

Chapter 1

Introduction and main conclusions

1.1 Summary

In January 2013, the Competition and Consumer Authority launched this analysis of the future of retail. The analysis arose from the competition-policy proposal from October 2012. The purpose of the analysis is i.a. to examine whether the current framework sufficiently supports retail players being able to act in ways which increase competition and productivity in the sector.

From 1995 to 2010, annual productivity growth in Danish retail was almost 0.5 per cent. This is just over 1.5 percentage points below the average for the Netherlands, Sweden and Germany. In particular, productivity development in Danish grocery retail drives this number down. The limited growth in the 1995-2010 period follows a period from 1970 to 1995 when productivity development in Danish retail was higher than in the comparator countries.

In 2010, Danish consumer prices for groceries were approximately 23 percent higher than those of comparable countries¹. Adjusting for differences in VAT rates and taxes, the price difference is 10 per cent. If we also correct for differences in wealth and campaign prices, Danish grocery prices are around 4-6 percent higher than in comparable countries. This 4-6 percent represents extra grocery costs of DKK 2-3,000 per year for an average household (measured in 2010 prices).

There may be a number of explanations for the limited productivity growth and high prices. The analysis examines how trade between suppliers and grocery chains as well as the legislative framework affects competition and productivity. Additionally, it examines how major trends in the future of retail are expected to affect competition and productivity. A consumer survey was also conducted to examine consumer preferences when purchasing groceries, consumer electronics, and clothing and shoes.

Grocery chains stock the products that consumers demand, and which thus give them the greatest possible earnings. The range of products in stores is thus continuously adapted to consumer preferences and behavioural patterns. Among other things, grocery chains' earnings are determined by the negotiations with their suppliers.

Trade between suppliers and grocery chains impacts i.a. on prices and consumer choice in grocery stores. The Danish grocery market consists of a few large grocery chains which dominate most of the market as well as a number of players with small market shares. The combined market share of the three largest grocery chains is over 85 percent, and these therefore occupy a key position in suppliers' efforts to reach Danish consumers. At supplier level, there is also a high concentration in many of the product categories - especially

¹ In this case, comparable countries means EU7, which, besides Denmark, comprises Belgium, Finland, France, Italy, the Netherlands and Germany. Price calculation is described in the Danish Competition and Consumer Authority's Offerings in the Danish Grocery Trade, 2012.

for several basic goods such as bread, milk and meat. The concentration, however, varies somewhat between product categories.

The high concentration among grocery chains, along with grocery chains' use of own-label and foreign products, means that grocery chains have a certain bargaining power with suppliers. This bargaining power can be used by grocery chains to obtain favourable terms, such as lower prices, better payment terms, better delivery terms etc. If the grocery chains obtain low prices from suppliers, this can benefit consumers in terms of lower prices in store. The high level of bargaining power may also help counteract potential negative impacts of a high concentration at supplier level.

Some suppliers feel that the grocery chains' demands in negotiations mean that only the biggest suppliers can remain on the market. For example, grocery chains are demanding that suppliers must contribute to marketing through their catalogues, TV spots etc., and that suppliers must pay to get access to stores and shelves. This may, in the view of some suppliers, mean that only the biggest suppliers can meet the grocery chains' demands, which may lead to a limited range of products for consumers.

A number of suppliers also believe that the grocery chains' demand for lower prices is reducing the suppliers' earnings and making it harder for them to commit resources to product innovation. An amalgamation of several suppliers (DLF - The Grocery Suppliers) therefore expressed the view that they want guidelines for the trade between suppliers and grocery chains, just as they have been introduced in some other European countries. In a European study, the share of companies who believe there is a need for further regulation of trade is relatively small in Denmark compared to other European countries. For this analysis, interviews were conducted with 15 suppliers. Among the interviewed suppliers, none want trade between suppliers and grocery chains regulated.

This analysis shows that the number of suppliers and the concentration at supply level largely remained unchanged in the period 2001 to 2010. Similarly, the operating margin among suppliers remained virtually unchanged during that same period. Thus, the demands made by Danish grocery chains did not result in fewer suppliers or a fall in their earnings.

Regulating trade could give the smaller suppliers easier access to the shelves of grocery chains. But the regulation of trade could also reduce the bargaining power of grocery chains, thus limiting the opportunities to achieve lower prices in negotiations with suppliers. This might ultimately harm consumers.

Recently, several grocery chains have indicated that, in adapting their offerings to consumer preferences, they are striving to enter into more collaborations with smaller, local suppliers. An increased focus on bringing smaller suppliers into the stores may help mature these suppliers, which may then, in time, increase competition in the market and allow consumers access to a wider range of goods.

A large proportion of consumers say they are happy with product offerings. In a survey, 63 percent of consumers said they were satisfied with the product offerings when purchasing groceries in physical stores. In comparison, 30 percent said prices were low.

The Danish Competition Act applies to a wide range of the issues involved in the negotiations between suppliers and grocery chains. If a dominant player in the market imposes unfair trading conditions which might contribute to shielding the market from competitors, it will - depending on the circumstances - be an infringement of the Danish Competition Act against which the Competition and Consumer Authority can take action.

Likewise, it can be an infringement of the Danish Competition Act if grocery chains agree to exclude a supplier or if a grocery chain, together with a dominant supplier, agrees to exclude another supplier. In this analysis, the Competition and Consumer Authority found no indications that infringements of the Danish Competition Act have taken place.

The Competition and Consumer Authority's overall assessment is that it would be inappropriate to impose guidelines or other forms of additional regulation on trade between suppliers and grocery chains in the grocery market. Guidelines or regulation of trade conditions can be harmful to consumers, as there is a risk they will weaken significant competitive parameters (price, delivery terms etc.) and thus limit competition, resulting in price increases.

Direct sales to consumers, bypassing the retail level, may give suppliers better access to the market. Direct sales to consumers would also exert greater competitive pressures on grocery retail. For example, direct sales to consumers could take place through web portals, where consumers can access multiple suppliers' products. In addition to increasing supplier access to the market, it could also increase the range of products which consumers encounter.

In general, e-commerce can help ensure that consumers have access to a wide selection of products (groceries as well as speciality products²) at low prices. In three years, the total turnover of e-commerce has increased by approx. 56 percent, and it is expected to play an increasingly important role in the future. E-commerce has already made a significant impact in some markets, e.g. consumer electronics, where consumers estimate that they make 36 percent of their consumer electronics purchases via the internet. By comparison, consumers estimate that they buy just 4 percent of their groceries online. E-commerce can help increase productivity and competition in the retail sector, which may contribute to lower consumer prices.

E-commerce is also expected to have an impact on store structure in retail. For example, e-commerce, which is largely made up of speciality items, is expected to lead to grocery stores having less speciality items on the shelves in the future.

According to the consumer survey, cheaper delivery of goods can make consumers engage in more e-commerce. In September 2013, the Competition and Consumer Authority demonstrated that Danish list prices for the shipping of smaller consignments (1-2 kg) are approximately 10-36 percent higher than in comparable countries when adjusted for differences in VAT. Higher costs for shipping and distribution can dampen the scope of e-commerce in goods sent by regular mail, such as electronics and clothes and shoes.

Most groceries have limited shelf life, which means there are high demands on delivery time and for the goods to be kept refrigerated during transport to the consumer. These items cannot therefore be sent by regular mail, unlike durable goods. The limited life of most groceries means that distribution costs for groceries are often higher than for speciality items.

So-called "click-and-collect" schemes allow consumers to order products (durable goods as well as groceries) online and then pick up the goods at a point close to home or work. This can help reduce distribution costs. In particular, click-and-collect is expected to grow within future grocery retailing. Click-and-collect may affect consumers with few local options for grocery shopping, as it could give them access to a wider product range.

² Speciality products – as opposed to groceries – are products which keep existing after use and are only worn out after an extended period. Examples of such products are clothes and shoes, furniture, consumer electronics etc.

One example of this is the city of Alken near Skanderborg where, with the help of a nearby Kvickly and Coops, online shop Osuma has opened a local grocery store where consumers can pick up the groceries they have ordered online. Thus, click-and-collect can help alleviate some of the problems which can arise in areas with few options to shop.

Besides e-commerce, an increased internationalisation is also expected to influence the future of retail. Increased internationalisation of the retail trade, in the form of more foreign stores and/or goods in Denmark, may mean that retail competition is increased. Furthermore, increased internationalisation also means that a spread of best practice is taking place across national borders, which may help further increase productivity.

However, there are several factors which may prevent foreign retail companies from establishing themselves in Denmark. First of all, the Danish market is a relatively small one. All other things being equal, this makes it less attractive to set up in Denmark. Secondly, restrictive legislation will discourage companies from establishing themselves in Denmark. Thirdly, as a foreign company it can be difficult to get a full and accurate picture of all the rules which apply to companies operating in retail in Denmark - this is especially true for rules specific to Denmark.

A third trend which is expected to play a greater role in the future of retailing is the implementation of internet and communications technology (ICT) in retail. In recent decades, ICT has evolved considerably. Digitisation (implementation of ICT) has brought new opportunities, which may i.a. help increase productivity in retail. Analyses show that Danish businesses have experienced productivity growth rates of approximately 0.5 percent per year as a result of digitisation. 0.5 percent per year will make a significant contribution to growth, which means that productivity in retail trade will increase by about 3 percent by 2020. In comparison, other capital investments in machinery, buildings, facilities etc. have led to productivity growth rates of 0.6 percent per year.

In this analysis, the focus has been on four directions within digitisation: the mobile Internet, the internet of things (a technology that makes it possible to track individual items from warehouse to purchase), big data (referring to the processing of large amounts of data) and cloud computing. The latter enables consumers and businesses to use applications and computer power on the Internet rather than depending on local access to these.

Several technologies can make the processes around inventory management, product procurement, shelf-filling etc. easier and less error-prone, which means that companies become more productive. Several of the technologies could also give consumers easier access to information about products, prices, inventories etc. This information can empower consumers to engage in more competition-promoting behaviour.

The legislative framework applicable to the retail industry also impacts competition and productivity in the retail trade. The Danish Business Lease Act is and the Danish Planning Act are among the pieces of legislation with significant impact on the retail industry.

The Danish Business Lease Act, which i.a. is intended to protect tenants (including retailers), regulates the market rent, owners' option of terminating leases and the possibility of the parties entering into fixed-term leases. Compared to similar countries (the Netherlands, Norway, Britain, Sweden and Germany), it is more difficult for owners in Denmark to terminate tenants' leases and to enter into fixed-term contracts with tenants. This means it may be harder for owners to switch tenants.

Thus, the Danish Business Lease Act may serve as a barrier for companies wanting to establish stores in a given area. The Danish Business Lease Act makes it difficult for landlords to change less productive tenants for more productive tenants and to change tenants to ensure that the offering of products corresponds to the products that consumers are demanding.

A less restrictive Danish Business Lease Act is expected to increase competition and productivity in the retail trade. On the other hand, the Danish Business Lease Act, as regards the future right to the premises, gives tenants security, which can increase tenants' incentives to invest in the premises.

Among other things, the purpose of the Danish Planning Act's provisions for retailers includes promoting a desirable shop structure. In comparison with the Netherlands, Norway, the United Kingdom, Sweden and Germany, Denmark has the most restrictive national limitations on the size of new stores.

In Denmark, since the revision of 1997 the Danish Planning Act has incorporated the principle that new stores should, as a general rule, be sited in the centre of town or in central districts, and restrictions were imposed on the size of new stores. Since 2007, this has meant that the gross floor area of grocery stores in the town centre and central districts cannot exceed 3,500 m². Outside these areas, shops intended to supply a local area cannot be greater than 1,000 m². The gross floor area for speciality shops can generally not exceed 2,000 m². The special Danish regulations may make it less attractive for foreign players to establish themselves in Denmark.

The vast majority of international experiences and studies show that large retail formats have a positive effect on productivity in the industry, as they have the opportunity to exploit economies of scale. Such is the case in Sweden, where an analysis shows that the new, large stores are more productive than the smaller stores they outperform while also encouraging the remaining stores to increase efficiency³. Other analyses also show that the English 'town-centre-first' Planning Act, which made it difficult to open large stores outside town centres, has led to weaker productivity growth in the UK⁴.

A study by McKinsey shows that discount stores are the store format in grocery retail which has the highest sales per labour hour. Among the stores with a wide range of products (full-line stores), hypermarkets are the store format with the highest sales per labour hour. In addition, hypermarkets, with their extra shelf space, are able to offer a wider product range. Hypermarkets' share of total grocery sales is about half as big in Denmark as it is in comparable countries.

The Competition and Consumer Authority estimates that the Danish Planning Act hinders increased productivity, a wider product range and the possibility of lower prices in Danish retail through restrictions on the sizes of stores.

For the purpose of the analysis, a consumer survey was conducted among Danish consumers, i.a. examining what is important for consumers when choosing which (physical) store to buy groceries from. The survey shows that Danish consumers attach a high level of importance to store location (e.g. that they are close to home or work) when choosing a store. Large product selections and low prices are also important for consumers' choice of store. Combined with the Danish Planning Act, this may help explain why the Danish grocery trade has a dense network of stores with many stores per inhabitant. In 2008, Denmark had approx. 1.07 stores per 1,000 inhabitants, while the average for other comparable EU countries was 0.97, a difference of about 10 per cent.

³ See Orth and Maican (2012).

⁴ See Haskel and Sadun (2012) and Cheshire et al. (2011).

A relaxation of the Danish Planning Act could affect the retail structure of the Danish retail trade. The consequences would i.a. depend on consumer preferences. The relaxation of the Danish Planning Act would lead to larger stores to the extent that a sufficient proportion of consumers prefer to shop in larger stores. If consumers place a high level of importance on shopping in larger stores, it will likely lead to a less dense store network and thus mean that some consumers will have greater distances to go to their nearest shopping option. Conversely, the store structure will not become less dense if consumers prefer to shop close to home or work rather than in larger stores. Developments in the importance of e-commerce may result in the need for a dense network of stores being smaller in the future. Whether it is appropriate to relax the provisions of the Danish Planning Act is based on a political balancing, where the consideration for increased productivity and competition must be seen in relation to how a relaxation would impact a number of other factors, particularly store structure in the retail trade.

Box 1.1**Main conclusions**

- » Annual productivity growth in the retail sector in Denmark was close to 0.5 percent from 1995 to 2010. This is just over 1.5 percentage points below the average for the Netherlands, Sweden and Germany. In grocery retail, annual productivity growth during the period 1995-2007 was negative (-1.4 percent). In the years before 1995, there was a relatively high degree of productivity growth in retail.
- » In 2010, Danish consumer prices for groceries were approximately 23 percent higher than those of comparable countries¹. After adjusting for differences in VAT rates and taxes, the price difference is 10 percent. If corrected for the differences in wealth and the scope of campaign prices, Danish grocery prices are around 4-6 percent higher than in comparable countries. The 4-6 percent is equivalent to extra grocery costs of DKK 2-3,000 per year for an average household (measured in 2010 prices).
- » Danish consumers attach a high level of importance to store location in their choice of (physical) store for grocery shopping. For example, it may be significant that the store's location is close to home or work. Large product selections and low prices are also important for consumers' choice of store.
- » The three largest grocery chains have a combined market share of over 85 percent of the grocery market, which leaves suppliers with few alternative sales channels to reach consumers.
- » The high concentration, along with grocery chains' use of own-label and foreign products, means that grocery chains have high bargaining power, which they can use in negotiations with suppliers to obtain favourable terms. This can benefit consumers, e.g. through lower prices. This is especially true in product categories where there are few suppliers and thus a high concentration in the supplier chain.
- » Several smaller suppliers have found that grocery chains' demands in negotiations mean that only the very largest suppliers can remain in the market and that they cannot devote sufficient resources to product innovation.
- » The number of suppliers remained largely unchanged in the period 2001-2010. Similarly, the operating margin among suppliers remained virtually unchanged during that same period. Thus, the demands made by Danish grocery chains did not result in fewer suppliers or a fall in their earnings. Several grocery chains have also indicated that they are working to enter into collaborations with smaller local suppliers.

» The Danish Competition Act is already applicable to a wide range of the issues involved in the negotiations, and further regulation of trade may restrict grocery chains' ability to put pressure on the largest suppliers in negotiations. The Competition and Consumer Authority therefore deems it inappropriate to regulate trade further.

» In three years, the total turnover of e-commerce has increased by approx. 56 percent, and it is expected to play an increasingly important role in the future. E-commerce has already made a significant impact in some markets, e.g. consumer electronics, where consumers estimate that they make 36 percent of their consumer electronics purchases via the internet. By comparison, consumers estimate that they buy just 4 percent of their groceries online. E-commerce can help increase productivity and competition in the retail sector, which can contribute to lower consumer prices. E-commerce also makes it easier for consumers in all parts of the country to access a wide range of products.

» Implementation of digitisation in retail has previously helped increase retail productivity significantly, by up to 0.5 percent per year, through more efficient working processes. 0.5 percent per year would make a significant contribution to growth, meaning that productivity in retail would increase by about 3 percent by 2020. In comparison, other capital investments meant an increase of 0.6 percent per year.

» The Danish Business Lease Act differs from similar legislation in other comparable countries in that it is more difficult for owners of commercial premises to enter into fixed-term contracts with tenants or terminate them. Thus, the Danish Business Lease Act may serve as a barrier for companies wanting to establish stores in a given area. A relaxation of the Danish Business Lease Act may help increase competition and productivity in retail, but on the other hand it could reduce tenants' incentives to invest in commercial premises.

» Among the six countries studied, Denmark has the most restrictive national limitations on the sizes of new stores. According to the current Danish Planning Act, new grocery stores can, as a rule, not be larger than 3,500 m², and new durable goods stores can generally not exceed 2,000 m².

» International experiences show that larger stores have a positive effect on productivity development. A relaxation of the Danish Planning Act could therefore increase productivity in retail. The consideration for productivity must be weighed against e.g. the consideration for store structure. A changed store structure will probably mean that some consumers will have a greater distance between their home and the nearest shop. The growing importance of e-commerce may reduce the need for a dense network of stores. To what extent a relaxation of the Danish Planning Act will lead to a change in store structure will depend on, among other things, consumer preferences.