km compared to 116 sq km); but
- has less people who are, overall, less affluent (GDP per capita £35,000 in Isle of Man compared to £57,000 in Jersey),<sup>20</sup> and
- evidence of comparable cost structure between the two islands (see below);

suggests that if three supermarket competitors are sustainable in the Isle of Man, this should be even more so, in economic terms, in Jersey.

Accordingly, with the assistance of the Office of Fair Trading in the Isle of Man, the JCRA visited the island in November 2007 and conducted market inquiries and interviews with a variety of industry participants. The findings from that visit are now outlined.

There are three supermarket chains operating in the Isle of Man: Shoprite, M&S and Tesco. Shoprite operates ten supermarkets in the Isle of Man with an average size of around 20,000 sq ft (the largest being 44,000 sq ft). It also operates three smaller grocery stores. M&S operates a High Street supermarket which, like in Jersey, tends to sell a subset of those groceries offered at the other supermarkets at a premium. But, unlike in Jersey (where the local M&S franchise is owned by Sandpiper, the operator and owner of another chain, Checkers), M&S in the Isle of Man is independent and not part of another chain. Tesco has one retail outlet in the Isle of Man, which is situated in Douglas and is 26,000 sq ft. The JCRA was advised that it plans to open a second outlet on the Isle of Man in the future.

As in Jersey, there are a number of smaller convenience stores in the Isle of Man. The main chain of 10 stores is operated by the Manx Co-op and is similar in operation to the Co-op in Jersey, being part of the same buying group. However, the average size of their stores (6,000 sq ft) is smaller than the supermarkets operated by the Co-op in Jersey. Apart from the Co-op, there are two other chains operated by Spar and C I Newsagents as well as a number of independent convenience stores. In addition, like Jersey the Isle of Man has a number of farm shops and specialty retailers.

The following parties were interviewed by the JCRA:

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<sup>19</sup> *Digest of Economic & Social Statistics 2007*, Economic Affairs Division, the Treasury, Isle of Man; and *Annual Survey of Hours and Earnings 2006*, Office for National Statistics.

<http://www.statistics.gov.uk/cci/nugget.asp?id=285>

<sup>20</sup> All data from *CIA World Factbook* at <https://www.cia.gov/library/publications/the-world-factbook>

<b>Contact</b>	<b>Organisation</b>
Andrew Lees and Ian Taylor	Tesco
Andy Thornton	Isle of Man Creameries
Brian McShane	Manx Co-Op
Deryck Nicholson	Shoprite PLC
Mel Warrender	C I Newsagents, Isle of Man
Steven Bradley, John Horsthuis and Peter Horsthuis	Isle of Man Chamber of Commerce
Tony Lyth	Colbourn Ltd
Vance King	Isle of Man Fatstock

Following these interviews, the JCRA came to the general view that the entry of Tesco was beneficial to the Isle of Man consumer. As discussed below, prices have tended to be lower since its entry and a number of parties made the comment that their entry has forced the other two to ‘lift their game’ with better shops and facilities.

A notable feature of the Isle of Man which is considered of particular relevance is the emphasis by the three chains on ‘buy-local’, including Tesco. Indeed, Shoprite has adopted ‘buy-local’ as its advertising motto.

The JCRA interviewed several local producers in the Isle of Man and questioned the impact on their sales since the entrance of Tesco in 2000. The response was positive. The JCRA was informed that Tesco has a policy of sourcing local produce and, hence, their sales have not declined. The JCRA were told that Tesco purchases bread, dairy products and meat products from local producers in the Isle of Man. There are no restrictions on milk imports into the Isle of Man, however, for local milk there is a set retail price of 50p per pint. Tesco therefore has the option to import and sell below 50p, however, it does not and purchases locally. Although this is not applicable to Jersey given the import restriction on milk, it is useful as it provides evidence supporting Tesco’s commitment to purchase locally.

Further, the Isle of Man Creameries told the JCRA that Tesco’s entry has resulted in the Creameries becoming more innovative and they have been encouraging farmers to produce a more diversified range, for example the introduction of organic products.

Tesco has confirmed this and have told the JCRA that they source a significant number of products from suppliers in the Isle of Man for sale in Tesco Isle of Man. The JCRA has been told that these include Dr Okells Beer, Laxey’s Flour, Ramsey’s Bakery, Fairybridge Tea and a full range of fresh produce.<sup>21</sup>

Buying locally is an active competitive strategy engaged in by all three on the basis that they will lose customers if they do not satisfy local preferences. Buying local also extends to supporting local groups such as sporting clubs and charities. Interviews with representatives from the local meat and milk suppliers confirmed the benefits to them from this ‘buy-local’ campaign of the supermarkets. This evidence from the Isle of Man

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<sup>21</sup> Email from Tesco to JCRA, 8 February 2008.

is consistent with a recent international study, discussed below, that businesses operating in more than one jurisdiction need to take into account local preferences.

In their submission, the Chamber believes on the basis of anecdotal evidence that, since Tesco entered the Isle of Man Shoprite has traded at a loss and its future is based on shareholder generosity rather than it being a successful commercial enterprise.<sup>22</sup>

This position, however, is not supported by evidence from Shoprite's annual reports for the years 2002-2006 and its half-year report for 2007.<sup>23</sup> These reports show that for the period starting in 2002 and ending in July 2007, Shoprite reported an operating profit from its retail operations in five of the six years reported (the only exception being 2005, when it reported an operating loss). Throughout this time, Shoprite faced competition from supermarkets operated by Tesco (which entered the Isle of Man in 2000) and M&S (and from other smaller grocery retailers such as Manx Co-op). It is also important to note that Shoprite expanded its operations considerably during this time period. This included the agreement with Wm Morrison Supermarkets PLC to purchase the leasehold interest of the Safeway store in Douglas in 2005. The deal was financed through bank facilities<sup>24</sup> which markedly increased the level of net interest repayments Shoprite had to make in subsequent years. While this expansion and the resultant increase in debt and interest payments may have adversely affected Shoprite's overall accounts, it still is reporting operating profits earned from its retail activities. Thus, in summary, Shoprite's published financial reports indicate that it maintained profitable retail operations and indeed invested to expand its business in the Isle of Man, while at the same time facing vigorous competition from the Tesco and M&S supermarkets and others.

Shoprite's continuing viability has not come easily – as one would expect in a competitive environment. Indeed, statements made by Shoprite personnel when interviewed by the JCRA, and from its 2006 Annual Report, show that competition has made Shoprite improve its own customer offering to compete on service, quality and price:

*For a number of years, Isle of Man consumers have benefited from a highly competitive grocery market and it is anticipated that this position will continue. The Directors have therefore placed a high priority on the continued development and upgrading of our retail infrastructure, and as a result, we believe that Shoprite is well placed to continue to deliver value to the Isle of Man consumer within a quality retail environment.*<sup>25</sup>

It is interesting to note that Tesco in its submission to the JCRA's consultation provided evidence that total occupied retail units in Douglas grew by 13 per cent between 2000

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<sup>22</sup> Chamber submission, p 11.

<sup>23</sup> Shoprite's annual reports are available on its website [www.manxshoprite.com](http://www.manxshoprite.com)

<sup>24</sup> Shoprite Group P.L.C. Annual Report and Accounts 2004, <http://www.manxshoprite.com/Accounts2004.pdf> p. 3.

<sup>25</sup> Shoprite Group P.L.C. Annual Report and Accounts 2006, <http://www.manxshoprite.com/Accounts2006.pdf> p. 3.

and 2005. This evidence is not indicative of retailers exiting the market in response to the entry by Tesco.

**(ii) Update of price comparisons**

In 2005, the JCRA compared food prices in Jersey and the UK.<sup>26</sup> In its comparison, the JCRA found that prices in Jersey were more expensive than in the UK, with some products being significantly higher priced.

In its report, the JCRA concluded that the price differential was attributable to several factors:

- the higher cost of doing business in Jersey, particularly the cost of labour and transport;
- inefficiency and diseconomies of scale in Jersey, particularly in the farm sector;
- high market concentration; and
- possibly different consumer purchasing habits.

The 2005 food study included comparisons with the Isle of Man in view of several similarities it had with Jersey. In this respect, it concluded that Isle of Man prices were generally less expensive. In particular, prices in June 2004 and June 2005 were compared. In June 2004, 12 out of the 17 groceries in the basket were less expensive in the Isle of Man. In 2005, 10 out of the 17 were less expensive.

The study also concluded that, for most groceries, Isle of Man prices fell between those in the UK (the least expensive) and Jersey (the most expensive). The JCRA commented that the less concentrated market in the Isle of Man may be a contributing factor to it having cheaper prices than Jersey:

*The retail food sector in the Isle of Man is less concentrated than in Jersey, traditionally having four supermarket operators (Manx Co-operative, Safeway, Tesco and Shoprite) and today having three, as a result of Shoprite's recent acquisition of the local Safeway. In contrast, Jersey traditionally has had three supermarket operators, and now only has two. The Isle of Man's reduced level of retail concentration may be a contributing factor to it having lower food prices generally than Jersey.*<sup>27</sup>

For the purposes of the current advice to the Minister, the JCRA has updated the 2005 price comparisons. The same basket of groceries was used, and the outcome is shown in Table 1 below.

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<sup>26</sup> *Comparison of Food Prices in Jersey and the United Kingdom*, JCRA response to request for advice under Article 6(4), 11 October 2005.

<sup>27</sup> *ibid.*, p 15.

**Table 1: Prices in Jersey<sup>28</sup> and the Isle of Man<sup>29</sup>  
for  
June 2004, June/July 2005<sup>30</sup> & June/November 2007<sup>31</sup>**

Product	Quantity	2004		2005		2007	
		Jersey	IoM	Jersey	IoM	Jersey	IoM
White loaf bread sliced 800g	800g	1.14	1.01	1.09	1.07	1.03	1.26
Brown loaf sliced 800g	800g	0.9	1.07	0.87	1.12	1.37	1.36
Tea Bags	250g	1.76	1.66	1.81	1.44	1.71	1.55
Coffee - Instant	100g	1.89	1.86	2	1.93	2.72	2.29
Potatoes old loose	1kg	0.6	0.37	0.62	0.71	0.88	0.63
Tomatoes	1kg	1.29	1.2	1.55	1.01	1.67	1.23
Onions	1kg	0.76	1.34	0.71	0.83	1.07	1.21
Apples - cooking	1kg	1.69	1.63	1.38	1.3	1.42	1.53
Oranges	Each	0.3	0.3	0.29	0.33	0.33	0.29
Bananas	1kg	1.17	1.07	1.36	0.99	1.21	1.02
Topside	1kg	7.83	7.8	6.81	7.09	7.34	7.09
Lamb loin with bone	1kg	11.2	12.64	12.13	12.76	11.09	12.49
Pork loin with bone	1kg	6.32	5.8	6.24	7.2	5.58	5.9
Fresh or chilled chicken	1kg	2.47	3.39	2.62	1.38	2.83	2.52
Milk full fat <sup>32</sup>	1 pint	0.56	0.47	0.55	0.5	0.54	0.5
Butter imported	250g	1.04	1	1.03	0.94	1.03	1.06
Cheddar cheese	1kg	5.91	3.59	5.69	5.43	6.56	4.55

Again, prices in Jersey are generally more expensive than in the Isle of Man. Eleven out of the 17 groceries are still more expensive in Jersey when compared to the Isle of Man – a similar result as when the comparison was conducted using June 2004 prices. The total

<sup>28</sup> *Comparison of consumer prices in Jersey and the UK: June 2004*, States of Jersey Statistics Unit; *Comparison of consumer prices in Jersey and the UK: June 2005*, States of Jersey Statistics Unit; and *Comparison of consumer prices in Jersey and the UK: June 2007*, States of Jersey Statistics Unit.

<sup>29</sup> *Isle of Man General Index of Retail Price 16 June 2004*, the Treasury, Isle of Man; *Isle of Man General Index of Retail Price 19 July 2005*, the Treasury, Isle of Man; and *Isle of Man General Index of Retail Price 14 November 2007*, the Treasury, Isle of Man.

<sup>30</sup> Data for Jersey is from June 2005. The June 2005 report was not available from the Isle of Man, therefore prices from the report dated 19 July 2005 have been included.

<sup>31</sup> Data for Jersey is from June 2007. Data for the Isle of Man is based on the prices as of 14 November 2007.

prices of the respective baskets indicate that the Jersey basket is £1.90 more expensive than the Isle of Man.

This update demonstrates that for at least three years, the majority of prices for this basket of goods were less expensive in the Isle of Man than in Jersey. Further, Tesco conducted their own price comparison between Tesco Isle of Man and the average price of certain products in Jersey. The results are presented in Table 2 below.

**Table 2: A price comparison of certain products comparing Tesco Isle of Man prices with the average price in Jersey for the same products in June 2007**<sup>33</sup>

Product	Jersey (pence)	Tesco Isle of Man (pence)	% Tesco cheaper
Beef mince (kg)	508	398	22%
Lamb shoulder (kg)	558	540	3%
Back bacon (kg)	878	494	44%
New potatoes (kg)	134	77	43%
Tomatoes (kg)	167	173*	-4%
Carrots (kg)	94	72	23%
Bananas (kg)	121	68	44%
Butter (250g)	104	74	29%
Sliced white bread (800g)	103	56	46%
Eggs (12, size 4)	220	182	17%

It is apparent from Table 2 that, if Tesco were to apply the same price list in Jersey, the majority of products included in this list would be less expensive.

These data are consistent with the findings of the JCRA's 2005 food study – that increasing competition in the supermarket retail sector in Jersey may lead to reduced prices, on average, for food, although for the reasons stated in the 2005 food study we would not expect prices to be reduced to UK levels.

As to the reasons why prices tend to be higher in Jersey than in either the UK or the Isle of Man, the JCRA's 2005 food study identified freight and labour as two main factors that likely result in higher average food prices in Jersey compared to the UK.<sup>34</sup> Given the importance of these factors, we have analysed them for Jersey compared to the Isle of Man, to see if the generally lower food prices in the Isle of Man can be attributed to lower freight or labour costs. As detailed below, the evidence we have reviewed suggests this is not the case.

<sup>32</sup> Milk prices in the Isle of Man are controlled by a government pricing order.

<sup>33</sup> *Comparison of consumer prices in Jersey and the UK: June 2007*, Statistics Unit; and *Tesco Price Data Week 15 2007* (assumes that 6 tomatoes weigh 400 grams).

However, before turning to freight and labour costs, the JCRA notes the claim that land costs in the Isle of Man are not as high as in Jersey.<sup>35</sup> The issue of relative land prices was raised in the 2005 food study, in which the JCRA concluded that, when all factors are considered, such as lower property rates in Jersey compared to the UK, overall property costs in Jersey are unlikely to be radically out of line with the UK.<sup>36</sup> Given the lack of evidence presented during the course of the current inquiry that overall property costs (of which there are many aspects such as land costs, building costs, property rates, etc) are appreciably lower in the Isle of Man than in Jersey, the JCRA has no basis to conclude that land costs are a significant contributing factor to retail price differentials between Jersey and the Isle of Man.

**(iii) Freight and labour costs**

An issue that arose during the consultation period was the claimed higher cost structure in Jersey that could lead to higher food prices compared to other jurisdictions. In particular, it was suggested that freight and labour costs are higher in Jersey.

In relation to **freight costs**, the Chamber claims that freight costs create an extra cost in the region of 5-12 per cent for Jersey retailers.<sup>37</sup> [CONFIDENTIAL REDACTED].

These percentages were supported by the JCRA's food study in 2005 which concluded that transport costs lead to increased costs of around 5-8 per cent.<sup>38</sup> The JCRA did note, however, that transport costs are not uniform across all food products and that transport costs will be higher for perishable items with a short shelf-life.

However, in the current inquiry, the JCRA was caused to revise its conclusion of generally higher freight costs in Jersey on the basis of new information given to it by the Co-op. The Co-op advised that, as they are part of the Co-op buying group in the UK, the majority of freight costs for ambient produce are paid for by their suppliers. Further, the Co-op advised that ambient produce constitutes 40 per cent of their total purchases.

In light of this new information, the JCRA collected data regarding freight costs from supermarket retailers in both Jersey and the Isle of Man. The results are presented in Table 3 below, which suggests that freight costs for Co-op in Jersey are often less than those for retailers in the Isle of Man.

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<sup>35</sup> Chamber submission, op. cit., p 11.

<sup>36</sup> *Comparison of Food Prices in Jersey and the United Kingdom*, op.cit., pp 8-9.

<sup>37</sup> *Freight costs to Jersey*, Mike Rogers, The Jersey Chamber of Commerce and Industry Incorporated: Chamber on-line, January 2008

<sup>38</sup> *Comparison of Food Prices in Jersey and the United Kingdom*, op.cit., p 7.

**Table 3: Freight costs per pallet for supermarket retailers in Jersey and the Isle of Man**

	Freight cost per pallet		
	Jersey	Isle of Man	
	Coop	Shoprite	Tesco
<b>Frozen</b>	87.72	[CONFIDENTIAL REDACTED]	[CONFIDENTIAL REDACTED]
<b>Chilled Fresh Meat</b>	66.56	[CONFIDENTIAL REDACTED]	[CONFIDENTIAL REDACTED]
<b>Ambient</b>	60.32	[CONFIDENTIAL REDACTED]	[CONFIDENTIAL REDACTED]

In relation to **labour costs**, the information supplied by the two supermarket chains in Jersey during the course of this inquiry indicates that rates of pay in the retail sector are higher in Jersey than in the UK. [CONFIDENTIAL REDACTED] This information is supported by the Co-op, which advised that the wage rate for a shop assistant working for Asda in the UK ranges between £5.69 and £6.69 per hour. The average is £5.39 per hour for a Co-op employee in the UK.

However, in the Isle of Man, the hourly rate for a general shop assistant at Tesco is between £5.94 and £7.26. Thus, while higher wages in Jersey may be a contributing factor to higher grocery store prices compared to the UK, the same may not necessarily be the case when comparing Jersey to the Isle of Man.

The JCRA notes comments by the Chamber in its Submission that the introduction of a new supermarket competitor would exacerbate the problem of high labour costs arising from a controlled labour market in Jersey.<sup>39</sup> While the focus of this report is not on conditions in Jersey’s labour market, the JCRA does observe that claims about the scarcity of labour and high labour costs have not prohibited an incumbent, Sandpiper through its M&S franchise, from recently opening two new Simply Food outlets in Jersey within the past six months (as described on page 4 of this report). Thus, if Jersey’s labour market is flexible enough to accommodate significant expansion by existing retailers in Jersey, the JCRA sees little reason why conditions would be different for new entrants.

**(iv) Consumer choice and product range**

As mentioned, consumer welfare is enhanced by a number of factors. This includes choice. Consumers have varied tastes and, therefore, varied supply is needed to cater for different consumer wants. In an article entitled, *Using the “consumer choice” approach to Antitrust Law*, it is stated that

<sup>39</sup> Chamber submission, op. cit., 7 January 2008, p 9.

*Consumers are able to satisfy their desires more closely to the extent the market contains different types, prices, locations, and qualities of products and services.<sup>40</sup>*

However, there is evidence to suggest that beyond a certain level of choice, there is diminishing returns as consumers find it too confusing to choose among the various options. For each industry, there will be an optimal level of consumer choice.

The UK's Competition Commission (the 'Commission') suggested that consumer choice in food retailing is adequately safeguarded when three or more supermarkets compete in a particular locality.<sup>41</sup> Given that the finding was based on local areas in the UK and not nationally, and that Jersey would be comparable to many 'local areas' in the UK, it is considered appropriate to conclude in relation to Jersey that three supermarkets would be optimal from a consumer choice perspective.

Furthermore, the Commission has more recently concluded that in many localities with only two supermarkets:

*...consumers may be adversely affected by the fact that the market is highly concentrated rather than more competitive.<sup>42</sup>*

They suggest that:

*...in those markets where competition is weak, a grocery retailer can degrade components of the retail offer, such as product range and quality, on a store-specific basis.<sup>43</sup>*

Not only will a third supermarket in Jersey increase consumer choice in terms of the number of supermarkets, it may also increase the range of products that is on offer. For example, Tesco offers a wide choice of "value" and "premium" products for a large proportion of their goods.

#### **(v) Groceries study by UK Competition Commission**

The Commission in a report released towards the end of last year could not find evidence of an adverse impact on competition or on the ability of other retailers ability to expand by the presence of Tesco in a market:

*In relation to the strong market position of Tesco, we have considered various aspects of its operations and their likely impact on competition in grocery retailing. In our view, there would obviously be cause for concern if one retailer were able to achieve and exploit market power. We are not convinced*

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<sup>40</sup> *Using the "consumer choice" approach to Antitrust Law*, Neil W Averitt and Robert H Lande, Antitrust Law Journal, Volume 74, p 192.

<sup>41</sup> *Supermarkets: a report on the supply of groceries from multiple stores in the United Kingdom*, Competition Commission, 2000, p 26.

<sup>42</sup> *The Supply of Groceries in the UK market investigation*, provisional findings report, Competition Commission, 31 October 2007, p 133.

<sup>43</sup> *ibid.*, p 9.

*that Tesco is in that position. The concerns we have regarding local competition are concerns that apply, in different degrees, to other grocery retailers and are not specific to Tesco. We continue to see expansion by grocery retailers other than Tesco, and do not see Tesco's purchasing cost advantage, share of national grocery sales or expansion into convenience store retailing acting as a barrier to expansion by other grocery retailers.<sup>44</sup>*

The Commission report also considered the effect of grocery retailing on the upstream supply chain, particularly on the suppliers of fresh produce, and found that grocery retailers are working alongside their suppliers to improve upstream efficiency:

*In relation to the groceries supply chain, the grocery retailers and their suppliers have worked to achieve an efficient supply chain that delivers low prices for consumers, and in recent years has achieved high rates of product innovation.<sup>45</sup>*

These findings by the Commission in the UK are consistent with the evidence the JCRA observed in relation to Tesco in the Isle of Man. Moreover, to the extent alleged abuses of dominance may occur in the supply chain, these would be subject to potential enforcement under the provisions of the Competition (Jersey) Law 2005.

**(vi) 'Buy-local' strategies**

In a recently published book, *Redefining Global Strategy: Crossing Borders in a World Where Differences Still Matter*, Pankaj Ghemawat concludes on the basis of empirical evidence that, rather than there being an inexorable trend to a standardized, globalized 'flat' world, businesses still need to take into account local differences to survive.

In a most relevant case study, he studied Wal-Mart's overseas strategies in retailing and has concluded that its international stores they have performed poorly – largely because of intrinsic as well as self-imposed difficulties in adapting a business model that worked well in the US:

*Visible manifestations include such merchandising missteps as stocking U.S.-style footballs in soccer-mad Brazil. But the problems run deeper: I estimate that of fifty policies and practices that distinguish the company domestically, thirty-five were historically carried over more or less completely, and twelve at least partially, to its international operations – an amazing degree of consistency in an industry subject to large cross-border differences.<sup>46</sup>*

On the basis of a number of case studies across a number of industries, Professor Ghemawat generally concludes that differences – which can be cultural, administrative, geographic or economic – between countries matter enormously, and unless cross-border companies seek to understand those differences, their global strategies are likely to fail.

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<sup>44</sup> *The Supply of Groceries in the UK market investigation*, op.cit., p 6.

<sup>45</sup> *ibid.*, p 4.

<sup>46</sup> *Redefining Global Strategy: Crossing Borders in a World Where Differences Still Matter*, Pankaj Ghemawat, Harvard Business School Press, 2007, pp 107-108.

This conclusion by Professor Ghemawat is supported in practice in relation to small island economies. As noted before, a notable feature of the Isle of Man which is considered of particular relevance is the emphasis by the three chains on ‘buy-local’. Indeed, Shoprite has adopted ‘buy-local’ as its advertising motto. It is an active competitive strategy engaged in by all three on the basis that they will lose customers if they don’t satisfy local preferences. Similarly, the JCRA considers that a new entrant into supermarket sector in Jersey, or indeed an incumbent supermarket operator, must avoid similar mis-steps as the Brazilian Wal-Mart example discussed above – that is, if it is to be competitive, it should have regard to local preferences before importing standardized products from overseas.

**(vii) Potential broader economic effects**

Lower food prices could result in lower prices in other industries of the Jersey economy. For example, the Jersey Hospitality Association has recently raised concerns that recent increases in food prices in Jersey could impact negatively on the future competitiveness of the Jersey tourism industry. It was reported in the *Jersey Evening Post* that ‘[t]he ‘dish price’ which, refers to the total costs of a meal, has gone up because of increases in food, labour and commodity prices so people can expect to pay more.’<sup>47</sup> This could be taken to indicate that given current market conditions, increases in costs will be passed onto tourists.

Jersey, like all jurisdictions big and small, will remain subject to global changes in food prices, regardless of the number of retailers. However, as noted above, the evidence we have reviewed, both now and in 2005, suggests that allowing new entry by a large supermarket into Jersey’s retail sector may lead to lower food prices on a micro-economic level. Thus to the extent that undertakings in Jersey’s hospitality industry source food and other products from local supermarkets, reduced prices in the retail sector could lead to reduced costs in other sectors, the benefits of which could be passed on.

## **5. DISCUSSION**

The theory postulates that competition benefits consumers and the economy. However, where competition is limited – such as when a sector is served by only two chains, such as in the supermarket sector in Jersey – the benefits are correspondingly limited. Indeed, there may be costs to society if competition is ineffective.

The evidence indicates that competition in the supermarket sector in Jersey is limited – prices of a basket of groceries are higher in Jersey than in the UK and the Isle of Man. As mentioned, the Isle of Man is considered an appropriate benchmark because of a number of similarities between the two islands.

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<sup>47</sup> *Hospitality trade rues rising costs*, Ramsay Cudlipp, *Jersey Evening Post*, 6 February 2008, p 4.

Competition by its very nature is a deliberate and ruthless process as competitors jockey for position and seek to gain an advantage against others by taking sales away. Particular competitors may be injured or competitively disadvantaged at a particular time but, as part of the process, they are expected to respond with their own competitive initiatives. The outward limits of this process are defined by competition law principles, which in Jersey have been given legal force in the form of the Competition (Jersey) Law 2005, as well as the role of the JCRA as the Law's enforcement authority.

In any event, evidence from the Isle of Man shows that the entrance of a third supermarket operator (Tesco) has not resulted in the exit of the incumbent operators or in a net decrease in the number of smaller retailers. To the contrary, in terms of productive efficiency of existing retailers, evidence from the Isle of Man indicates that increased competition from a major multiple has forced local firms to 'raise their game'.

The Chamber in its submission made much of the effect on the 'social fabric' of Jersey from the entry of a third supermarket competitor. While this issue does not squarely fall within the economic responsibilities of the JCRA, it does nonetheless recognize the importance of the 'social fabric' in Jersey to its cultural well-being and identity.

A particular social issue that has been raised is the effect on the farming sector and other small businesses that currently supply groceries and farm produce to grocery retailers in Jersey. The fear is expressed that a new supermarket entrant, particularly a large one from overseas, will source the majority of its product from overseas thus leaving local suppliers out in the cold.

However, the evidence available to the JCRA would suggest that this fear is largely unfounded. The evidence for this view comes from two main sources:

- the experience in the Isle of Man, where Tesco has adopted a strategy of supporting the local community it relies on. Indeed, a 'buy local' strategy is adopted by all supermarkets in the Isle of Man; and
- the evidence in Professor Ghemawat's book *Redefining Global Strategy* that differences between countries matter enormously and that, unless cross-border companies adapt to those differences, their global strategies are likely to fail.

The discussion up until now has focused on the supermarkets. In relation to the convenience store sector the main concern expressed is that the entrance of a third supermarket operator could impact upon the convenience store sector – leading to the exit of small business in the Island. However, the evidence to the contrary is coming from the UK, as the Competition Commission has concluded:

*Those convenience store operators that provide consumers with a strong retail offer will continue to survive and prosper.*<sup>48</sup>

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<sup>48</sup> *The Supply of Groceries in the UK market investigation*, op. cit., p 4.

In Jersey, a policy framework paper has assessed the impact on convenience and small retail outlets and concluded:

*It was generally felt that there would be no impact on the high street (as there are few convenience stores there) and little impact on small shops (as they are typically used for 'top-up' shopping).<sup>49</sup>*

Furthermore, the JCRA does not expect the entrance of a third supermarket competitor to have an adverse effect on the productive efficiency of other small retailers such as farm shops and specialty retailers in the Central Market. As noted above, such specialty retailers tend to offer a smaller set of products (although, potentially a more diverse range of products in the areas in which they specialise) compared to supermarkets, which tend to offer a broader array of products. Because of this, consumers tend to view specialty retailers and supermarkets differently – using the former for more specialised purchases while using the latter for regular ‘stock-up’ purchases.<sup>50</sup> To the extent speciality retailers and supermarkets overlap in products, the former often provide a greater level of personal service compared to the latter, and competition and consumer choice can extend to attributes beyond simply price comparisons, to consider factors such as quality, service, and location.<sup>51</sup> Finally, to the extent farm shops and speciality retailers operate both as retailers and wholesale suppliers,<sup>52</sup> they can benefit from the buy-local strategies (discussed above) that appear to be an important factor in competition among supermarkets in the Isle of Man.

The update of the 2005 price comparison indicated that the majority of prices for the basket of goods are less expensive in the Isle of Man than in Jersey. This finding was consistent with a similar study provided by Tesco. The latter found that for the majority of products in June 2007, Tesco Isle of Man was less expensive than the average price in Jersey. Several submissions suggested that higher cost structures in Jersey could be attributed to the price differentials, the main cost components being freight and labour costs. The JCRA conducted its own study and found that the cost structures of the respective islands, specifically for the current retail situation, are not too dissimilar. The JCRA therefore concludes that prices could fall from the introduction of a third supermarket operator in Jersey.

Secondly, the JCRA finds that entry by a third operator would increase consumer choice in terms of the number of stores available and the range of products on offer. This finding is consistent with the UK’s Competition Commission’s finding which says that consumer

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<sup>49</sup> *A Framework for Managing the Development of the Retail Sector in Jersey*, op.cit., p 25.

<sup>50</sup> The consumer’s view expressed in the letter to the Jersey Evening Post, quoted above at footnote 16, supports this.

<sup>51</sup> See JCRA Decision C 015/06.2 Concerning the General Practitioners Out-of-Hours Cooperative, 23 April 2007, para 37 where it is stated that ‘...consumers value attributes such as quality, service and location as much (if not more than) price.’

<sup>52</sup> Such as, for example, Classic Herd in St Peter, which operates a farm shop and also supplies cheese to the Co-op. See <http://www.genuinejersey.com/ClassicHerd.htm>

choice in food retailing is adequately safeguarded when three or more supermarkets compete in a particular locality.<sup>53</sup>

## 6. CONCLUSION

After considering the evidence and taking into account comments made in submissions, the JCRA, on balance, advises the Minister that the economic impact of new entry into the retail sector by a large supermarket competitor would be economically beneficial in terms of increasing:

- consumer welfare;
- the productive efficiency of existing retailers; and
- the Jersey economy overall.

We note, however, that the terms of reference for this report were limited to determining the economic impact of new entry – consistent with the JCRA’s role and expertise. Other considerations, such as planning, population growth, and environmental impact, also are undoubtedly important, but were beyond the scope of our inquiry. Thus, this report does not purport to be the final word in this debate, but aims to contribute positively to it, and help the Minister make as fully informed decision as possible.

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<sup>53</sup> *Supermarkets: A report on the supply of groceries from multiple stores in the United Kingdom*, op.cit., p 26.