Competition, choice and rising prices in groceries

July 2023

Competition & Markets Authority

The Competition and Markets Authority has excluded from this update certain information which it considers should be excluded having regard to section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure).

Contents

Page

Summary

Context and scope

The price of food and some other groceries in the UK has risen sharply in the period since the COVID-19 pandemic. This has added to pressure on household finances that have also been stretched by rising energy, road fuel and housing costs.

On 15 May 2023, we announced that we were stepping up our work in the grocery sector, to understand whether any failure in competition was contributing to prices being higher than they would be in a well-functioning market.[1] Our Open Letter to Grocery stakeholders, published on 30 May, set out further details on our approach to this work.[2]

The initial focus of our work, and of this update,[3] has been on retail competition, especially between the major supermarkets[4] and discounters.[5] We have considered whether weak or ineffective competition between retailers has been contributing to high prices. In doing so, we have looked at both the extent to which rivalry between retailers ensures they keep their prices as low as possible (the supply side), and the extent to which consumers are willing and able to shop around to get the best deals (the demand side). In the time available we have focused on indicators of effective retail competition at an aggregate level. In the next phase of our work, we will consider the drivers of prices and the effectiveness of competition for particular product categories, both at the retail level and up the supply chain.

As well as looking specifically at the effectiveness of retail competition, we have considered the impact of, and response to, rising grocery prices for different sets of consumers: even if competition is working well at an aggregate level, the effects of high prices, and options for mitigating these effects, will vary considerably, and not everybody will benefit from competition to the same extent.

Groceries prices are affected by competition not just between retailers, but also between firms operating at other levels of the supply chain, in particular:

- competition between suppliers who make the products and sell them to the retailers, and/or direct to consumers; and

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[1] CMA update on action to help contain cost of living pressures - GOV.UK (www.gov.uk)
[2] An open letter from the CMA to the groceries sector - GOV.UK (www.gov.uk)
[3] This review has been carried out under the CMA's general review function in section 5 of the Enterprise Act 2002.
[4] Asda, Morrisons, Sainsbury's and Tesco.
[5] Aldi and Lidl.

- competition between raw material providers who provide the inputs to groceries suppliers.

The wider groceries supply chain is highly complex and comprises thousands of businesses and supply relationships. In order to examine whether the wider supply chain is working well for consumers, and to gain a deeper understanding of the price and competition dynamics across the supply chain, while ensuring our work is timely and impactful, we have identified as part of this update a number of indicative product categories that may merit further consideration over the coming months (see next steps, below). This should not be taken as an indication of any provisional concerns that competition is not effective for those products.

Approach

To inform our initial analysis and assessment, over the last two months, we have met with and gathered written evidence from over 50 stakeholders: consumer organisations, 11 retailers,[6] industry groups, the Bank of England, research companies, industry analysts and experts, and central and devolved government departments. We would like to thank all those who provided information to support our work.

We have also gathered and analysed data, including on retailer market shares, retail food prices, and the prices of relevant inputs (including commodity prices); and we have reviewed industry reports and publications from expert commentators and analysts.

Findings

What has been driving rising prices in this sector?[7]

Food price inflation[8] remains at historically high rates, although it has started to decline from its peak of 19.1% in March 2023. Analysts and industry experts expect food price inflation to continue to fall, perhaps to around 8-10% by the end of 2023; but while the rate of increase is likely to slow, food price levels are expected to continue to rise at least until mid-2024.

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[6] Tesco, Sainsbury's, Asda, Morrisons, Aldi, Lidl, Iceland, Co-op, M&S, Waitrose and Ocado. The term "retailers" in this report generally refers to this group.
[7] In this update, we have looked in particular at the drivers of *food* price inflation (rather than the wider category of 'groceries'), since they are influenced by a range of common factors. However, retailers generally compete in the supply of groceries (rather than just food), and so our consideration of retail competition reflects this wider category.
[8] Food here refers to the wider ONS CPI inflation division, 'Food and non-Alcoholic Beverages'.

Several factors have contributed to recent high food price inflation, some of which have arisen from, or been exacerbated by, Russia’s invasion of Ukraine in February 2022. In particular:

- There have been significant rises in the cost of animal feed, fertiliser and key commodities (such as wheat and sugar) which exceed the inflation levels seen in retail food prices.
- Increased energy costs have been felt at all levels of the supply chain, from farms to transport to manufacturing to refrigeration.
- Rising wages and labour shortages have affected the cost of food production, processing and retailing.
- The depreciation of sterling, particularly against the US dollar, during 2022, has raised the domestic price of imported products and inputs.

The lag between changes in input prices and retail prices is affected by the duration of contracts (for example, for fertiliser and energy supply), and the lead times of some food production processes. These lags first delayed increases in food price inflation as input costs rose and are now contributing to its persistence even as the cost of some inputs has fallen. Rising wages and additional regulatory requirements are, in the view of a range of stakeholders, likely to continue to put upward pressure on production costs, even as the price of other inputs falls.

Has weak or ineffective competition between groceries retailers contributed to recent price inflation?

To help answer this question, we collected evidence on market concentration; entry and expansion over time; retailer profitability; prices and pricing strategies; and the willingness and ability of consumers to identify, access and act on the best deals (i.e. to shop around). In the time available this initial evidence-gathering and analysis cannot provide a complete and determinative view on the state of competition in groceries retailing. However, the evidence we have seen indicates that recent high price inflation for groceries to date does not appear to have been driven at an aggregate level by weak or ineffective competition between retailers. In particular:

- Throughout the last ten years the discounters (Aldi and Lidl) gained market share from the major supermarkets, and this coincided with a decline in major supermarkets' average operating margins (operating profits as a percentage of revenues), which fell from 4.4% in 2013/14 to 2.8% in 2020/21.

- In 2020/21 and 2021/22, the operating profits from the grocery businesses of the 11 retailers from which we requested information were broadly steady – in aggregate and as a percentage of revenues. However, operating profits fell by

41.5% in aggregate in 2022/23, compared with the previous year, while average operating margins fell from 3.2% to 1.8%. This occurred as a result of retailers' costs (notably the cost of goods, labour and energy) increasing faster than their revenues, and indicates that they have not 'passed through' to consumers all of the cost increases that they have incurred.

- Retailers that have allowed their prices to become materially higher than their competitors have tended to lose market share. The lowest-price retailers – notably the discounters – have gained share from their competitors, and the magnitude of these gains has increased during the recent period of high price inflation. This suggests that retailers are constrained in their ability to raise prices without losing market share.

- Relatedly, consumers are shopping around: switching and going to multiple retailers to get the best deals. This behaviour exerts pressure on retailers to keep prices low in order to sustain and build market share. Consumers are also 'trading down' to save money, switching away from brands to own-label (and within own-label from premium to value).

- Retailers pay close attention to their rivals' prices and – particularly for commonly-purchased grocery items – respond competitively to price differences. In the context of other features that we observe in the market – particularly consumer switching, changes in market shares and falling margins – these strategies appear to reflect price competition. We explain further how large retailers' pricing strategies differ from those seen among supermarkets in our road fuel market study in the box on page 63.

Are there consumers who miss out on the benefits of competition between retailers?

Although large retailers generally price at a 'national' level (that is, the same product will be priced identically across their large stores, and online), not everyone benefits in the same way from competition between groceries retailers.

- The discounters, which are typically the cheapest retailers, do not offer online shopping; and Aldi is not present at all in Northern Ireland. Some consumers will not be able to travel to these stores and will therefore not be able to access these lower prices (although they may nonetheless benefit from the general price pressure the discounters put on other retailers).

- Those who cannot travel to a large store, and who are unable to shop online, may be reliant on convenience stores, where prices are generally higher, and value own-label ranges may not be available.

- Own-label products have seen higher rates of inflation than branded goods, and discount stores have seen higher rates of inflation than other supermarkets. We have not seen evidence that competition issues are driving these higher inflation rates; and they could be explained by slimmer margins on own-label products, which make them more sensitive to underlying cost increases.[9] Nonetheless, consumers who were already minimising their food spend will have faced higher increases in the prices they pay, and will have had fewer options to reduce their food spend as prices increased. Many in this group are likely to be on lower incomes, and already spending a higher proportion of their income on food.[10]

Retail competition may also be stronger in some grocery products than others. For example, the discounters sell a smaller range of groceries, and it is possible that competition may be less effective in keeping prices low for products that they do not stock. In the time available, we have not considered this question, or assessed the strength of competition within specific product categories. More detailed consideration of particular product categories will be a focus of the next phase of our work.

How do retailers' relationships with their suppliers affect groceries prices?

Larger retailers appear to have the information and bargaining power necessary to ensure that the prices they pay to own-label suppliers are reflective of underlying costs. However, they generally have less ability to negotiate with suppliers of powerful, 'must stock' brands. We will be looking more closely at the role of own-label and branded suppliers in the next phase of our work.

Could weak or ineffective retail competition contribute to groceries price inflation in future?

We have been told that retailers are looking to increase their groceries profit margins above the low levels seen in 2022/23. The evidence we have received to date on whether they will be able to do so – in the form of monthly profitability data from April 2023 – is mixed. The existing competitive environment is likely to put limits on the extent to which retailers can achieve higher margins without losing market share. However, consumers will understandably be looking for reassurance that effective competition will ensure continued pressure on retailers to pass on cost savings to their customers. This is something we will be monitoring carefully in the months ahead,

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[9] In addition, for a given change in absolute (pounds and pence) price, a lower-priced product will register a higher rate of inflation than a higher-priced one. For example, the inflation rate resulting from a 10p increase on items costing £1 and £2 will be 10% and 5% respectively.
[10] For the average household, 14.4% of total weekly expenditure went on food and non-alcoholic drinks in financial year (FY) ending 2022/23. This rose to over 18.3% for lower income households (those in the bottom fifth of the income distribution).

particularly as input costs fall, so that people can continue to have confidence that retail competition issues are not contributing to the level or persistence of groceries price inflation.

Could weak or ineffective competition in other parts of the groceries supply chain, or in specific product categories, be contributing to price inflation?

This question will be addressed as part of our continuing work in this sector. At this stage, we have not seen evidence of specific competition concerns in particular product categories, or in other parts of the supply chain. We have initially identified as part of this update a number of indicative product categories that may merit further consideration over the coming months, in order to gain a deeper understanding of price and competition dynamics across the supply chain and for particular product categories. In selecting these, we have taken account of a number of factors, including the rate of consumer price inflation (including whether this has differed materially from similar product categories, and from input price inflation); the importance of the product to consumers; and the potential for further scrutiny to shed light on the groceries supply chain and/or consumer behaviour. This should not be taken as an indication of any provisional concerns that competition is not effective for those products.

The initial product categories we have identified for potential further consideration are: baby formula, baked beans, bread, chilled desserts, lemonade, mayonnaise, milk, pet food, poultry and ready meals. These may change as we continue our work in this sector. We have not yet formed a view on whether competition issues exist in the product categories initially identified.

Next steps

In the coming months, we will:

- continue to monitor indicators of retail competition to ensure that people are benefitting from competitive prices as input costs fall;
- continue the work we have already begun gathering evidence from branded and own-label suppliers, to consider competition at this level of the supply chain and its impact on groceries prices;
- examine in more detail supply chains, inflation drivers and the role of competition for the product categories we have initially identified. Some of these will be looked at in more depth than others, depending on what we find.

We plan to publish a further update on our work in autumn. As part of this, we may make recommendations, or announce further work in particular areas if we find anything which justifies further scrutiny.

1. High food price inflation and its impact on consumers

1.1 This section sets out the evidence that we have seen on developments in food price inflation and the ways in which higher food prices are harming UK consumers.

The role of the CMA

1.2 The CMA's purpose is to help people, businesses and the UK economy by promoting competitive markets and tackling unfair behaviour.

1.3 In the context of high price inflation for groceries, we decided in May 2023 to step up our work in this sector. Many of the drivers of food price inflation fall outside the scope of the CMA's remit and powers. Reflecting our purpose, the focus of our work has been on whether weak or ineffective competition has kept groceries prices higher than they would be in a well-functioning market.

1.4 We have taken forward this work under the CMA's general review functions.[11] This enables us to collect evidence and publish our analysis and assessment of it; but it does not give us powers to compel industry participants to give us information. Taking this approach has enabled us to carry out our work in a timely and responsive way.

1.5 In the event that the CMA finds evidence of weak or ineffective competition, it has a number of tools at its disposal. We can make recommendations, to government or others, to address any concerns; we can undertake more detailed work, with statutory information-gathering powers, over a longer time period, through a market study or investigation; or, if there is evidence that competition or consumer protection law has been broken, we can open an investigation and take enforcement action where appropriate. At this stage of our work, we are not taking any of these steps; but, as set out in Section 6, our evidence-gathering and analysis is continuing over the coming months.

1.6 In the event that our work does not reveal evidence of weak or ineffective competition contributing to high grocery prices, this should provide some assurance to people that, to the extent they are able to shop around and exercise choice, they have the best possible chance to mitigate the effect of rising prices on themselves and their families. Nonetheless, we recognise that rising food prices have had a very detrimental impact on many households,

[11] Sections 5 and 6 of the Enterprise Act 2002.

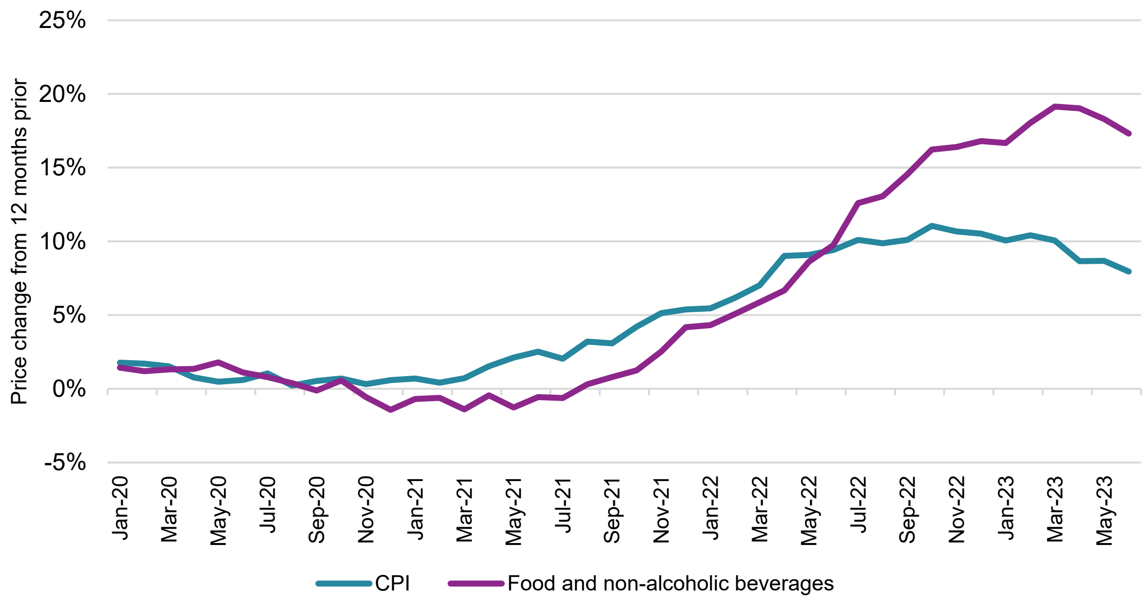
especially those on lower incomes and not everyone has equal opportunities to shop around for the best deal.

Food price inflation has been persistently high

1.7 Inflation for food and non-alcoholic beverages was 17.3% in June 2023, down from its high of 19.1% in March 2023 which was the highest rate in 45 years. Food and non-alcoholic drink prices were, in aggregate, 23.7% higher in June 2023 than they were before the Russian invasion of Ukraine in January 2022 and 29.1% higher than in January 2021, when UK COVID-19 restrictions started to ease. In its May 2023 Monetary Policy Report, the Bank of England said that 'food and other goods price inflation have recently surprised on the upside' and contributed to a higher-than-expected rate of general inflation.

1.8 Figure 1, below, shows that food price inflation started to rise later than the general rate of consumer price inflation (CPI), and has been slower to fall. We discuss the reasons for this in Section 2.

Figure 1: CPI and Food and Non-Alcoholic Beverages 12-month inflation rate, Jan '20 – Jun '23



Source: Consumer price inflation from the Office for National Statistics ('**ONS**')

1.9 Other measures of food prices also show high rates of inflation, albeit slightly lower than the Office for National Statistics (ONS) statistics. For example, the British Retail Consortium (BRC)'s shop price index (SPI)[12] shows food price inflation in the year to June 2023 of 14.6%, down from 15.4% in May 2023

[12] https://brc.org.uk/news/corporate-affairs/cheaper-staples-help-inflation-fall/

and 15.7% in April 2023.[13] The BRC explained that the reasons the SPI shows a different rate from the ONS data include: the SPI records loyalty card prices (eg Tesco Clubcard) whereas the CPI does not; the items in each index's respective baskets are not identical; and the weights allocated to these items differ.

1.10 The BRC stated that the slowdown in food price inflation was ‘largely driven by lower energy and commodity costs starting to filter through to lower prices of some staples including butter, milk, fruit and fish’.[14] The BRC also reported that, according to their index, fresh food inflation fell from 17.2% in May 2023 to 15.7% in June 2023. Meanwhile, ambient food inflation fell slightly from 13.1% in May 2023 to 13.0% in June 2023.[15]

1.11 Food price inflation has also been high in other countries, suggesting common cost pressures, though it appears to have started to decline more quickly in many other countries than in the UK. This can be seen in the European Union, France and Germany, where food and non-alcoholic beverage inflation peaked at 19.2% (EU), 16.9% (France) and 21.2% (Germany) in March 2023, before falling to 15% (EU), 14.9% (France) and 14.5% (Germany) in May 2023.[16]

1.12 ONS data[17] suggests that some elements of the shopping basket have experienced particularly high inflation in the UK. For example, olive oil, mayonnaise and granulated white sugar saw price rises of 65%, 57% and 54% respectively from January 2022 to May 2023. Some products, in contrast, have experienced much lower price inflation than others. Examples include lemons and sweet potatoes, which saw price increases of 3% and 4% respectively from January 2022 to May 2023.

1.13 Inflation in non-food groceries has also been high, though not as high as for some types of food. In terms of the household essentials, for the period January 2022 to May 2023, retail prices for washing up liquid have risen by 24%, laundry detergent by 28%, kitchen roll by 36% and household cleaner by 39%.[18]

1.14 Although the rate of food price inflation is forecast to fall, it is generally expected to remain in double figures for the rest of this year (as we discuss in Section 2 (‘Outlook for inflation’). If that is the case, food prices will continue to

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[13] The SPI measures changes in the price of 500 of the most commonly bought items and demonstrates the extent to which retailers contribute to inflation through the pricing of commonly bought goods.
[14] Food inflation eases in May (brc.org.uk)
[15] Cheaper staples help inflation fall (brc.org.uk)
[16] Consumer price indices (CPIs) - Complete database (oecd.org)
[17] https://www.ons.gov.uk/economy/inflationandpriceindices/articles/shoppingpricescomparisontool/2023-05-03
[18] Shopping prices comparison tool - Office for National Statistics (ons.gov.uk)

rise for the foreseeable future, albeit at a slower rate, and this will continue to put a strain on households.

High food prices particularly affect lower income households

1.15 Citizens Advice Scotland told us that consumers have been affected not just by higher food prices but also by higher energy bills, and higher mortgage or rental costs, which make the additional spend on food even harder to manage.[19] Higher prices hurt all consumers, but especially those on lower incomes and those who cannot access large stores.

1.16 Food shopping is a significant and essential element of household spending. For the average household, 14.4% of total weekly expenditure went on food and non-alcoholic drinks in the financial year (FY) ending 2021.[20] This rose to 18.3% for the 5.6 million households in the bottom fifth of the income distribution.[21] These shares are likely to have grown following recent increases in food prices. Around half of all adults (51%) in a recent ONS survey reported that they were worried about the cost of food, a slightly higher proportion than were worried about the cost of energy (48%).[22]

1.17 The recent increase in inflation has been particularly felt by lower income households because they spend a higher proportion of their income on essentials such as food, housing, and energy and have fewer discretionary purchases that they can avoid or postpone. Housing and household services (which includes water, electricity, gas and other fuels) and food prices continue to be the largest contributors to annual inflation.[23] These costs account for 46.1% of low-income[24] households' spending compared with 37.9% of high-income[25] households.[26]

1.18 The ONS produces estimates of the inflationary impact on different income groups. As of October 2022, it estimated that the one tenth of households with the lowest incomes were experiencing an annual inflation rate of 12.5%, whilst the tenth of households on the highest incomes were experiencing a rate of

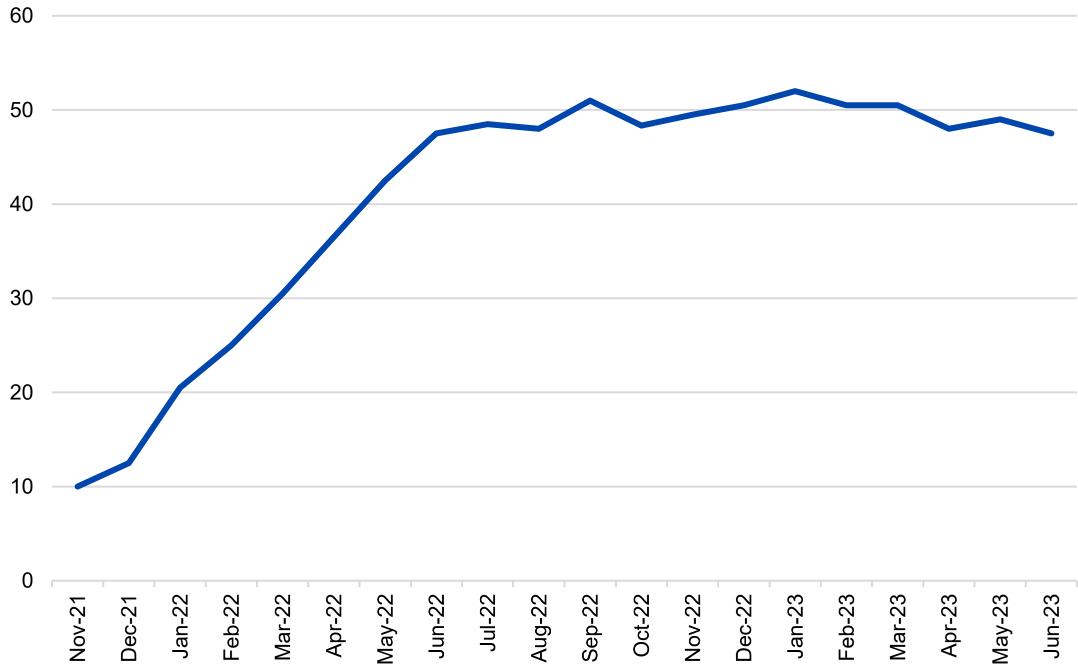
[19] Discussion at roundtable of stakeholders, Edinburgh, 27 June.
[20] Family Food 2020/21 - GOV.UK (www.gov.uk)
[21] Viewpoint Special: Exploring what's next for food inflation (igd.com).
[22] Public opinions and social trends, Great Britain - Office for National Statistics.
[23] Consumer price inflation, UK - Office for National Statistics
[24] Those in the second income decile (where 1 equals lowest-income households, 10 equals highest-income households).
[25] Those in the ninth income decile (where 1 equals lowest-income households, 10 equals highest-income households).
[26] CPIH-consistent inflation rate estimates for UK household groups - Office for National Statistics

9.6% - a gap of 2.9 percentage points.[27] There is, therefore, a strong distributional impact in the current cost-of-living crisis and, for households on lower incomes, rising food prices can be particularly difficult to manage.

People have been buying less food and referrals to food banks have increased

1.19 ONS data suggests 49% of adults are buying less than they used to when shopping for food, and this has roughly been the case for the past year (as shown in figure 2).[28] The Institute of Grocery Distribution (IGD) also found that 41% of people planned to further reduce spend on food and grocery shopping in the next few months (from April 2023), rising to 48% of those on the lowest incomes.[29]

Figure 2: Percentage of adults stating they are 'buying less when shopping for food in the past two weeks'



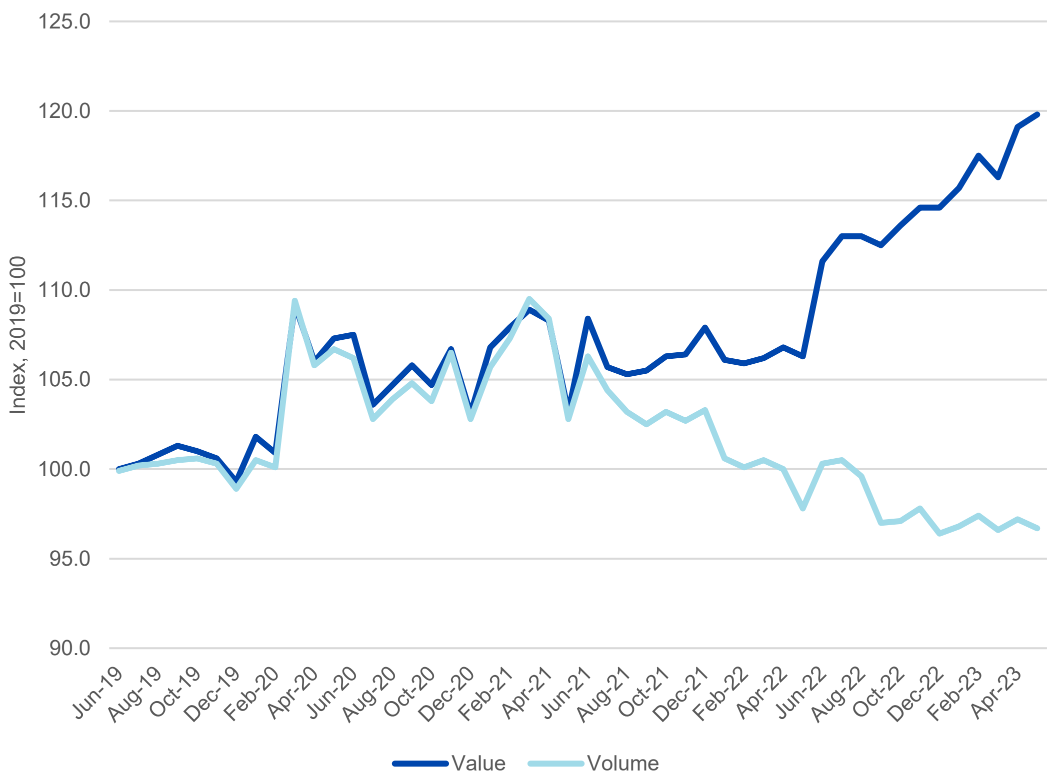
Source: ONS, Opinions and Lifestyle Survey[30]

1.20 Retailers have also observed that customers are reducing their consumption. All 11 retailers that we requested information from told us that, for some

[27] ONS distributional analysis uses the same items collected for the main CPI calculation, along with the same prices, so the differences between the household groups are driven by differing spending patterns, rather than differing items, price increases or substitutions. As such, experienced inflation may be lower for groups that are able to substitute or trade-down.
[28] Cost of living insights - Office for National Statistics (ons.gov.uk)
[29] Viewpoint Special: Exploring what's next for food inflation (igd.com)
[30] Cost of living insights - Office for National Statistics (ons.gov.uk)

consumers, basket spend had remained level, meaning that people were buying fewer, or cheaper, items to complete their usual shop. ONS data on the value and volume of food sales (figure 3 below) shows that sales value has increased and volume has fallen suggesting that, overall, consumers are both spending more and getting less. Sales volumes show a notable peak in March 2020 when lockdowns were put in place and supermarket shopping replaced food sales in pubs, cafes and restaurants, followed by a fall below pre-Covid levels once inflation began to rise in February 2022.

Figure 3: Food retailers' total sales value and volume, June 2019-April 2023 (2019=100)



Source: ONS Retail Sales Data, May 2023.[31]

1.21 People are also taking other steps in responses to higher food prices which could have detrimental impacts on health.

(a) The Food Standards Agencies in Wales and Scotland both told us that they had heard of people switching off fridges, eating uncooked food or keeping food beyond sell-by dates in order to save money, all of which could be detrimental to health and safety.

(b) We heard from Food Standards Scotland that it is usually more expensive, on a per calorie basis, to buy healthy food than less healthy

[31] Retail sales, Great Britain - Office for National Statistics (ons.gov.uk)

food.[32] There is, therefore, a risk that people switch from fresh food to unhealthier options. In Age Scotland's recent survey, 19% of the over-50s surveyed said they were eating less healthily.[33]

(c) The Resolution Foundation found that a fifth of survey respondents in March 2023 reported being in food insecurity, with half of those experiencing severe food insecurity meaning they had eaten less or skipped meals for seven or more days in the last month. They also found that, in their survey, 43% of people on means-tested benefits have had to eat less or skip meals due to rising costs.[34]

1.22 Usage of food banks has also been rising.

(a) Between 1 April 2022 and 31 March 2023, almost 3 million food parcels were distributed by food banks in the Trussell Trust's UK network. This is the most parcels ever distributed in a financial year, and an increase of 37% from the same period the previous year.[35]

(b) The IGD found that 8% of people said they would use a food bank in the next few months (in April 2023) rising to 27% of those on the lowest incomes.[36]

(c) Citizens Advice has already helped 64,734 more people than it had this time last year with food bank referrals and charitable support, with over half of those people accessing support for the first time. Around 60% of the people Citizens Advice help with crisis support are disabled or have a long-term health condition, and a high proportion are of working age. There are also clear disparities between different ethnic groups, different types of housing tenure and household type.[37]

Consumers have also been 'trading down' and switching to cheaper retailers

1.23 There is considerable evidence that consumers have been 'trading down' to save money, either by buying own label products instead of branded items (or value rather than premium own-label) or by shopping at cheaper retailers ('trading out').

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[32] Discussion at roundtable of stakeholders, Edinburgh, 27 June.
[33] Discussion at roundtable of stakeholders, Edinburgh, 27 June.
[34] Hoping-and-coping.pdf (resolutionfoundation.org), section 5.
[35] Microsoft Word - EYS UK Factsheet 2022-23_FINAL (trusselltrust.org)
[36] Viewpoint Special: Exploring what's next for food inflation (igd.com)
[37] Data shared by Citizens Advice.

(a) The share of branded products sold by many retailers has declined as customers switched to own-label alternatives.

(i) One retailer told us that in financial year 2022/23 sales volumes of branded products fell by 2.8% compared to the previous year; premium own brand products fell by 2.9% and standard own brand products fell by 2.5%, while sales volumes of economy own brand products increased by 8.7%.

(ii) Another retailer told us that the share of sales of branded products decreased by 0.5 percentage points in April 2022 to March 2023 from the previous year and has continued to decline in this financial year.

(iii) A retailer supplied research which showed that, in the 12 months to May 2023, 29% had switched to buying more supermarket own brand items and 24% had switched to buying the cheapest brand available in the supermarket.

(iv) One retailer told us that the shift from branded to own-label had been particularly strong in canned goods, rice and pasta, another mentioned shifts for pasta sauces, baked beans, ketchup and cereals.

(v) Kantar data suggests that the cheapest own label lines have seen sales increase by 46% compared to a year ago.[38]

(b) Supermarkets have seen their volumes fall, and they have lost share to Aldi and Lidl. Aldi and Lidl have seen their sales (by value) increase by around 25% in the 12-week period to 16 April 2023.[39] We discuss the growth of Aldi and Lidl in section 3.

1.24 Consumers are also changing the types of products they buy, as well as trading down within ranges. For example, many are trading fresh vegetables for frozen or tinned (which are cheaper and last longer), and high value protein sources (fish) for lower value sources (such as sausages or chicken).[40] The IGD found that 24% of people said they were eating lower quality food, eg cheaper cuts of meat, rising to 33% on the lowest incomes.[41] Many retailers have also observed customers buying smaller pack sizes.

1.25 Many retailers also noted that volumes were also increasing for some higher value products (eg premium branded ready meals) to replace the experience

[38] Britons turn to stores' bargain ranges as grocery price inflation stays above 17% | Supermarkets | The Guardian
[39] UK grocery price inflation dips but too soon to call the peak (kantar.com)
[40] BRC roundtable, other conversations with retailers.
[41] Viewpoint Special: Exploring what's next for food inflation (igd.com)

of dining out: restaurant meals have been replaced by pizza night at home and the retailers are offering deals focused on capturing this business. One retailer told us that they had also seen this during the last recession.

1.26 We heard from the BRC that the food price inflation experienced by consumers may not have been as high as the headline levels captured in the ONS data because people are changing their consumption patterns and shifting to cheaper options. Nonetheless, for a number of reasons, shopping around, trading down and trading out are likely to provide only partial mitigation to the significant impact that consumers have felt from high food price inflation:

(a) Some consumers had been very careful about their food spend even before the current cost-of-living crisis. That is, they were already buying the cheaper ranges and using the cheapest stores available to them. These consumers will have faced particularly high rates of inflation because own-label products have shown higher inflation than branded goods (see paragraphs 4.4 to 4.7), and discount stores have shown higher inflation than other supermarkets (see paragraphs 3.41 to 3.43). Analysts at Bernstein told us that they had observed more trading down in the 2010-2012 downturn than now partly because more consumers today are already buying own label and using discounters.[42]

(b) In many cases, people are not trading down but are simply buying less to maintain the cost of their weekly shop. The cost of their basket may remain unchanged but they are clearly worse off.

(c) Consumers are likely to experience a (perceived or actual) loss of quality from trading down or trading out. For example, the overall shopping experience may be less enjoyable at discounters (as they do not aim to compete on the quality of the in-store experience), and some value tier own-label products may use lower quality ingredients than branded or premium own-label ranges.

(d) Shopping around is costly to consumers, both in terms of the time taken to compare product prices across retailers, and in terms of the time taken to travel to multiple stores. The increasing prevalence of lower prices being offered through loyalty schemes may have made it harder for consumers to make like-for-like price comparisons if unit prices are not clearly displayed.

[42] Bernstein, (Bruno Monteyne, Senior Analyst, European Food and Home Personal Care; William Woods, Equity Research Analyst, European Food Retail and Delivery), meeting of 12 June 2023. They also said that they thought that some people had saved during COVID-19 and that this group did not yet need to trade down.

(e) Not all customers are able to access lower priced groceries.

   (i) Many consumers will not be able to easily access the lower prices at the discounters if they cannot get to a store (through distance or lack of transport options).

   (ii) Some customers cannot easily access a large store of one of the major supermarkets (either because of distance and/or lack of access to transport) and rely on a smaller convenience store for their grocery shopping. Convenience stores are usually more expensive and have much smaller ranges than large supermarkets (often with fewer budget own-label options). People living in Northern Ireland are relatively more dependent on smaller shops than the rest of the UK and we heard that there are more convenience stores per person in Scotland than the rest of the UK.[43]

1.27 It is clear, therefore, that high grocery price inflation has been felt very keenly by most people and in particular by certain groups, such as those on lower incomes or those who cannot access the lowest priced groceries (eg rural communities or those with poor transport options).

[43] Discussion at roundtable of stakeholders, Edinburgh, 27 June.

2. The food supply chain: why food price inflation has been so persistently high

2.1 Food supply is a complicated industry, comprising thousands of UK and overseas businesses, from farmers, through to processors, distributors and retailers. The larger retailers generally have hundreds of different suppliers (in some cases well over 1,000). According to the Food and Drink Federation (FDF), food and drink manufacturers directly employ over 450,000 people in the UK.[44]

2.2 Some food, such as fresh produce and milk, is transported and sold more or less as it is (with some packaging); other products such as ready meals involve multiple ingredients and processes. For some products, such as olive oil, the UK is heavily dependent on imports; others, such as fresh eggs, tend to be sourced predominantly from within the UK.

2.3 The cost of goods accounts for around 70% of revenues generated by retailers on average across the sector. Of the remaining 30%, 27% relates to other costs incurred by the retailers, such as labour, energy, warehousing, distribution, marketing and administration costs, with the remaining 3% equating to the retailer's profit.[45]

2.4 The diagram below provides a simplified overview of the stages in the food supply chain, and some of the key costs incurred at each stage of production. The price that a customer pays for a food item in a supermarket is influenced by factors throughout the supply chain: in particular, costs of inputs into farming (animal feed, fertiliser, and commodities such as wheat), energy costs (for processing, transport and refrigeration), labour costs (for produce picking, processing, transport and staffing large retail stores) and exchange rates (which affect import costs).

[44] FDF Submission to the CMA, June 2023.
[45] The share of the retail price that is cost of goods, the retailers cost of operating and retailer margin can be backed out from aggregate industry data for gross profits and operating profits.

Figure 4: Simplified illustration of the food supply chain, including indicative examples of costs at each stage

A range of factors has contributed to high food price inflation

2.5 Several factors have contributed to recent high food price inflation. Some of these have arisen from, or been exacerbated by, Russia's invasion of Ukraine in February 2022. This confluence of factors – large shocks in both commodity prices and energy prices, coupled with rising labour costs and exchange rate depreciation – has been described to us as a 'perfect storm' and 'completely atypical'. One retailer said that these 'conditions have been the most challenging we have seen for a long time'. The FDF said that 'the turbulence experienced in recent years in agrifood supply chains is without precedent', stemming from the sequential structural shocks of Brexit, the Covid pandemic and the war in Ukraine.

2.6 Below, we discuss in more detail some of the global factors that have driven high food price inflation.

Coronavirus (COVID-19) pandemic and subsequent rise in global demand

2.7 The COVID-19 pandemic resulted in supply chain disruptions and production difficulties. The FDF told us that 'global shipping faced unprecedented disruption impacting global supply chains'.

2.8 As COVID-19 restrictions eased in 2021, consumer and agricultural demand grew throughout the world (with a particularly strong upswing in China) and suppliers struggled to meet this demand. Statistics compiled from the ONS Business Insights and Conditions survey found on average that 34.3% of businesses (excluding microbusinesses) involved in the manufacture of food and drinks products reported experiencing global supply chain disruption between March 2022 and January 2023. This was almost twice the proportion across all businesses (18.8%).[46] This increase in global demand also generated an increased demand for energy, which caused energy prices to rise.

2.9 A number of stakeholders told us that, in mid-2023, supply chains and product availability had not fully recovered since COVID-19.

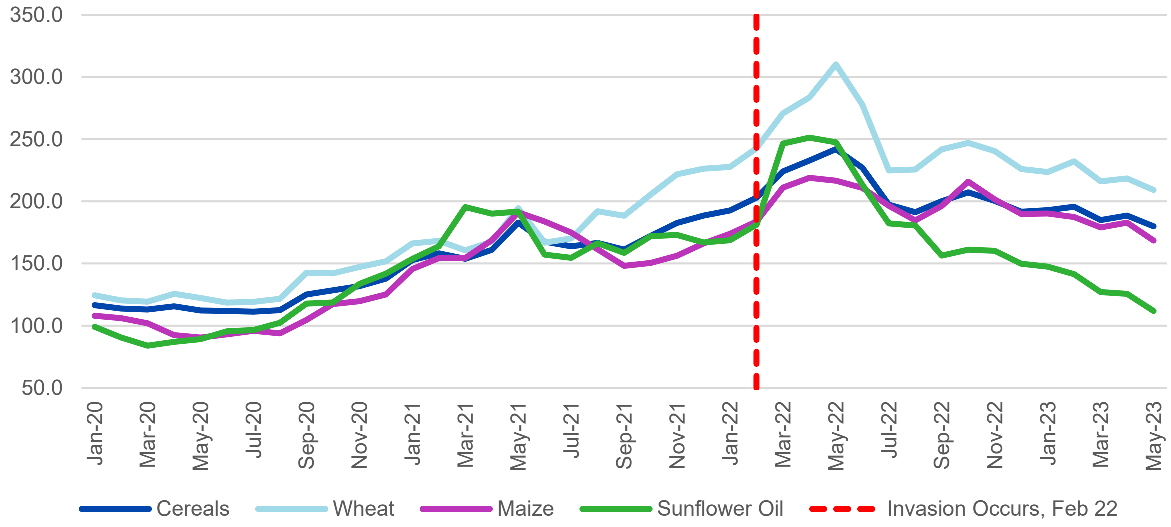
Invasion of Ukraine

2.10 In 2021, Russia and Ukraine were among the top global exporters of wheat, barley and vegetable oils. Following Russia's invasion of Ukraine in February

[46] Recent trends in UK food and drink producer and consumer prices - Office for National Statistics

2022, exports of these goods were disrupted, and global commodity prices for cereals and vegetable oil reached all-time highs.[47]

Figure 5: Global Commodity price indices- pre and post Ukraine Invasion



Source: IMF[48]

2.11 The Food and Agriculture Organization of the United Nations reported that the global food price index averaged 159.7 points in March 2022, the highest level since its inception in 1990.[49] The global food price index has fallen back down to pre-invasion levels for many commodities as other countries around the world started to make up any shortfall in produce. The Black Sea Grain Initiative was also agreed to allow the safe export of grain from certain Ukrainian ports.

2.12 However, prices for cereals remain well above the levels seen in early 2020, as shown in figure 5 above. Stakeholders including the National Farmers Union (NFU) and the Agricultural and Horticultural Development Board (AHDB) told us that there is continued global food market sensitivity to the ongoing conflict in Ukraine. For example, the recent collapse of the Kakhovka dam in Ukraine in June 2023 caused wheat futures to rise by up to 3%.[50]

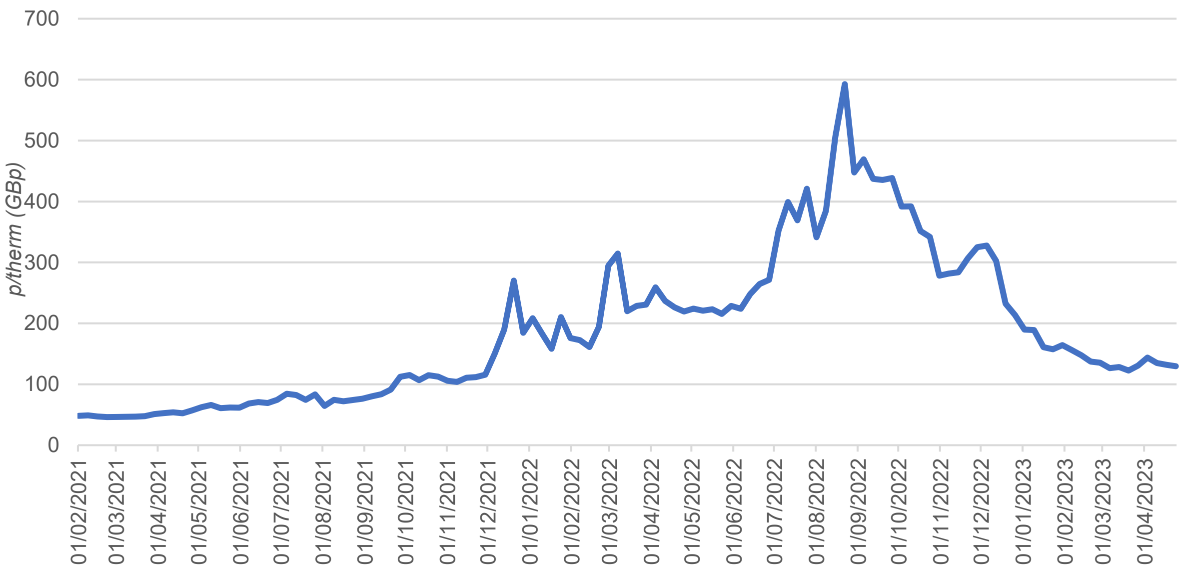
Energy and fuel costs

2.13 Following the supply side impact that COVID-19 had on gas and oil prices, the invasion of Ukraine caused a large spike in energy prices from February 2022. Sanctions and planned bans on Russian energy exports created

[47] https://www.fao.org/worldfoodsituation/foodpricesindex/en/
[48] https://www.imf.org/en/Research/commodity-prices
[49] FAO Food Price Index | World Food Situation | Food and Agriculture Organization of the United Nations
[50] Wheat Jumps on Dam Blast, Escalation of Fighting in Ukraine - BNN Bloomberg

volatility in the wholesale gas and oil markets amid concerns about their effect on energy supply. Figure 6 shows how the gas price peaked and fell back, though it remains above the level it was in early 2021.

Figure 6: Gas prices for forward delivery contracts peaked in August 2022 (weekly average, GB)



Source: Ofgem[51]

2.14 Agriculture and food production are highly energy intensive sectors and use a great deal of road fuel, gas and electricity. In our stakeholder meetings the NFU and AHDB both cited rising energy costs as one of the principal drivers for increasing food input costs.[52] The relative importance of energy in food production is reflected in ONS analysis of the energy intensity of items in the CPI basket. The ONS estimates that food and non-alcoholic beverages have amongst the highest energy of all items in the basket, excluding items directly impacted by energy, such as transport and household energy.[53]

2.15 Energy is also a large cost for retailers (for example, for refrigeration, lighting, and heating). One retailer told us that its energy bill increased by around 70% in 2022. While some food and drink manufacturers were able to take advantage of the government energy relief scheme, which capped the cost of energy, their energy costs in 2022 were still much higher than in previous years.

[51] https://www.ofgem.gov.uk/energy-data-and-research/data-portal/wholesale-market-indicators
[52] Meeting with CMA and NFU; CMA and AHDB.
[53] The energy intensity of the Consumer Prices Index - Office for National Statistics

Animal Feeds and Fertilisers

2.16 Russia's invasion of Ukraine has impacted the price of animal feeds, as both countries are significant exporters of agricultural commodities. Animal feed prices peaked sharply in spring 2022 and have not substantially reduced since then[54] due to high commodity prices for input materials (such as feed wheat and soya meal) alongside higher production costs.[55]

2.17 Fertiliser prices rose sharply in spring 2022 and, though they declined relatively quickly to reach pre-invasion levels by March 2023, these prices are still substantially higher than pre-2021 levels (as shown in figure 7 below).[56] Fertiliser prices closely tracked rising natural gas prices in 2022, and supply chain disruptions and economic sanctions on Russia (the top exporter of nitrogen fertilisers in 2021)[57] further restricted supply and created higher prices.

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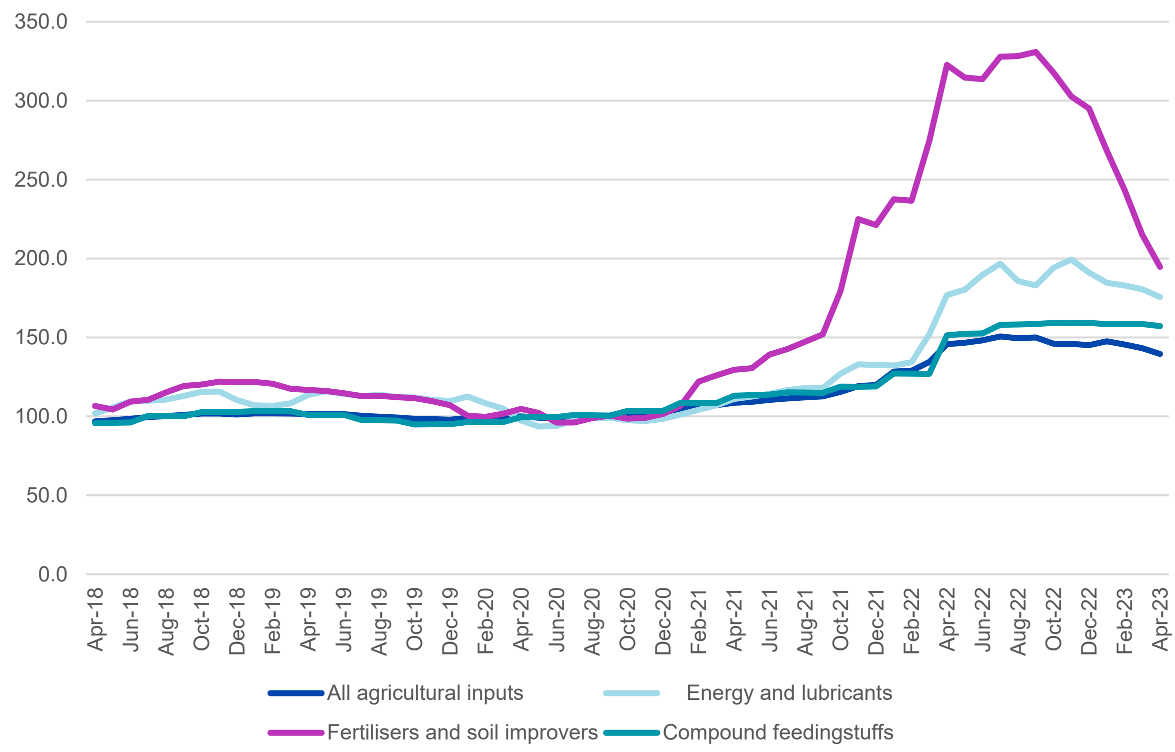
[54] DEFRA Agricultural Price Index (2020=100) time series: January 2014 onwards
[55] Feed prices and markets | AHDB
[56] DEFRA Agricultural Price Index (2020=100) time series: January 2014 onwards
[57] Fertilizers in Russia | OEC - The Observatory of Economic Complexity

Figure 7: Price inflation for key agricultural inputs since 2018 (monthly, 2020=100)



Source: ONS Agricultural Price Index (2020=100) time series: January 2014 onwards

Labour Shortages and Increased Wages

2.18 We understand that labour is a very significant operating cost for retailers, based on evidence from their financial statements (which we analyse in Section 3, below). One retailer told us that its most significant cost (after goods purchased from suppliers) was labour. The retailer also told us that certain food products are more labour intensive to make, with labour costs making up 24% of the total cost of ready meal production, for example.

2.19 While representatives for the agricultural sector have expressed concerns about labour supply for several years, more acute labour shortages throughout the food production, haulage and farming sectors were experienced from early 2021. Stakeholders told us that this was caused in part by workers leaving the labour market during and after the COVID-19 pandemic, and shortages due to EU workers leaving the UK.

2.20 In August 2021, a cross industry report estimated there to be 500,000 vacancies in the food and drink sector.[58] The FDF said that current vacancies in the food manufacturing sector were 'uncomfortably high' and significantly more acute than across the economy or the whole manufacturing sector, with

[58] PowerPoint Presentation (nfuonline.com)

a shortage of high-skilled workers, technical specialists, and production operatives.[59]

2.21 Labour shortages often result in an increase in the wages paid to attract and retain labour. The UK national living wage has also increased by 17% since 2021.[60] This has resulted in higher labour costs across the food sector, most of which use the UK national living wage as their base salary. The FDF told us that wage price inflation was a key factor in increasing costs and helping keep them 'baked in', as once wages have increased, they are nearly impossible to reduce. [61]

Exchange Rates

2.22 Pound Sterling (GBP) reached a 37 year low against the US dollar in the Autumn of 2022 ($1.07)[62]. UK food prices are affected by exchange rate movements because many global commodities (eg wheat) are priced in US dollars and because an unfavourable exchange rate makes imported food and inputs more expensive. This leaves the UK food industry exposed to global price shocks. In the recent past food prices increased following large depreciations to sterling in 2008 and 2016.[63]

2.23 In 2021, the Department for Environment, Food and Rural Affairs (DEFRA) estimated that the UK supplied around 58% of domestic food consumption, meaning that over 40% of food consumed in the UK depends on imports.[64] This figure is supported by ONS estimates of import intensity of food and non-alcoholic beverage products in the CPI basket.[65]

2.24 Products typically sourced from abroad include fish and seafood, as well as produce that does not grow at all (or only seasonally) in the UK, such as bananas, tomatoes and soft fruit. The BRC told us that the effects of changes in exchange rates on retail prices may be delayed as contracts are often negotiated in advance.[66] Though the pound has regained in strength against the dollar in 2023 (see figure 8), some import contracts may have been fixed for a period at the lower rates.

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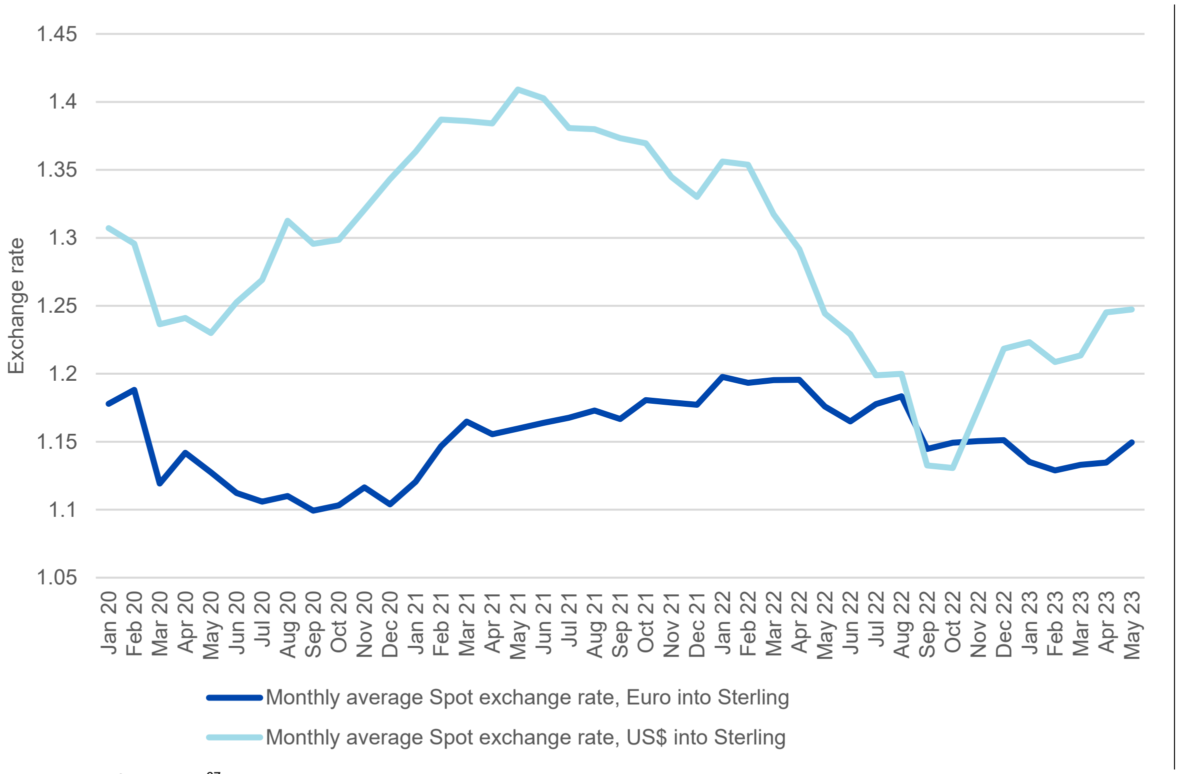
[59] FDF written Submission to the CMA, June 2023.
[60] National Minimum Wage and National Living Wage rates - GOV.UK (www.gov.uk)
[61] FDF written submission to the CMA, June 2023.
[62] Bank of England Database- Daily spot exchange rate, US$ into Sterling
[63] Additional factors affecting global food prices in 2008 included adverse weather, increased energy costs and demand from emerging market economies: Bank of England Inflation Report August 2008. Sterling crisis: what are the historical precedents? - Economics Observatory
[64] Food statistics in your pocket - GOV.UK (www.gov.uk) – DEFRA.
[65] Contributions to the 12-month rate of CPI(H) by import intensity - Office for National Statistics
[66] Meeting with BRC.

Figure 8: Monthly average spot exchange rate for Euro and US$ into sterling (January 2020 to May 2023)



Source: Bank of England[67]

Climate Related Shocks

2.25 Extreme weather events can also contribute to shortages of certain foods, leading to higher prices. Droughts, heatwaves, flooding, and wildfires have all affected the global supply of staple food products. For example, in Spring 2023, consumers in the UK experienced a shortage of tomatoes, cucumbers, and other salad vegetables due to unfavourable weather conditions in key growing countries such as Spain and Morocco.

2.26 Brazil, the largest sugar producer, has been affected by poor weather conditions and Europe produced its smallest sugar beet crop in 20 years due to the impacts of dry summers and drought.[68] The price of granulated white sugar in UK shops rose by 54% between January 2022 and May 2023. Over the same period, the global price of sugar rose by around 39%, and in May 2023 sat at around double its average level across 2020.[69]

[67] Bank of England | Database
[68] Confectionery firms try to sugar coat price rises - BBC News
[69] IMF Primary Commodity Prices

Avian Influenza

2.27 In 2022 the UK experienced its largest outbreak of avian influenza which led to 3.8 million bird deaths in the UK.[70] 97 million birds were lost worldwide in 2022, impacting global supply chains.[71] Most of these deaths were from culling due to potential exposure to avian influenza rather than from confirmed cases. Poultry producers at the time warned of consequential supply shortages and rising costs.

2.28 Consumers may have noticed this impact when some supermarkets rationed egg supplies in Autumn 2022. In November 2022, DEFRA imposed mandatory housing for bird flocks in England (as a measure against avian influenza) forcing poultry producers to keep flocks in lit and heated barns until April 2023.[72] This further increased the cost of producing eggs.

Food prices for consumers tend to lag behind rises or falls in costs

2.29 It is striking that CPI annual inflation peaked in October 2022 whereas food price inflation appears to have peaked in March 2023 (with only a very slight fall to April 2023). This 'lag' (along with the high level of food price inflation) has contributed to concerns that weak competition in the food supply chain may be causing food inflation to persist.

2.30 Some features of the food supply chain mean that it takes time for increases – and decreases – in input costs to feed through into intermediate prices and prices paid by consumers.[73] In the current episode of high food prices, on the way up, consumer food prices lagged behind rising input and output producer price inflation.[74] Although the rate of output producer price inflation for food is now falling, we are yet to see a notable fall in consumer price inflation for food (see figure 9 below).

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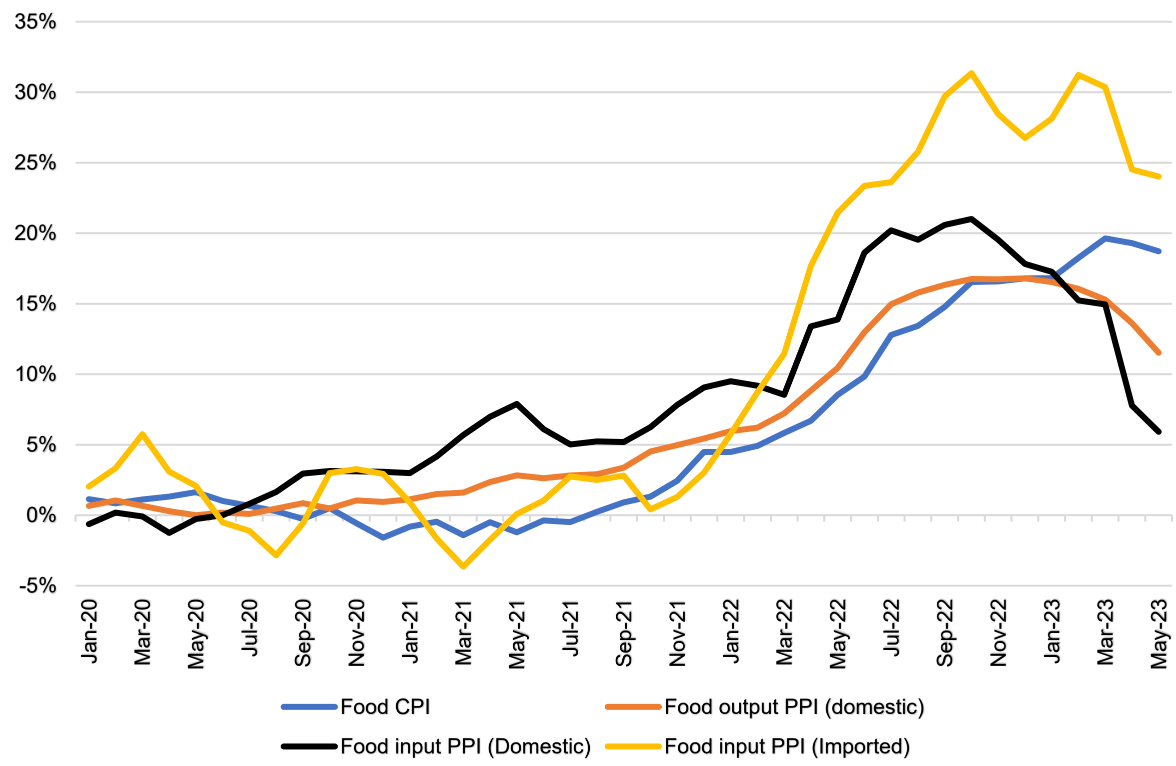
[70] Bird flu 2022: Dealing with the UK's largest ever outbreak - House of Lords Library (parliament.uk)
[71] Record avian flu outbreak sees 48m birds culled in UK and EU - BBC News
[72] [Withdrawn] Avian influenza: Housing order to be introduced across England - GOV.UK (www.gov.uk)- Defra
[73] Monetary Policy Report May 2023 (bankofengland.co.uk), page 57, Viewpoint Special: Exploring what's next for food inflation (igd.com)
[74] Food Producer Price Inflation (PPI) measures the change in the prices of goods bought and sold by UK food manufacturers. Food Input PPI measures the change in the prices of both imported and domestically sourced inputs paid by UK food manufacturers. Food Output PPI measures the change in the price UK food manufactures receive for their output (ie food products) on the domestic market (factory gate price), that is, the price they charge to retailers.

Figure 9: Food Input and Output PPI with CPI (Jan 2020 – May 2023)[75]



Sources: ONS producer price inflation, ONS consumer price inflation

2.31 DEFRA has modelled the typical lag between rises in inputs for food production and retail prices. It finds that the lag tends to be between 4 months and 7 months, or 4 and 9 months, depending on the food sector. The FDF has said that there is a lag of 7 to 12 months for higher input costs to be reflected in retail prices, due to the nature of contracts across the supply chain. The BRC told us that it estimated the lag between input costs and consumer prices to be between 3 to 9 months, depending on the product and commodities involved in its production.[76]

2.32 As noted in paragraph [x], the UK imports a relatively large proportion of its food. A notable characteristic of the current period of high food inflation is that price rises of imported inputs to food production have been larger and more sustained than those of domestic inputs. While only around 10% of inputs to food manufacturing are imported,[77] around 30% of food within the CPI basket

[75] Charts reflect CPI and PPI price data to May 2023, published by the ONS on 21 June 2023. The ONS typically revises published PPI indices in the months following initial publication. Revisions from the July PPI release – published by the ONS on 19 July 2023 are not reflected in figure 9.
[76] Meeting with BRC, 6 June 2023.
[77] Supply and use tables - Office for National Statistics (ons.gov.uk)

is directly imported.[78] The ONS does not provide separate inflation figures for these items.

Causes of the lags in food supply chains

Fixed-price contracts for energy, commodities and other inputs

2.33 The principal cause of the lag is the long-term contracts which are common practice in the food industry, meaning that input costs only change when the agreements are renegotiated, even if the market price for the commodity has changed in the meantime. We have heard evidence that this is a widespread feature of food supply.

2.34 One of the main areas where fixed contracts apply, and where lower prices will take some time to feed through, is in energy. Some contacts of the Bank of England's agents[79] (including firms in the food supply chain) report that they are on fixed energy contracts from last year, which will not renew until later this year, so many food suppliers are still subject to elevated energy costs.[80] The Association of Convenience Stores (ACS) explained that many of its members (ie independent convenience stores) were on similar contracts, in which energy prices may be fixed for 1 or 2 years. We also heard from retailers that many of their suppliers were committed to energy contracts at prices which are higher than the current spot price. Therefore, although energy prices for producers peaked around November 2022 and energy prices have fallen since then, it will take some time for this to feed through for lower costs for food production and supply in many cases.

2.35 Agricultural inputs are another important area where fixed price contracts are important, meaning that farmers may be locked into paying higher prices, even as the current cost of animal feed or fertiliser falls. Fertiliser prices peaked around September 2022 and animal feed prices around October 2022, though as shown in figure 7 above prices remain well above 2020 levels.

2.36 We heard that fertilisers will typically be purchased in the autumn for the following year's harvest,[81] meaning that many current stocks of fertiliser will have been bought at peak prices. When the market was particularly volatile, farmers were tending to purchase more on forward contracts and less on the spot market, to hedge against further rises. The NFU told us that last year

[78] Statistics. The average direct import intensity of food and non-alcoholic beverages within the CPI basket is around 30%, based on the 2015 detailed edition of the input-output analytical tables.
[79] Agents | Bank of England
[80] Monetary Policy Report May 2023 (bankofengland.co.uk), page 75.
[81] Monetary Policy Report May 2023 (bankofengland.co.uk), page 57.

some farmers committed to buying fertilisers at high prices for a longer term, in response to uncertainty over price rises, but that this now means they are committed to paying more for longer despite the reduction in fertiliser prices.[82] The FDF also noted that some commodity inputs can take several months to be shipped across the globe and that inventory held as buffer stocks also delays the transmission of price inflation (or deflation).

Agricultural cycles and food production processes

2.37 A further factor is the long production cycle of some food and drink products, which are reliant on agricultural and industrial processes. Cost changes will flow through in different ways, depending on the lead time for the product to be produced and the inputs which make up the majority of its costs. For example, cost changes in fresh produce or milk can be felt fairly quickly as there is a short lead time between production and the produce appearing on the shelf, though feed and fertiliser are a large part of this cost stack and may have been purchased the previous year. Changes in input costs for mature cheese will take longer to feed through to the shelf. To give another example, tomatoes are canned after harvesting in autumn, and then prices will remain fairly stable until 12 months later when the next batch is generated. A retailer told us that frozen food will be made in batches and a supplier might make three months of stock in one period.

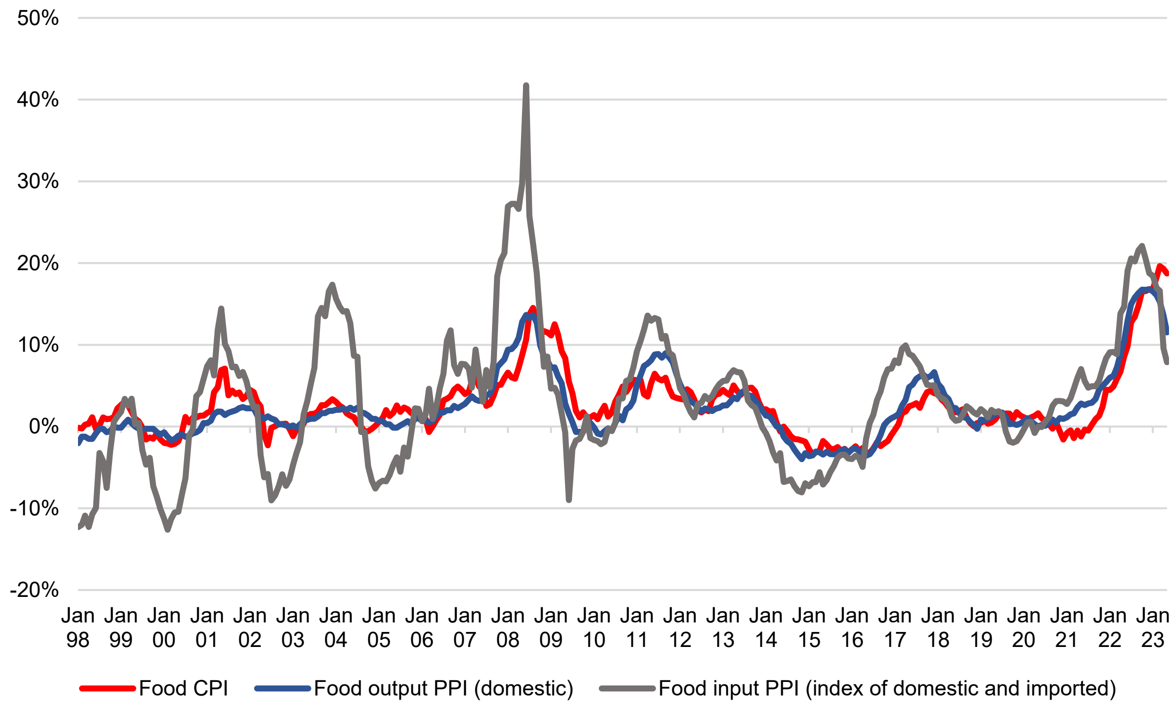
2.38 The length of the lag will also depend on the type of contract that the supplier has with the retailer (we discuss this in more detail below). There is greater transparency of costs, and therefore faster pass-through, in own-label production, and this tends to include more fresh and chilled products than tinned and processed food.

What we can learn from previous price shocks

2.39 There have been periods of high and increasing food price inflation in the past in the UK, most notably in 2008-2009 following the global financial crisis, and in 2017, following the UK's decision in 2016 to leave the European Union, as shown in figure 10 below. The chart shows changes in food CPI (the prices paid by consumers), output food PPI (the price paid by retailers to food producers) and input price PPI (the price paid by food manufacturers, combining domestic and imported goods).

[82] NFU in Cardiff Roundtable discussion with the CMA.

Figure 10: Food consumer price inflation, input food producer price inflation and output producer price inflation[83]



Source: ONS producer price inflation, ONS consumer price inflation[84]

2.40 Food prices rose in 2008-2009 in large part due to a significant depreciation in the GBP of around 27% from January 2007 to January 2009, which contributed to a large peak in imported input prices.[85,86] In 2016, there was also a large depreciation in sterling, where its value fell around 12% in just three months (June 2016 to October 2016), which again contributed to a peak in input costs.[87,88]

2.41 Figure 10 shows that retail food price inflation is generally less volatile than the movements in input producer price inflation (the costs of food manufacturers). However, since around 2010, there have been fewer periods where manufacturing output price inflation or retail price inflation has deviated significantly from changes to input prices. In the current period of food price inflation, however, the retail food price inflation has been as high as that for

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[83] As above, Food input PPI (index of domestic and imported) is the price of food inputs both domestically and internationally sourced by UK food manufacturers and food output PPI is the price received by UK food producers for output sold to the domestic market.
[84] Chart reflects CPI and PPI price data to May 2023, published by the ONS on 21 June 2023. The ONS typically revises published PPI indices in the months following initial publication. Revisions from the July PPI release – published by the ONS on 19 July 2023 are not reflected in figure 10.
[85] Versus a basket of trade-weighted currencies.
[86] CMA analysis of: Bank of England Database- Monthly average Effective exchange rate index, Sterling
[87] Versus a basket of trade-weighted currencies.
[88] CMA analysis of: Bank of England Database- Monthly average Effective exchange rate index, Sterling

the input prices. We consider that a number of reasons could be contributing to this:

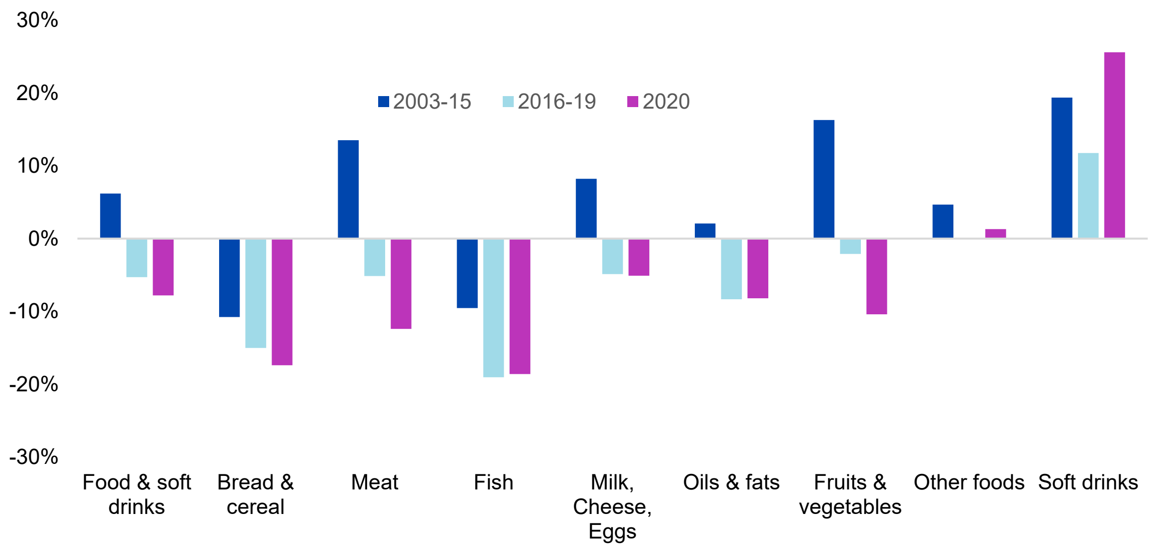
(a) When profit margins are low, more of the cost increases are likely to be passed on, as there is less scope to absorb them. Margins in grocery retail are lower than in 2009/2010, as explained in Section 3, below. Firms operating in more competitive markets are incentivised to charge the lowest prices possible in order to increase market share, and thus are likely to pass on cost reductions to consumers. There may be more competition in the retail grocery sector than in previous shocks, as a result of the significant growth of the discounters.

(b) During this period of food price inflation, there have been multiple shocks – energy costs, commodity price increases and labour market tightness – which was not the case in previous episodes of food price inflation.

Price comparisons with the EU

2.42 Since 2016, UK food prices have generally been lower than the EU average. Eurostat figures show that over 2003-2015, UK prices for food (including soft drinks) on average were about 5% above the EU-27 average. Since then, however, the UK's relative price level has fallen due to relatively low food price inflation in the UK, and in 2020 the UK price level for food and soft drinks was about 7% below the EU average (as shown in figure 11), though this varies by category: bread and cereal and fish were cheapest compared to other EU countries and soft drinks were more expensive.

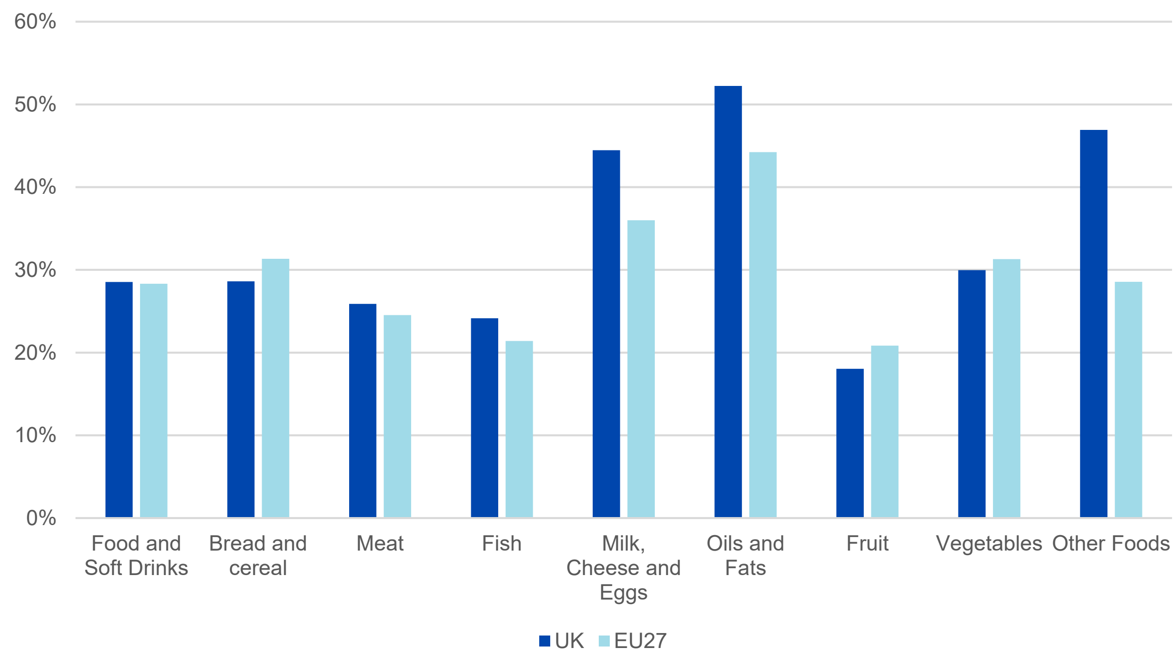
Figure 11: UK food prices relative to EU average



Source: Eurostat and ONS price level data

2.43 Since our departure from the EU, UK food prices relative to EU prices are no longer recorded on Eurostat. However, as seen in figure 12, we can instead consider the growth rates of prices in the UK and the EU. We see that food prices have on average risen at a very similar level since 2021 for both the UK and the EU27, so we can infer that prices in the UK are still lower than those in the EU, on average, despite inflation in the EU falling faster than in the UK so far. The difference in price growth does vary by category, however: UK prices have risen faster for dairy and eggs, oils and fats and 'other foods' which includes prepared sauces and ready meals.

Figure 12: Food price growth, UK vs EU27, Jan 21 – May 23



Source: Eurostat and ONS price level data[89]

2.44 Food prices can vary between countries for a wide range of reasons, including the strength of competition at different stages of the supply chain, but also production and distribution costs, trade policy, regulation and climate. We have not considered whether and how far differences in competitive conditions, or even the quality of food available, might explain price variations between the UK and EU.

Outlook for inflation

2.45 In May 2023, the Bank of England stated that 'food price inflation is likely to fall back more slowly than previously expected',[90] and that food prices are not

[89] Chart reflects price data to May 2023.
[90] Monetary Policy Report May 2023 (bankofengland.co.uk), page 6, 22.

expected to fall, just rise at a slower rate.[91] Commentators and industry participants agree that the rate of food price inflation is likely to have peaked and will continue to fall into 2024. Food prices are not generally expected to fall, however, except in a few categories. Several stakeholders have characterised the upcoming months as a period of 'disinflation' rather than deflation, referring to the expectation that inflation is expected to slow but prices, in general, will not fall.

2.46 The IGD expects food price inflation to be 8-10% in December 2023, and around 1-3% for the whole year of 2024.[92] The IGD notes that sustained food price deflation is uncommon in the UK and that there has only been one period of this in the last 50 years. The BRC anticipates that food inflation will 'drop to single digits this year', though the way they measure it is slightly different from the ONS, as noted above.[93] The IGD also notes that any further price shocks may slow the forecast decrease in food price inflation.[94]

2.47 A number of stakeholders highlighted the difficulties in predicting food price inflation. The FDF told us that the peak of ingredient costs may have been reached and that food price inflation should be in the low double digits by the end of the year but noted that another major supply shock could easily change this picture. The AHDB said that, while producer input prices had become more stable, they could still be affected by continuing supply-and-demand volatility and the situation in Ukraine.[95]

2.48 Retailers also agree that food price inflation has started to fall and will continue to slow over the coming year. One retailer said that this would continue into next year, with prices beginning to stabilise over the next 12 months following gradual return to historically normal levels of inflation. Another retailer said that they expect food inflation to fall 'closer to 5% by the end of the year'.

Retailers have cut prices for certain products

2.49 In recent months, retailers have announced price cuts for a range of staple products, including milk, bread, pasta and oils. They explained that the reasons for these cuts were because input costs had begun to fall for these products and, for subsequent cuts, to stay competitive with the market. Sainsbury's also announced reductions in the price of toilet paper because

[91] Monetary Policy Report May 2023 (bankofengland.co.uk), page 58.
[92] Viewpoint Special: Exploring what's next for food inflation (igd.com)
[93] https://brc.org.uk/news/corporate-affairs/cheaper-staples-help-inflation-fall/
[94] Viewpoint Special: Exploring what's next for food inflation (igd.com)

the pulp price had fallen. These price reductions are summarised in table 1 below. We discuss retailers' pricing strategies in Section 3.

Table 1: Some recent price reductions in staple products

Product	Date	Retailer	Reduction in price
Milk[96]	12 April	Tesco	4-6%
	13 April	Sainsbury's	4-6%
	14 April	Aldi, Lidl, Asda	4-6%
Bread and Butter[97]	09 May	Sainsbury's	Bread 5%, butter 12%
	10 May	Tesco, Aldi, Lidl	Bread 5%, butter 12%
Pasta and cooking oil[98]	16 May	Tesco, Aldi	Tesco: Oil 6-5%, pasta 16% Aldi: 5-10%
Toilet Paper[99]	14 June	Sainsbury's	Up to 11%

Source: press releases (as footnoted)

2.50 Food price inflation has been gradually falling since its peak in March 2023. Since we began our assessment in mid-May, some retailers have announced further price cuts across a larger range of product categories. For example:

(a) On 12 June, Waitrose[100] cut the prices of over 200 everyday products including tomato ketchup, golden caster sugar, salads, and ice cream and has said that half of these products are now at least 10% cheaper.

(b) On 19 June, M&S[101] announced price reductions for over 70 staple products, including beef mince and anti-bacterial hand wash, with stated reductions of between 3 and 25%.

(c) On 19 June, Morrisons[102] announced price reductions for 47 high-volume items, including mince, squash, cereals and pitta bread, with an average price cut of over 25%.

(d) On 30 June, Tesco[103] announced price reductions for over 500 products, including tuna, rice and plastic bin bags, with price cuts on average of 13%.

2.51 The retailers gave several reasons given for these price cuts:

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[96] Aldi, Lidl and Asda follow rivals in cutting milk prices - BBC News
[97] Sainsbury's, Tesco, Aldi, and Lidl cut bread and butter prices - BBC News
[98] https://www.thegrocer.co.uk/supermarkets/pasta-and-oil-prices-cut-as-deflation-war-heats-up/679293.article
[99] https://www.about.sainsburys.co.uk/news/latest-news/2023/14-06-23-toilet-paper
[100] Waitrose Media Centre | Waitrose reveals sizzling summer deals with over 200 price cuts on customer favourites. (johnlewispartnership.media)
[101] M&S Food Invests in the Price Of 200 Products as Part of its Trusted Value Promise to Customers | Marks & Spencer (marksandspencer.com)
[102] https://www.morrisons-corporate.com/media-centre/corporate-news/morrisons-cuts-prices-of-nearly-50-products-including-summer-favourites/
[103] https://www.tescoplc.com/tesco-cuts-price-of-more-than-500-key-products-including-fruit-veg-tuna-and-rice/

(a) Reducing prices to encourage customer loyalty and attract new customers, especially in products that people frequently bought;

(b) Passing on cost reductions where they had occurred;

(c) Reacting to price movements by competitors;

(d) Targeting seasonal products (such as ice cream) or passing on reductions in costs for produce that is now in season in the UK (eg strawberries).

Not all costs are expected to fall

2.52 Industry participants in different areas of the supply chain, including the NFU, FDF, and BRC, as well as retailers, have given various reasons why some upward pressure on food prices will remain. We heard that these factors had an effect across the supply chain and can affect producers, manufacturers, and retailers.

(a) **Labour costs.** Food supply is a labour-intensive industry and labour costs are likely to remain at current higher levels (or increase further). Many employees in the food industry (especially retail) are on the National Living Wage, which rose by almost 10% in April 2023. Retailers noted that future labour cost savings can, therefore, only be made by increasing efficiencies.

(b) **Regulation.** Various regulations which have recently entered into force (or will shortly do so) may raise the cost of producing and selling food. Many of these are initiatives aimed at improving sustainability or promoting healthy diets and food safety and are welcomed by the industry in principle. We heard that, while individually these measures may not materially increase costs, the cumulative effect could be significant. These include:

(i) High in fat, sugar and salt (HFSS) restrictions preventing retailers selling less healthy products in certain key locations like store entrances and checkouts, or through volume discounts including 'buy-one-get-one-free'.[104] The restriction of HFSS products by location was introduced in 2022 and retailers incurred costs relating to familiarisation, product assessment and updating IT systems – the BRC estimated the total of these costs for UK retailers to be around £500 million.[105] Restrictions on volume promotions may affect

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[104] Restricting promotions of products high in fat, sugar or salt by location and by volume price: implementation guidance - GOV.UK (www.gov.uk)
[105] Meeting with BRC, 6 June 2023.

retailers using less profitable promotions like price cuts as an alternative.[106]

(ii) A plastic packaging tax was introduced in 2022. Any plastic packaging manufactured or imported by suppliers and retailers which contains below 30% recycled plastic is subject to the tax.[107] This can increase production costs for food suppliers and retailers. The FDF told us that a potential response to the rising production costs was the introduction of smaller packaging sizes where agreed with retailers. Difficulties sourcing recycled plastic and the plastic packaging tax have increased production costs for food manufacturers and in turn for consumers.[108]

(iii) The UK Government, Welsh Government and the Northern Ireland Executive have plans to introduce a deposit return scheme (DRS) for drinks containers, and expect that in most cases retailers would host the return points for used containers.[109] During the consultation on these plans, many respondents raised concerns that smaller retailers may find it difficult to host and operate a return point.[110] Several retailers in Scotland have already installed reverse vending machines and entered into related maintenance contracts in response to Scotland's separate DRS plans, but these have now been delayed.[111]

(iv) Extended producer responsibility requirements for packaging are coming into force during 2023-24 and mean that suppliers and retailers may have new recycling responsibilities, including requirements to collect data about their packaging and pay waste management fees.[112] One retailer welcomed the changes but told us the new requirements would represent a material cost for their business.

(v) 'Natasha's Law' was introduced in 2021 and requires prepacked for direct sale food (like bread baked in supermarkets) to have allergen labelling.[113]

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106 Impact assessment for restricting volume promotions for high fat, sugar, and salt (HFSS) (publishing.service.gov.uk)
107 Check which packaging is subject to Plastic Packaging Tax - GOV.UK (www.gov.uk)
108 Discussion at roundtable of stakeholders, Edinburgh, 27 June.
109 Deposit Return Scheme for drinks containers moves a step closer - GOV.UK (www.gov.uk)
110 Introducing a deposit return scheme in England, Wales and Northern Ireland (publishing.service.gov.uk)
111 Scottish deposit return delayed until October 2025 - BBC News
112 Extended producer responsibility for packaging: who is affected and what to do - GOV.UK (www.gov.uk)
113 Natasha's legacy becomes law - GOV.UK (www.gov.uk)

(c) **Brexit.** Many retailers and industry bodies told us that the UK exit from the EU has impacted the cost of producing and supplying food in several ways.

(i) Several stakeholders told us that Brexit had contributed to ongoing labour shortages in the sector. The FDF told us that labour costs associated with Brexit have contributed to higher costs for agricultural producers.[114] The House of Commons Environment, Food and Rural Affairs Committee also found that significant labour shortages were caused by Brexit and accentuated by the pandemic, affecting crop-picking, meat and poultry production and processing, hospitality and logistics.[115]

(ii) Stakeholders mentioned the impact on food prices due to greater trade barriers on imports from the EU. This is supported by analysis from the Centre for Economic Performance, which found that the increase in prices of imported products was particularly pronounced for products sourced predominantly from the EU, such as pork, jams and tomatoes. Their analysis estimated that the impact of Brexit on food prices stands at an added £250 per household between December 2019 and March 2023.[116]

(iii) Several stakeholders in Northern Ireland described uncertainties and likely costs associated with the new Windsor Framework, which is planned to be gradually implemented over the next year and aims to overcome some of the practical issues which have already increased costs for food manufacturers and suppliers operating in Northern Ireland. The Windsor Framework (detailing the processes for those importing and exporting goods between the UK and EU) includes provisions allowing UK goods intended for Northern Ireland only to bypass some of the checks required for those goods that may cross the Irish border and reach the European Union. However, some stakeholders were concerned that the framework is introducing significant costs for suppliers and retailers, including the costs of different labelling for EU and NI-only products, and additional costs for suppliers who have to adjust their product offering to reflect divergences in food standards between the EU and UK.[117] The BRC

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[114] Discussion at roundtable of stakeholders, Edinburgh, 27 June.
[115] Labour shortages in the food and farming sector - Environment, Food and Rural Affairs Committee (parliament.uk)
[116] brexit18.pdf (lse.ac.uk)
[117] Northern Ireland Roundtable discussion.

told us that border customs checks are proving ‘more costly than first anticipated from the Windsor Framework agreement.’[118]

(iv) The EU's Common Agricultural Policy (CAP) assisted farmers in the form of subsidies. CAP funding to UK farmers was mostly distributed through direct payments in the Basic Payment Scheme, which continued after Brexit but is now being phased out in favour of a new agricultural subsidy regime. The NFU told us that the progressive reductions in the basic payment scheme could have a negative effect on farmer confidence, which may lead to lower future production.[119]

(d) **Supply chain volatility.** Stakeholders including the NFU, the FDF and the AHDB noted that the food supply chain remains subject to volatility from a number of sources:

(i) Variable weather patterns (and adverse weather events) are likely to persist. For example, there have been poor harvests in Spain and Italy which mean that the olive oil price continues to rise.

(ii) The situation in Ukraine remains uncertain. The Black Sea grain initiative is due to be renewed in July 2023 and global agricultural prices could increase if this outlet for Ukrainian exports is shut off.

(iii) The AHDB felt that the oil price could remain volatile.[120] If the oil price rises, this will increase transportation costs.

(e) **Groceries Supply Code of Practice (GSCOP).** One retailer said that its ‘ability to successfully negotiate price reductions in the context of a deflationary economic environment could be impacted by the provisions of the Groceries Supply Code of Practice’. Another retailer said that: ‘It is important to note the impact of the Groceries Supply Code of Practice (GSCOP) when considering these CPIs [cost price increases] and CPDs [cost price decreases] negotiations. GSCOP aims to promote fairness and requires retailers to be reasonable in their dealings with suppliers. It is not a reciprocal obligation. Consequently, a proportion of suppliers refuse to engage properly when we seek to negotiate CPDs. Further, GSCOP protects large, branded suppliers who are considerably larger than [us] and already have much greater bargaining power.’

(f) **Rising profit margins.** The Bank of England notes that many of its agents’ contacts thought that one reason for a slower fall in food price

[118] Call with BRC, 6 June 2023.
[119] Meeting with NFU.
[120] Meeting with AHDB, 15 June 2023.

inflation would be some rebuild in profit margins, which had been squeezed along the supply chain.[121] The potential for higher retail grocery profit margins in the future is discussed further in Section 3.

Conclusion on the food supply chain

2.53 Food production and supply is a complicated industry, with thousands of participants, both small and large. It is an important employer and contributor to UK GDP. An unprecedented conjunction of supply shocks has caused significant rises in energy, commodity, and labour costs throughout the supply chain from farmers to supermarkets, made worse in some cases by adverse movements in the exchange rate. Although input price increases have been falling in recent months, structural lags mean that food price inflation is only just beginning to reduce from its record high. Commentators generally think that food price inflation has peaked but expect it to persist well into next year. We are unlikely to see a material fall in food prices overall.

[121] Monetary Policy Report May 2023 (bankofengland.co.uk), page 73.

3. Retail competition in food and groceries

Introduction

3.1 Although food prices are determined by interactions across all parts of the food supply chain, much recent public attention has been focused on whether food retailers, and especially the major supermarkets, are contributing to high food price inflation.[122] In this section, we have looked at the evidence on competition in grocery retailing to understand whether weak or ineffective competition might allow retailers to keep prices and profits higher than they would otherwise be, either as food inflation has risen, or as it now begins to fall. Competition in other areas of the supply chain (such as between food manufacturers) will also influence prices paid at the retail level. As a next step, we will continue the work we have already begun gathering evidence from branded and own-label suppliers, to consider competition at this level of the supply chain and its impact on groceries prices.

3.2 In order to assess whether there is effective retail competition, we have considered a number of factors, including: market concentration; entry and expansion over time; profitability; prices and pricing strategies; and the willingness and ability of consumers to identify, access and act on the best deals (i.e. to shop around).

3.3 The evidence used to inform this consideration has been gathered from a range of sources:

(a) We requested information from 11 retailers: Tesco, Sainsbury's, Asda, Morrisons, Aldi, Lidl, Iceland, Co-op, M&S, Waitrose and Ocado.

(b) We have engaged with industry bodies from across the supply chain, such as the National Farmers Union, the Agriculture and Horticulture Development Board, the Food and Drink Federation, the Scottish Wholesale Association, the Federation of Wholesale Distributors and the Association of Convenience Stores.

(c) We have also spoken to a wide range of other stakeholders: industry analysts, consumer groups, think tanks, and the Groceries Code Adjudicator, to get their views.

[122] For example, https://www.unitetheunion.org/news-events/news/2023/march/food-prices-the-british-public-are-hostages-to-greedflation/

(d) We have gathered evidence on market shares, relative prices, price changes and consumer behaviour from Which? and Kantar.

3.4 In the time available, this initial evidence-gathering and analysis cannot provide a complete and determinative view on the state of competition in grocery retailing. However, we have gathered evidence on indicators of competition at an aggregate level to take a view as to whether weak competition might be contributing to high food price inflation.

Views on retail competition

3.5 We heard from a wide range of stakeholders that the UK grocery market is highly competitive. Analysts from Bernstein said there was effective price competition in the UK food sector, and that most companies, particularly supermarkets, currently had lower margins than they did before COVID-19. A number of industry bodies including the FDF (representing food suppliers, who use retailers to distribute their products) also agreed that the UK food retail market was highly competitive. The NFU told us that in the context of consumer pricing it thought retailers operated within a competitive market and had seen no evidence of industry participants exploiting market power.[123] We also heard a similar message from the Resolution Foundation, a think tank, who told us that the UK food retail market was very competitive, and that prices in this sector were 'highly contested'.

3.6 In terms of retailer perspectives, a retailer which is present in 11 countries told us that in their view the UK market was 'one of the most competitive in the world'. Lidl is present in over 30 countries, with over 12,000 stores, and also said that the UK market was among the most competitive that they operate in, and that retailers were fiercely fighting for market share.[124]

Market structure

Overview

3.7 The retail groceries sector in Great Britain (ie not including Northern Ireland) has at least 11 nationwide retailers, as well as many thousands of independent and franchise convenience stores.[125] Not all nationwide retailers

[123] NFU meeting with CMA. The NFU also noted that it continues to encounter concerns over retail treatment of suppliers using their market buying power. We intend to consider competition in the supply chain in the next phase of our work.
[124] Lidl meeting with CMA on 29 June 2023.
[125] The UK merger control regime has an important role to play in maintaining effective competition in this market. For example, in 2019 the CMA blocked a merger between Sainsbury's and Asda after finding that it would lead to

are present in Northern Ireland (eg Morrisons and Aldi do not operate there), while Northern Ireland has some retailers – such as SuperValu – that operate across the island of Ireland, but not in Great Britain.

3.8 The nationwide retailers offer a somewhat differentiated shopping experience.

(a) Tesco, Sainsbury's, Asda and Morrisons are the major supermarkets and pitch themselves as offering something to all demographics. They aim to stay competitive with the discounters on a number of key lines and offer – to slightly varying degrees – a wide range of products, with tens of thousands of individual stock-keeping units (SKUs). Tesco is the largest retailer in the market with a 27% share; and collectively the four major supermarkets accounted for around 65% of the groceries market (June 2023).[126]

(b) The discounters (Aldi and Lidl) offer much smaller ranges than the major supermarkets and compete on a low price offering with few frills and few well-known brands, though they aim to match or exceed the quality of the major supermarkets on their own-label products. Together, the discounters have an 18% market share (June 2023).[127]

(c) M&S and Waitrose are positioned at the higher end of the market, aiming to charge a price premium based on quality. M&S has smaller store sizes and almost exclusively offers own-label products. Waitrose is more comparable in its range and store size with the major supermarkets and had a 4.5% market share in June 2023.[128]

(d) Co-op is more convenience-focused with, in general, smaller shops serving a local area. It had a 5.8% market share in June 2023.[129]

(e) Iceland is positioned at the lower cost end of the market, specialising in frozen foods and promotions on major brands. In June 2023, it had a 2.3% market share.[130]

(f) Ocado is an online-only retailer and positioned towards the higher end of the market (offering M&S products alongside its own-label range). Ocado aims to offer a very large range of products, served from its fulfilment

increased prices in stores, online and at many petrol stations across the UK: CMA blocks merger between Sainsbury's and Asda - GOV.UK (www.gov.uk).

[126] Kantar grocery market share data, 12 weeks ending June 2023
[127] Kantar grocery market share data, 12 weeks ending June 2023
[128] Kantar grocery market share data, 12 weeks ending June 2023
[129] Kantar grocery market share data, 12 weeks ending June 2023
[130] Kantar grocery market share data, 12 weeks ending June 2023

centres, and to compete on quality factors such as availability of delivery slots and few substitutions. It had a market share of 1.7% in June 2023.[131]

Developments over time

3.9 Key developments in the retail grocery market over the last ten years include:

(a) The growth of the discounters (Aldi and Lidl), whose market share has increased from under 6% in 2012 to nearly 18% today. This trend has accelerated recently as consumers have switched from the major supermarkets to discounters in response to rising prices (see paragraphs 3.66 to 3.73, below). Aldi was the fastest growing retailer in the 12 weeks to 11 June 2023, reaching a record market share of 10.2%, with Lidl's growth only just behind.[132] The effect of this development on market concentration is discussed below.

(b) The growth of online delivered groceries, which accelerated during COVID-19 lockdowns. These now account for over 11% of sales (a fall from its lockdown peak of 15%).[133] Around half of consumers do at least some of their grocery shopping online.[134] Online delivery is more concentrated – notably, the discounters do not offer this service – but most retailers, including the large supermarkets, offer the same prices online as in their larger stores. Many consumers can access a broader range of supermarkets online than might be available within a reasonable travelling distance.

(c) The growth of the convenience stores, driven in part by the entry and expansion of the large supermarkets into this sector. There are now almost 50,000 smaller stores across the UK. Tesco told us that the growth of the convenience store sector had not displaced any of the large stores but had grown as an additional channel offering additional options for consumers.[135]

(d) The CMA has reviewed a number of mergers in the sector and acted where necessary to prevent a loss of competition. Most notably, in 2019, it blocked a merger between Sainsbury's and Asda after finding it would

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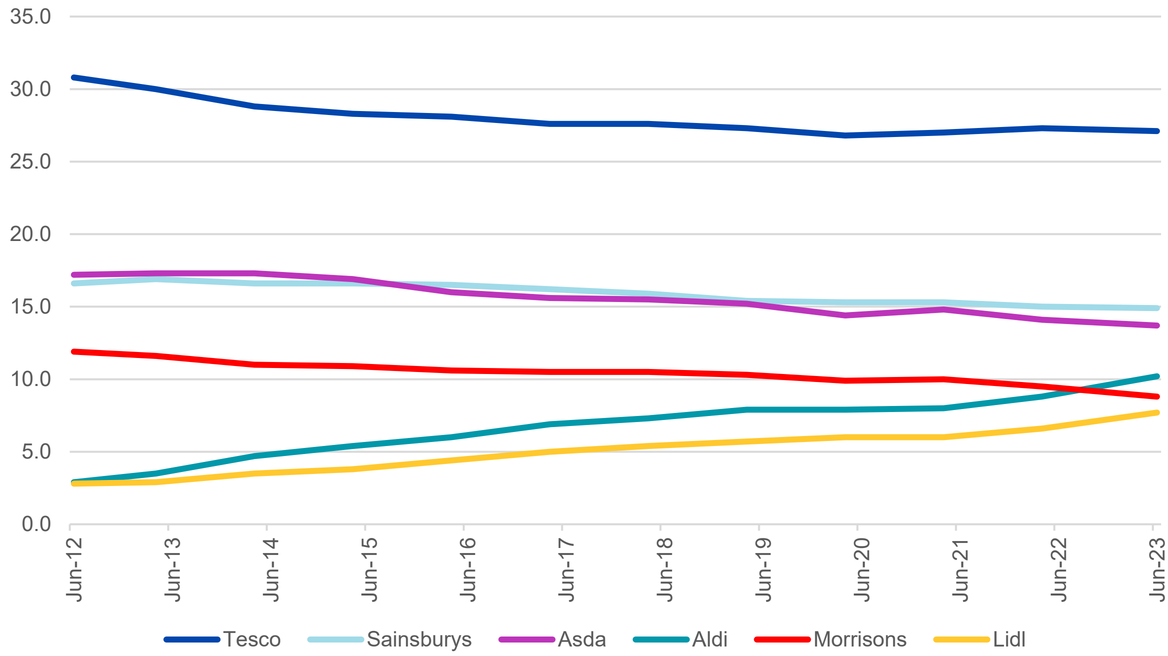
[131] Kantar grocery market share data, 12 weeks ending June 2023
[132] UK grocery inflation falls to slowest monthly rate this year but shoppers still feeling the pressure (kantar.com)
[133] Kantar May Retail Round Up.
Over half of UK consumers now purchase groceries online - Latest Retail Technology News From Across The Globe - Charged (chargedretail.co.uk)
[135] Meeting with Tesco 20 June 2023.

lead to increased prices in stores, online and at many petrol stations across the UK.[136]

3.10 Figure 13 below shows the change in market shares of the six largest retailers since 2012. The growth of the discounters, and the corresponding decline in the shares of the four large supermarkets, is evident from these trends. This has been reflected in a decline in the Herfindahl-Hirschman Index (HHI)[137] for the retail grocery sector, which fell from 1,760 to 1,440 in 2020. It has since stabilised, and in June 2023 stood at around 1,450.

Figure 13: Market Share of 6 largest retailers (%) June 2012- June 2023



Source: Kantar, with CMA analysis

Retailer profitability

3.11 This section sets out our analysis of supermarket profitability. We look first at retailers' publicly available financial statements, before turning to the more detailed information provided to us by the supermarkets in response to voluntary requests for information. In summary:

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[136] CMA blocks merger between Sainsbury's and Asda - GOV.UK (www.gov.uk)
[137] The HHI potentially reflects both the numbers of firms in the industry and their relative size. It is defined as the sum of the squares of all the market shares in the market, and so gives proportionately greater weight to the larger market shares. Markets with an HHI above 1,000 are likely to be regarded as concentrated: Competition Commission, Guidelines for market investigations (CC3), Annex A.

(a) Retailer revenues have increased in the past year, but by less than the rate of inflation. The retailers attribute this to consumers changing their behaviours to mitigate the impact of price rises (i.e. buying less and trading down to cheaper alternatives), and to retailers themselves not 'passing through' all of the increases in costs that they have incurred. We discuss how retailers approach cost increases in more detail in Section 4.

(b) Retailer gross margins and operating margins have fallen in the past year as retailers' costs, notably the cost of goods, the cost of labour and the cost of energy, have increased and exceeded increases in revenues.

(c) Retailers are forecasting increases in their operating margins in the current year to levels broadly in line with historical averages. It remains to be seen whether retailers will be able to rebuild margins in this way. The data that we have seen is mixed: some retailers have started to grow operating margins, but others have not.

Analysis of Supermarkets' Financial Statements

Revenue

3.12 We have analysed the financial statements of the four largest supermarkets[138] and the two discounters[139, 140] in the period from 2003 to 2023. Collectively, these six retailers account for over 80% of the grocery market in Great Britain.[141]

Figure 14 below compares the retail revenues reported by the major supermarkets and the discounters in their financial statements. These figures include not just groceries, but other sources of revenue including non-grocery items (eg clothing) and fuel.[142]

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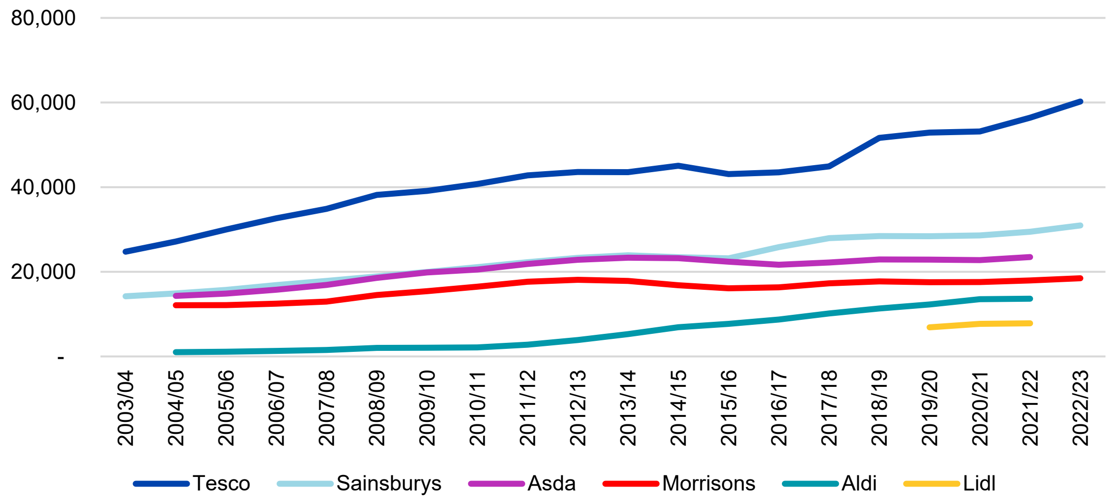
[138] Tesco plc (financial accounts up to 25 February 2023), Sainsburys plc (financial accounts up to 4 March 2023), Asda Group Limited (financial accounts up to 31 December 2021) and Wm Morrison Supermarkets Limited (financial accounts up to 30 October 2022).
[139] Aldi Stores Limited (financial accounts up to 31 December 2021) and Lidl Great Britain Limited (financial accounts up to 28 February 2022).
[140] Prior to FY 2019/20 Lidl's UK results were included within the financial statements of Lidl UK Gmbh (a company incorporated in Germany). Since 2019/20 Lidl's UK results have been presented within the financial statements of Lidl Great Britain Limited.
[141] Grocery Market Share - Kantar (kantarworldpanel.com)
[142] The other product categories included in retail revenues vary between retailers, depending on how the retailers internally monitor and report performance, and the scope of their business. For example, the supermarkets include fuel in their retail revenue, whereas the discounters do not sell fuel and Tesco includes the performance of its operations in the Republic of Ireland in its "UK & ROI" retail revenue, whereas all of the other retailers report their UK operations separately.

Figure 14: Comparison of the retail revenues reported by the supermarkets and the discounters in the period from 2003 to 2023



Source: Published accounts for Tesco plc, J Sainsbury plc, Asda Group Limited, Wm Morrisons Supermarkets Limited, Aldi Stores Limited, Lidl Great Britain Limited, CMA analysis

Note: Publicly available financial statements were not available for Asda, Aldi or Lidl for FY 2022/23.[143]

3.13 When the impact of one-off acquisitions is removed,[144] the growth in retail revenues broadly splits into three periods:

(a) From financial year (FY) 2003/04 to FY 2011/12 the supermarkets reported steady growth, with annualised revenue growth rates of between 5.6% (Morrisons) and 7.1% (Tesco). In this period Aldi grew at an average rate of 18.9%.[145]

(b) In the period from FY 2012/13 to FY 2017/18 supermarket retail revenues slowed and in one instance decreased.[146] At the same time Aldi's revenue increased by 19.9% year on year, reflecting the continued rapid increase in discounter market share.

(c) Since FY 2018/19, the supermarkets and the discounters have all reported growth in retail revenues.[147] Albeit the discounters' revenues have continued to grow faster than the supermarkets.

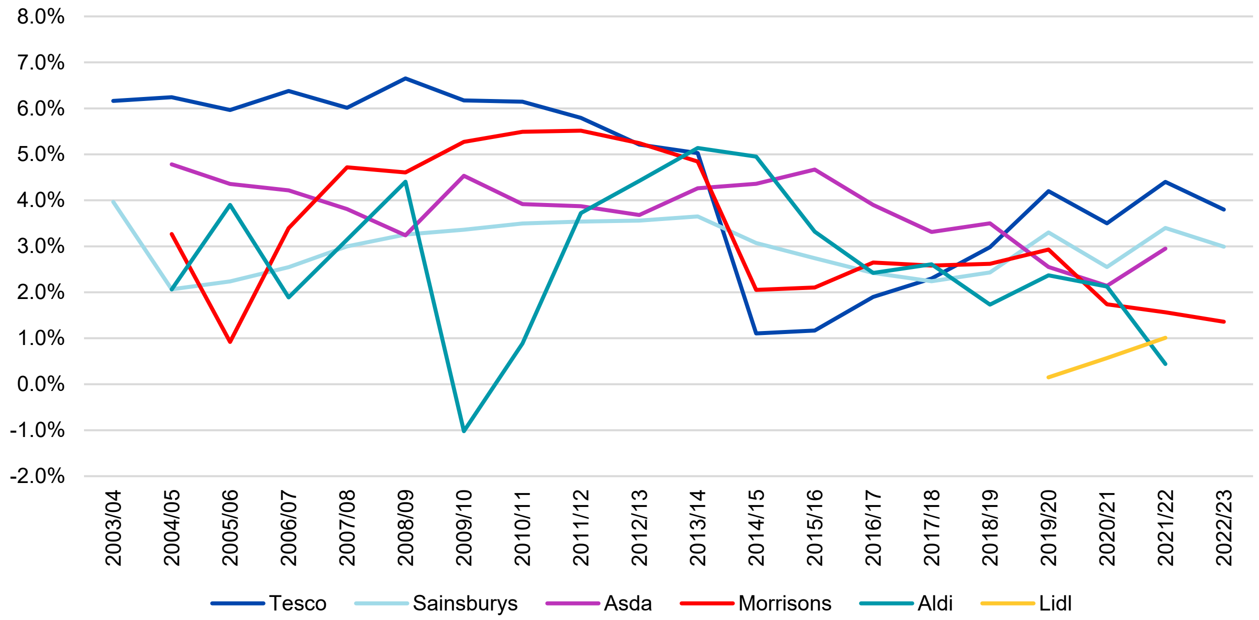
143 Publicly available financial statements were not available for Asda, Aldi or Lidl for FY 2022/23. Companies have nine months to file their accounts and Asda, Aldi and Lidl have not reached the filing deadline for their FY 2022/23 financial statements.
144 Sainsbury's acquisition of Argos in April 2016 and Tesco's acquisition of Booker in November 2017.
145 Lidl only started reporting its UK operations separately in FY 2019/20.
146 Morrisons had an annualised rate of growth of -0.3% in the period from FY 2012/13 and FY 2017/18.
147 Annualised growth rates for the supermarkets in the period from FY 2018/19 to FY 2022/23 ranged from 1.4% (Asda and Morrisons) to 6.2% (Tesco). Annualised growth rates in the same period were 6.5% for Aldi and 6.8% for Lidl.

3.14 In the most recent financial year (FY 2022/23) supermarkets' revenues increased. Tesco's revenue increased by 6.8%, Sainsbury's by 5.1% and Morrisons by 2.8%.[148] The increases in revenue are below the rate of inflation. In real terms, when the impact of inflation is removed, revenues at all three retailers fell in FY 2022/23.

Profitability

3.15 Figure 15 below compares the operating margins[149] for the retail operations of the supermarkets and the discounters. Operating margins in their statutory accounts are calculated as the revenues the business receives less the costs attributable to the point of sale (such as the cost of goods sold, warehousing costs, transportation costs and the cost of operating the stores), less administrative expenses, as a percentage of total revenues.

Figure 15: Comparison of the operating margins reported by the supermarkets and the discounters in the period from 2003 to 2023



Source: Published accounts for Tesco plc, J Sainsbury plc, Asda Group Limited, Wm Morrisons Supermarkets Limited, Aldi Stores Limited, Lidl Great Britain Limited, CMA analysis
Note: Publicly available financial statements were not available for Asda, Aldi or Lidl for FY 2022/23.[150]

[148] Publicly available financial statements were not available for Asda, Aldi or Lidl for FY 2022/23. Companies have nine months to file their accounts and Asda, Aldi and Lidl have not reached the filing deadline for their 2022/23 financial statements.
[149] We have used retail operating profits (including fuel) for Tesco, Sainsbury's and Asda in our analysis. We have used retail underlying profits before exceptional items for Morrisons. We have used operating profits for Aldi and we have used profits before interest and tax for Lidl, which are analogous to operating profits.
[150] Publicly available financial statements were not available for Asda, Aldi or Lidl for FY 2022/23. Companies have nine months to file their accounts and Asda, Aldi and Lidl have not reached the filing deadline for their FY 2022/23 financial statements.

3.16 Analysis of figure 15 shows that, until FY 2013/14 the major supermarkets' retail operating margins ranged from 1% to 7%, with the average being 4.4%. In subsequent years, these margins declined, and by FY 2020/21 they ranged from 1% to 5%, with the average being 2.8%. This fall coincided with a period during which the discounters' market share was increasing.

3.17 The operating margins for the discounters have been lower than the supermarkets, averaging 1.7% in the period from FY 2015/16 to FY 2021/22.

3.18 In the most recent financial year (FY 2022/23) Tesco's, Sainsbury's and Morrisons' operating margins fell, albeit they remained broadly in line with average margins for the last five years. Our analysis of the other retailers' revenues and profitability in FY 2022/23 is limited by the lack of publicly available information. The discounters and Asda are yet to file their financial statements for FY 2022/23,[151] while Morrisons' most recent financial statements cover the year to October 2022.

Analysis of information supplied in response to our request for information

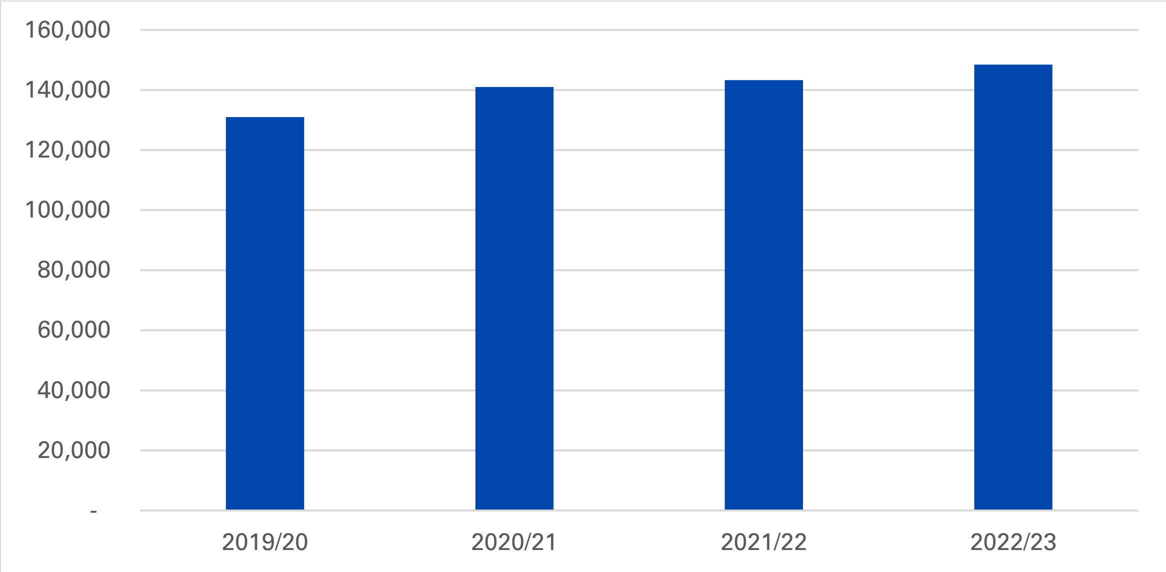
3.19 To gain a more up to date and detailed understanding of the performance of the retailers' grocery businesses, we requested information from the major supermarkets, the discounters and other retailers, including Iceland, Co-op, M&S, Waitrose and Ocado. We received responses from all of the retailers, which we summarise in this section.

Revenues

3.20 Figure 16 shows the aggregate revenues for retailers' grocery businesses between 2019/20 and 2022/23. Revenues increased by 3.6% in FY 2022/23 (the most recent year), which is less than the rate of inflation. In real terms, adjusting for inflation, aggregate retailer revenues fell by 6.6% in FY 2022/23.

[151] Privately owned companies are required to file their financial statements within nine months of the end of the financial year.

Figure 16: Aggregate revenues for the retailers' grocery businesses between FY 2019/20 and FY 2022/23 (£m)



Source: RFI responses from retailers, CMA analysis

3.21 The retailers explained that revenues have not kept pace with inflation because:

(a) consumers have reduced the volume of goods that they purchase;

(b) consumers have 'traded down' from the retailers' core ranges to the retailers' value ranges, which are cheaper;

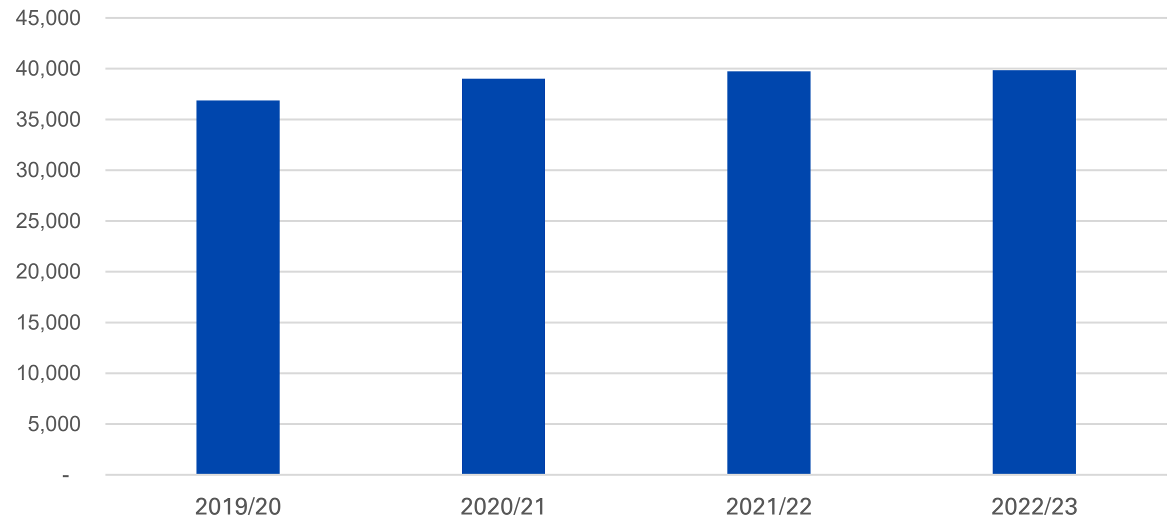
(c) consumers have done more shopping at the discounters, which have tended to be cheaper; and

(d) they had not 'passed through' all of the cost increases that they have incurred, and that this was a further reason why revenues have not increased in line with inflation.

Gross profits

3.22 Figure 17 below shows aggregate gross profits for the retailers over the last four years. The definition of gross profit can differ between retailers but is broadly calculated as revenues less the cost of goods.

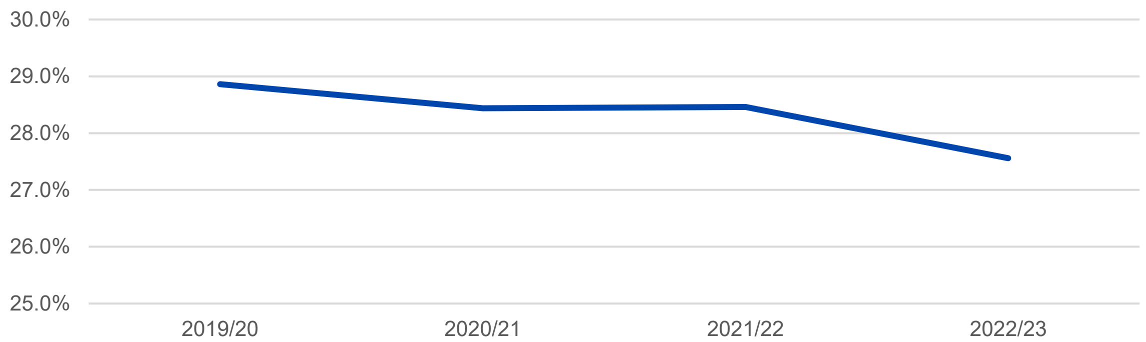
Figure 17: Aggregate gross profit for the retailers' grocery businesses between FY 2019/20 and FY 2022/23 (£m)



Source: RFI responses from retailers, CMA analysis

3.23 Aggregate retailer gross profits increased by 0.3% in FY 2022/23. This is less than the increase in aggregate revenues (3.6%), meaning that the average cost of goods has increased more than average selling prices. As a result, the weighted average gross margin – calculated as aggregate gross profit as a proportion of aggregate revenue – has decreased, as set out in figure 18 below.

Figure 18: Weighted average gross margin for the retailers' grocery businesses between FY 2019/20 and FY 2022/23



Source: RFI responses from retailers, CMA analysis

3.24 The retailers explained that the reason for the decrease in average gross margins is due to:

(a) Consumers 'trading down' from the retailers' core ranges to the retailers' value ranges, which tend to be lower margin. The retailers' comments are

consistent with our review of profitability data by product range, which indicates that value ranges tend to have a lower (and sometimes negative) gross margin.

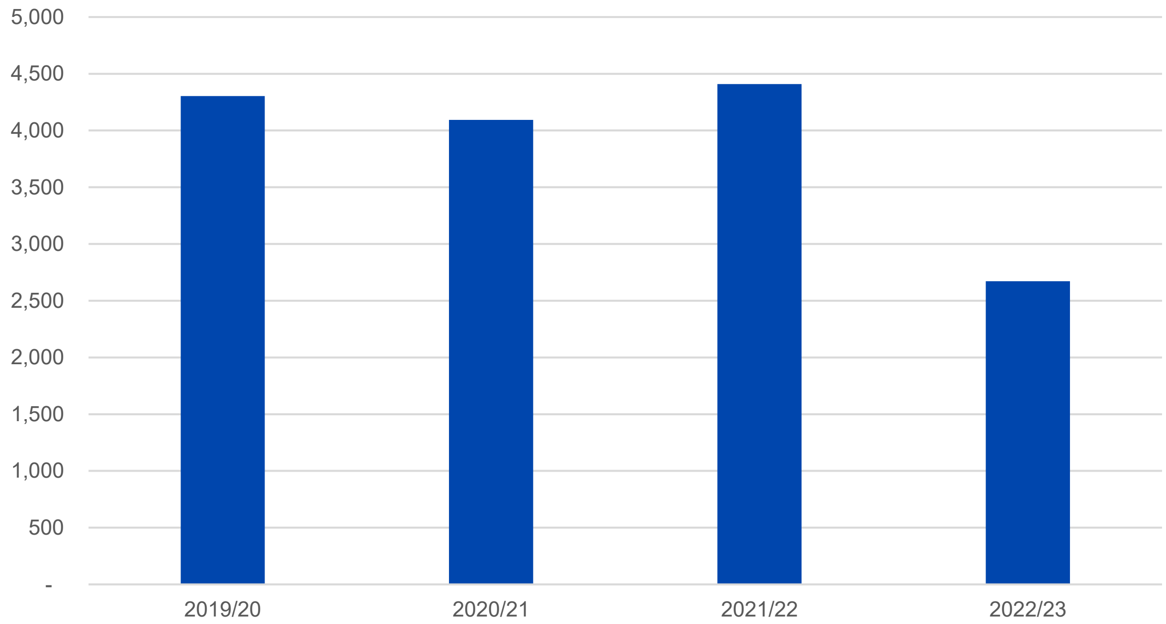
(b) Retailers not 'passing through' all of the cost increases they have paid to their suppliers.

Operating profits

3.25 Our analysis of the retailers' financial data indicates that their largest operating cost is the cost of labour, with other significant operating costs being: property costs, energy costs, distribution costs (mainly fuel costs), marketing costs, information technology costs and central administrative costs.

3.26 In figure 19 below, we summarise the aggregate operating profits for the retailers.

Figure 19: Aggregate operating profit for the retailers' grocery businesses between FY 2019/20 and FY 2022/23 (£m)



Source: RFI responses from retailers, CMA analysis

3.27 Analysis of figure 19 shows that aggregate retailer operating profits decreased by 41.5% in the most recent year. The retailers explained that operating profits have decreased mainly due to:

(a) the reduction in gross margin (as noted above);

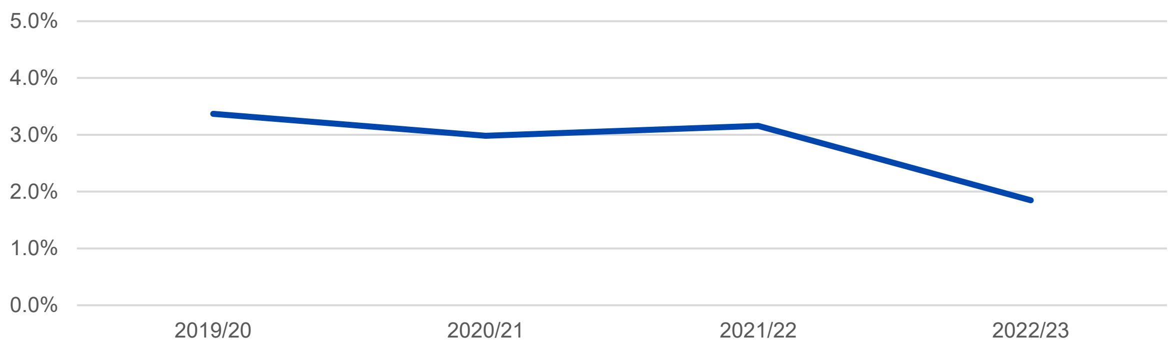
(b) increases in the wholesale cost of energy; and

(c) increases in staff costs caused by increases in the living wage.

3.28 The retailers added that the reduction in their operating profits in FY 2022/23 would have been greater had they not implemented cost reduction programmes to manage and reduce their operating costs.

3.29 The decrease in the aggregate operating profit is also illustrated in figure 20 below, which shows a decrease in the weighted average operating margin (aggregate operating profits as a proportion of aggregate revenues).

Figure 20: Weighted average operating margin for the retailers' grocery businesses between FY 2019/20 and FY 2022/23



Source: RFI responses from retailers, CMA analysis

3.30 In summary, in FY 2022/23 the retailers' aggregate operating profits have reduced in both absolute and percentage terms. The decrease in the aggregate operating margin is consistent with the retailers' explanation that they have not 'passed through' to consumers all of the increases in labour and energy costs that they have incurred.

Forecast operating margins

3.31 As part of our request for information, we asked the retailers to provide details of their financial performance in the most recent months and their forecast profitability for the current year (FY 2023/24) and most retailers provided this information.

3.32 The forecasts show that retailers are planning to increase their operating margins in groceries in the current year. If the retailers achieve their planned increases in operating margins, it would broadly return operating margins to the levels that the retailers achieved between FY 2019/20 and FY 2021/22, when the retailers' weighted average operating margin was between 3% and 3.5%.

3.33 The financial performance data for the most recent months (April and May 2023) indicates that there is mixed evidence on whether retailers will be able to increase their margins: some retailers are achieving their forecasts, while others are underperforming against them. Hence, we are yet to see evidence of sustained growth in operating margins across the industry.

3.34 Our analysis of retailers' recent financial data and forecasts broadly aligns with the views of the industry analysts who we have spoken to, who predict that operating margins will either remain flat or increase very steadily over the next few years.

3.35 This is also consistent with the guidance provided by Tesco and Sainsbury's in their most recent trading statements. Tesco notes that they 'expect to be able to deliver a broadly flat level of retail adjusted operating profit in 2023/24'[152] and Sainsbury's forecasts underlying profit before tax for FY 2023/24 in line with FY 2022/23. [153, 154]

3.36 We consider that, if retailers are likely to 'rebuild' margins, this would likely occur in the coming months. Retailers' input costs are likely to fall – or at least rise less quickly – as lower prices for energy and commodities feed through, and consumers do not necessarily have a clear idea of what the 'right' price should be in the context of high but falling food price inflation.

3.37 The evidence we have received to date on whether retailers will be able to build margins in groceries is mixed. The existing competitive environment is likely to put limits on the extent to which retailers can achieve higher margins without losing market share. However, consumers will understandably be looking for reassurance that effective competition will ensure continued pressure on retailers to pass on cost savings to their customers. This is something we will be monitoring carefully in the months ahead, particularly as input costs fall, so that people can continue to have confidence that retail competition issues are not contributing to the level or persistence of groceries price inflation.

Retailers are seeking cost savings to protect margins

3.38 Several retailers told us that they were looking for efficiencies and other cost savings to protect against higher costs. Given that labour is a major operating

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[152] 1Q Trading Statement 2023/24 (tescoplc.com)
[153] Sainsbury's recorded an underlying profit before tax of £690m in FY 2022/23 and forecasts an underlying profit before tax of between £640m and £700m in FY 2023/24.
[154] In its FY 2023/24 Q1 Trading Statement, Sainsbury's notes that its "Outlook [is] unchanged" from the guidance included in its FY 2022/23 annual report: J Sainsbury plc Q1 2324 Trading Statement.pdf (sainsburys.co.uk).

cost, one particular focus is on ways to reduce these costs. One retailer told us they were particularly looking for ways to reduce labour costs, such as more self-service tills, shift optimisation and shelf-ready packaging.

Price competition and consumer behaviour

3.39 Below, we set out the evidence we have collected on how retailers set prices, and how consumers respond to price differences and price changes between retailers. Consumers are increasingly concerned about the rising price of groceries. In a well-functioning market, we would expect in this context to see retailers seeking to retain customers, and win new ones, by competing on price; and we would expect consumers to be able to identify and respond to price differences between retailers.

3.40 In summary:

(a) Retailers closely monitor competitors' prices, and aim to stay competitive with rivals, particularly for the most commonly purchased items, with a view to sustaining and increasing sales volumes. Given the number of retailers and items in question, this overall approach manifests itself in a range of different pricing strategies.

(b) Consumers are increasingly prepared to shop around to find the best prices, and lower-priced retailers have been successful in winning market share.

Observed price variation between retailers

3.41 The discounters offer the lowest prices in the market, as shown in Which?'s monthly supermarket price comparison.[155]

[155] Which? Supermarket price comparison. Which? tracks the daily prices of up to 200 branded and own-label products over the course of a month to work out the average cost per item. These averages are added up to get a 'trolley total' for each retailer. Which? produces a larger 'trolley' comparison of Asda, Sainsbury's, Morrisons, Tesco, Ocado and Waitrose, as well as a smaller 'basket' comparison which also includes the discounters, Aldi and Lidl. Throughout this document, we only used the smaller 'basket' comparison data. The contents of the basket vary from month to month and products are regularly rotated. Which? data is supplied by an independent price comparison company.

Table 2: Which?'s price comparison across the retailers, May 2023

Supermarket	Average basket price[156] May 2023
Aldi	£68.60
Lidl	£70.51
Asda	£76.45
Sainsbury's	£77.13
Tesco	£77.56
Morrisons	£79.09
Ocado	£83.90
Waitrose	£86.91

Source: Which?

3.42 Although they remain cheaper overall, in general, inflation rates for the discounters than among other retailers, as shown in the Which?[157] data below:

Table 3: Which's inflation comparison across the retailer, May 2023

Supermarket	Annual inflation for the month of May 2023
Lidl	23.5%
Aldi	22.0%
Morrisons	17.5%
Asda	17.1%
Tesco	14.2%
Sainsbury's	14.0%
Waitrose	12.6%
Ocado	9.6%

Source: Which?

3.43 The higher inflation seen at the discounters is not necessarily a sign of them becoming less competitive. When margins are slim, more costs may need to be passed on to stay viable. There is also a mathematical reason why a lower-priced retailer may have higher rate of inflation: for example, if two products increase their retail price by 10p due to rising costs, this will equate to 10% inflation on a product that was previously £1 and 20% inflation on a product that was previously 50p.

How retailers set their prices

3.44 We spoke to all of the retailers about their pricing strategies to understand how they compete. Retailers generally have national pricing policies, whereby

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[156] Average price for a standardised basket of equivalent goods selected by Which?.
[157] Supermarket food price inflation tracker from Which? - Which?

prices for the same product in the same store format across the country are identical.[158] Retailers that operate different store formats generally charge higher prices in convenience stores than in supermarkets. Those that offer online shopping generally charge the same price online as available in supermarkets, plus a delivery charge.

3.45 All of the retailers told us that they closely track their competitors' prices, and that they needed to stay competitive on price to avoid losing volume. Retailers stated that lower volumes put pressure on operating margins because they have a range of fixed costs (eg energy, property costs and, to some extent, wages).

3.46 Being 'competitive' on price means different things to different retailers. Generally, retailers look to assess their competitiveness with reference to a basket of commonly purchased products. The discounters (Aldi and Lidl) generally aim to price below the cheapest supermarket. Other retailers aim to set prices close to, matching or slightly below competitors. Some use the discounters as a reference point; some use Tesco (being the supermarket with the largest share); while others compare to more than one other retailer.

3.47 Retailers differed in the extent to which input costs, and the prices paid to suppliers, informed their retail pricing decisions. For some, this was an important consideration, while others set prices (at least for the basket of most commonly purchased items) exclusively with reference to what competitors are charging.

3.48 In addition to tracking and staying competitive in relation to baskets of commonly purchased goods, larger retailers generally consider it important to match, or at least stay close to, the lowest market prices for certain very popular items (eg milk, eggs, bread, chicken and bananas), even if costs were not covered. These are sometimes classed as 'known value items': items which consumers are very familiar with; are aware of how much they cost; and which, if not priced competitively, may cause them to see the retailer as being 'bad value'. As Kantar says, 'retailers know just how important it is to offer even small savings on staple products like milk to get customers through the door'.[159]

3.49 In addition to their general approach of tracking commonly purchased items, some retailers have introduced publicised price-matching policies to compete with the discounters. Tesco and Sainsbury's both have an Aldi price-match

[158] Some retailers that operate in Northern Ireland charge different prices here than in Great Britain.
[159] https://www.kantar.com/inspiration/fmcg/2023-wp-uk-grocery-sees-218-million-royal-sales-bump-as-inflation-inches-down

scheme where several hundred items are matched to Aldi prices. These price matches are advertised in store and online alongside the relevant products.

3.50 Tesco and Sainsbury's 'Aldi price-match' schemes tend to focus on the products which people most commonly buy (eg milk, eggs, bread, chicken, and bananas): the price-match products tend to represent a fairly small number of the total number of products sold (for example, over 500 for Tesco[160] and around 350 for Sainsbury's) but account for a much higher volume. One retailer's view was that the 'Aldi price matching schemes' were a method of generating publicity for the policy that these retailers would adopt anyway of matching the lowest prices in the market for some key lines.

3.51 Some retailers have also been running 'price-lock' campaigns to guarantee not to raise prices of certain products for a given period of time (eg 2 months),

Box 1: Pricing strategies and competition in road fuel and groceries

In the final report of our road fuel market study, we observed how the fuel pricing strategies of supermarkets could limit competition. In particular, we found that Asda and Morrisons played a price leadership role, setting profit targets for fuel, and adjusting prices to meet them. Tesco and Sainsbury's priced at a differential to the two 'leaders'. This dynamic meant that, as Asda and Morrisons raised their margin targets, there was no significant loss of market share: that is, the other two supermarkets followed the leaders upwards, rather than seeking to undercut them.

We have not seen evidence of the same dynamic at work in respect of the groceries pricing strategies of large retailers. In particular:

- There is not such a straightforward leader-follower dynamic. Retailers use a variety of reference points (in terms of both products and other retailers) to evaluate their price competitiveness. This is reflected in Figures 21and 22, which shows how the relative price levels of the large retailers fluctuate.
- There is evidence of price competition, with the major supermarkets' groceries prices gradually becoming closer to those of the discounters (see Figure 22); margins across the large retailers declining (see Figure 20); and the most price competitive retailers winning market share (see Figure 23). This contrasts with the fuel market, where the price differential between retailers has not fallen, margins have risen and market share has remained relatively stable.
- Pricing strategies in respect of 'known value items' may more closely resemble those used in fuel retailing. However, the approach is not necessarily driven by the price leadership of a single retailer; but instead by the importance for retailers not to appear 'expensive' versus their competitors for these items.

160 https://www.tesco.com/groceries/en-GB/zone/aldi-price-match

though retailers have told us that these may be phased out to allow some price reductions to occur, as input costs fall in some categories.

Consumer responses to price changes

3.52 For competition to be effective, consumers need to be able to discover information on what different competitors offer (**access**), evaluate which offering best meets their needs, in terms of price and quality (**assess**) and switch between different sellers in response (**act**). The access, assess and act framework is a useful way to examine whether a market is working well on the demand side.

Can consumers access and assess price information?

3.53 Retailers argued that customers were 'savvy' and would shop around for the best deal, especially in the current climate. They also argued that consumers could – and did – easily compare grocery prices between stores, either in person or online and would therefore be aware of where to find the cheapest options.

3.54 The evidence we have seen on consumer behaviour and market shares over time (see paragraphs 3.62 to 3.72) indicates that many consumers do switch and shop around between retailers in response to differences in price competitiveness across commonly-purchased groceries. We have not explored in detail how consumers make these judgements, although we note that some organisations produce rankings of the "best value" retailers: for example, Which? publishes widely-reported monthly rankings of 8 retailers according to the price of a basket of commonly-purchased goods.[161]

3.55 For consumers looking to compare prices for products in the same store, prices for individual products are usually clear and accurate.[162] However, this is not always the case. For example, a review by the Society of Chief Officers of Trading Standards in Scotland (SCOTSS) found that a small percentage of products did not have prices displayed, or were incorrectly charged at the till, and that convenience stores had lower compliance than national retailers.[163]

3.56 Moreover, making certain comparisons – for example, between the value of different pack sizes – requires clear and accurate unit price information. Alongside this update, we have published our review of how retailers are

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[161] https://www.which.co.uk/reviews/supermarkets/article/supermarket-price-comparison-aPpYp9j1MFin
[162] The Price Marking Order 2004 requires that retail goods have a selling price that is unambiguous, easily identifiable, includes VAT and is clearly legible.
[163] The SCOTTS Supermarkets and Convenience Shops Pricing Project 2022-23, which ran from October to December 2022, found that 4.1% of the total products (18,559) examined at national retailers did not display a selling price. 3.7% of products tested at point of sale (5,675) at national retailers were incorrectly charged at the checkout. For convenience stores, 14.3% of products did not display a selling price and 9.7% were incorrectly charged.

displaying unit prices.[164] This review found some problems with unit pricing, which may affect consumers' abilities to identify the best value product. For example, we found retailers using inconsistent measurements to unit-price comparable products within their stores and online, making it difficult to compare prices. We also saw issues with the legibility of unit pricing information in store, and that unit prices were not always displayed for products on promotion.[165]

3.57 Comparing prices for individual items, and personal shopping baskets,[166] *between* stores is possible, but potentially time-consuming where large numbers of products are involved. Consumers are faced with a choice either of visiting multiple stores; of looking online at retailers' websites;[167] or of using price comparison apps such as Trolley.co.uk.[168]

The role of loyalty cards

3.58 In some retailers, discounts or promotional offers are increasingly only available to customers with loyalty cards. For example, Tesco told us that all in-store promotional discounts (as opposed to price-matching or price-freezing schemes) require a Clubcard to access. Sainsbury's introduced discounts for Nectar card holders in April 2023 and plans to expand the number of promotions within the scheme. It also plans to introduce 'further enhancements' this year, including personalised discounts for online shopping.[169] The Co-op recently introduced 'member prices' for certain products, accessible only to its membership.[170]

3.59 It is possible that the growth of promotional discounts linked to loyalty schemes could affect customers' willingness and ability to respond to price differences between retailers. For example:

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[164] https://www.gov.uk/cma-cases/unit-pricing
[165] We consider that some, but not all, of the problems we have found in this review are likely to be due to ambiguities in the legislation. We have therefore made to the Department for Business and Trade to reform the Price Marking Order 2004. We are also calling on all retailers to comply with their legal obligations to ensure the accuracy and legibility of all their unit prices and asked that they take steps to ensure that all the unit pricing information they give to consumers is clear and consistent, both in store and online.
[166] As opposed to the standardised baskets used by, for example, Which? in its rankings of the best-value retailers.
[167] Although Aldi does not offer online delivery, it offers click and collect and therefore its prices are available online. Lidl appears to have prices online for at least some products to enable a price comparison
[168] Heinz Tomato Ketchup - Top Down Squeeze Bottle (910g) | £4.00 Best Price | Compare Prices & Where To Buy - Trolley.co.uk
[169] https://www.about.sainsburys.co.uk/~/media/Files/S/Sainsburys/documents/reports-and-presentations/2023/Q1_Trading_Statement_2324/J%20Sainsbury%20plc%20Q1%202324%20Trading%20Statement.pdf
[170] https://www.co-operative.coop/media/news-releases/co-op-set-to-turbo-charge-its-membership-proposition-with-gbp240m-investment

(a) If supermarkets do not display unit prices for promotional deals, this could affect customers' ability to make comparisons. As noted above, our recent review found that unit prices were not always displayed for products on promotion.

(b) If it is difficult or time-consuming to sign up to loyalty schemes, this could inhibit switching. We have not seen evidence to suggest that this is likely to have a material impact on the strength of competition between retailers in the current market conditions, given that it is relatively straightforward to sign up for more than one scheme. According to Kantar data, more than 90% of consumers have at least one loyalty card and usage is rising.[171]

Conclusion on consumers' ability to access and assess pricing information

3.60 At a time of high inflation and pressure on household finances, it is more important than ever that consumers are able to access and assess price information, so they can assure themselves that they are getting the best possible deal. There are some obstacles that prevent consumers from doing this, meaning the prices they pay in certain circumstances may be higher than they need to be. In principle, such obstacles can also inhibit effective competition, by reducing the incentives on retailers to keep prices low, although we have not seen evidence to date that this is currently happening.

3.61 Our review of unit pricing has made recommendations to government to address ambiguities in the legislation governing the display of unit prices; and it calls on retailers to comply with their legal obligations to ensure the accuracy and legibility of all their unit prices.

Are customers acting in response to price changes?

Retailer views

3.62 The retailers have told us that customers are very focused on value at the moment and more price sensitive than ever before. They argued that they cannot raise prices to an uncompetitive level, even for a short while, without losing volume to competitors and changing customer perceptions of whether they offer value.

3.63 One retailer said that customers are less likely to pay more for softer benefits (such as the in-store experience). This aligns with the evidence that

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[171] https://www.kantar.com/inspiration/fmcg/2023-wp-battle-for-shoppers-heats-up-as-grocery-price-inflation-hits-new-high

consumers are increasingly visiting the discounters which focus more on price than the quality of the shopping experience. One retailer told us that they had seen more volume loss in stores that competed more directly with discounters than in stores that did not.

3.64 We heard that customers were reverting to shopping little and often (that is, more frequent shops with smaller basket sizes on each visit) which is consistent with people spreading shopping across more than one retailer.

The evidence suggests that consumers are switching between retailers

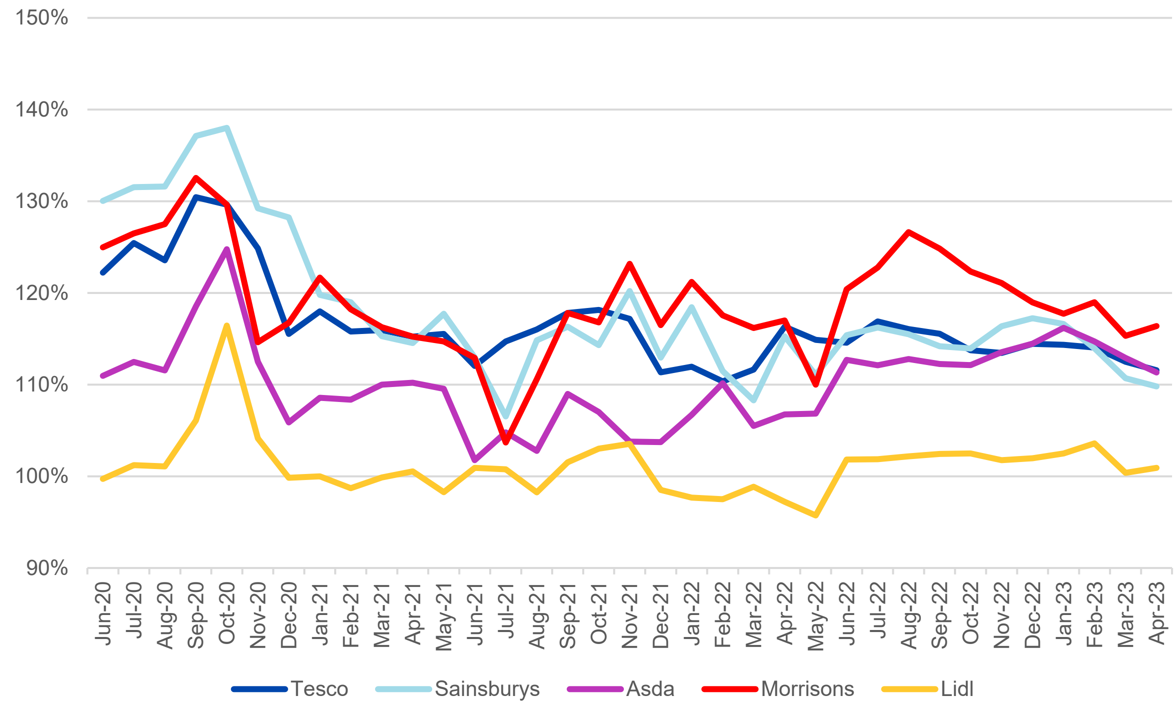
3.65 Consumers appear to be reacting to changes in price – or at least to higher prices generally – by changing their shopping habits. ONS data suggests that 49% of people are shopping around more because of increases in the cost of living.[172] A recent survey supplied by a retailer found that three quarters of people had changed their shopping habits over the past 12 months, with 13% having changed their main supermarket and 22% saying that they were shopping at a greater variety of supermarkets. According to Kantar, consumers visit at least three retailers in any given month on average.[173]

3.66 Aldi and Lidl have been growing particularly fast lately, as customers seek out the cheapest prices in the market. During the 18 months between June 2020 and December 2021, the market shares of Aldi and Lidl grew by 2.7% and 8.6% respectively. However, in the 17 months between January 2022 and May 2023, their shares grew by 15.4% (Aldi) and 11.3% (Lidl).[174]

3.67 We have tested the claim that consumers react to price changes by shopping elsewhere. We have compared the relative price of each of the major supermarkets, and Lidl, as a percentage of Aldi's basket price.[175]

Figure 21: Price as % of Aldi

[172] Public opinions and social trends, Great Britain - Office for National Statistics
[173] https://www.kantar.com/inspiration/fmcg/2023-wp-battle-for-shoppers-heats-up-as-grocery-price-inflation-hits-new-high
[174] CMA analysis of Kantar market share data.
[175] Using Which? monthly supermarket basket price data. Which? tracks the daily prices of up to 200 branded and own-label products over the course of a month to work out the average cost per item. These averages are added up to get a 'trolley total' for each retailer. Which? produces a larger 'trolley' comparison of Asda, Sainsbury's, Morrisons, Tesco, Ocado and Waitrose, as well as a smaller 'basket' comparison which also includes the discounters, Aldi and Lidl. Throughout this document, we only used the smaller 'basket' comparison data. The contents of the basket vary from month to month and products are regularly rotated. Which? data is supplied by an independent price comparison company.



Source: Which?, CMA analysis

3.68 Interpretation of the data is made more difficult by the changes to the contents of the basket each month, depending on which products are available to be compared at every retailer. Some months will involve a comparison of a smaller basket than others. This could explain some of the sudden movements in relative price. Nonetheless, it gives a rough idea of changes in relative pricing position between the retailers. We can observe a number of things from the changes in retail prices:

(a) Lidl's price generally tracks Aldi's price fairly closely.

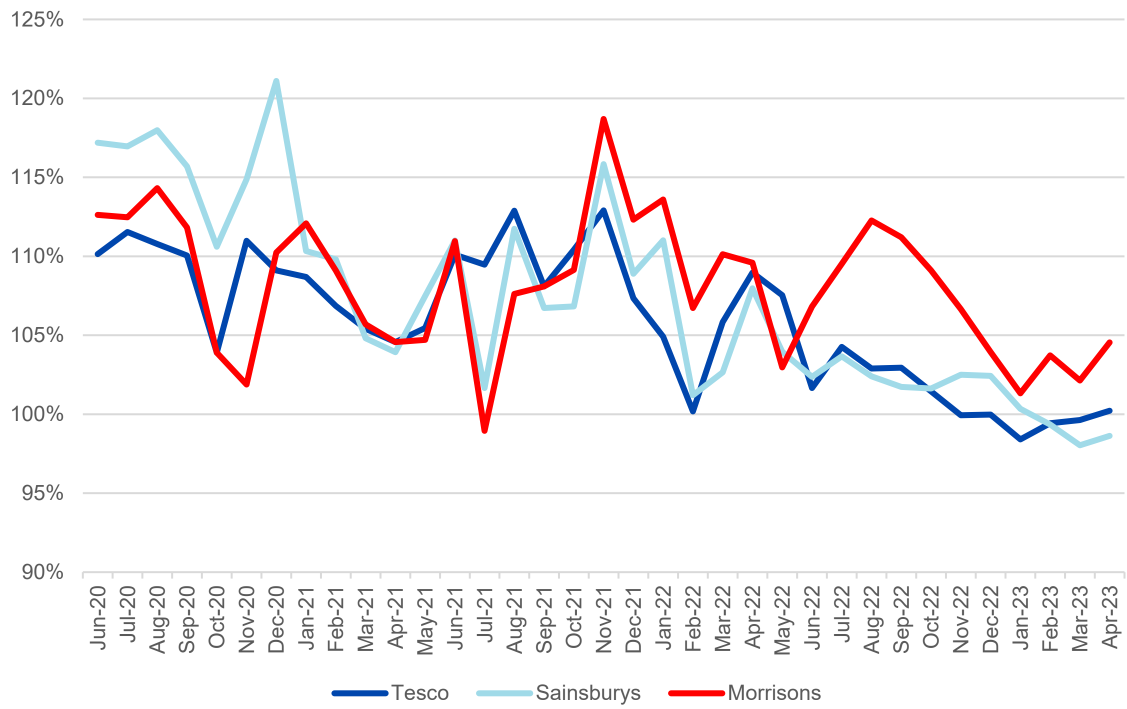
(b) Tesco and Sainsbury's prices are closer to those of the discounters than they were in mid-2020.

(c) Relative price levels fluctuate, suggesting that there is not a straightforward policy of price tracking among the major supermarkets, but that strategies have adapted.

3.69 We have also looked at the relative prices for the four major supermarkets, in comparison to Asda's prices.[176] Tesco and Sainsbury's have become more price competitive with Asda, while Morrisons' prices have remained above the rest of the major supermarkets. Fluctuation of relative prices again suggests that there is not a straightforward policy of price tracking.

[176] Based on Which?'s monthly basket analysis.

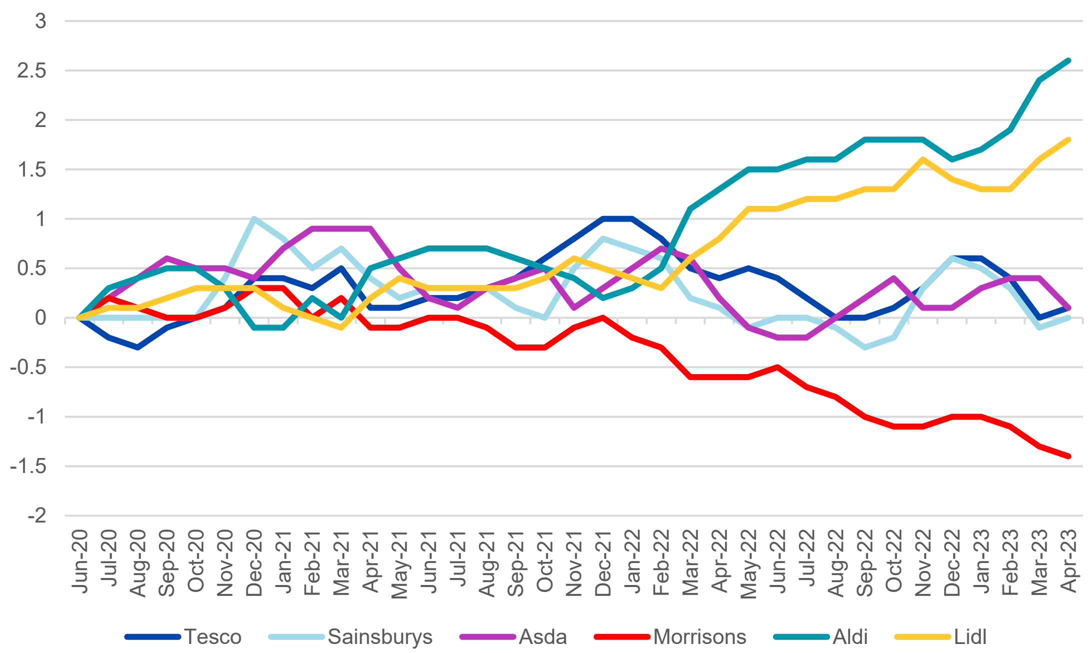
Figure 22: Supermarket prices as % of Asda price



Source: Which?, CMA analysis

3.70 We can compare the changes in relative prices to changes in market share over the same period, as shown in figure 23 below. The recent uplift in the shares of Aldi and Lidl is clearly visible.

Figure 23: Change in market share since June 2020



Source: Kantar, CMA analysis

3.71 Price is not the only consideration that people take into account when choosing which supermarket to shop at, out of the range they can access. They will also consider range, convenience and quality. Nonetheless, we can observe some changes in market share which correspond to changes in relative prices, for example:

(a) The growth of the discounters is clear, especially over the past 18 months, as food price inflation has risen.

(b) Morrisons' market share has fallen at around the same time as its relative price has risen.

(c) Sainsbury's' relative price was high from June to October 2020. It then fell fairly rapidly, and we can see a corresponding increase in Sainsbury's' market share during this period.

3.72 We conclude that:

(a) The relative prices within the group of major supermarkets, and between the major supermarkets and the discounters, are not static. This suggests that retailers do not just passively track their competitors' prices but have conscious and adaptive pricing strategies.

(b) Although the price differential between the major supermarkets and the discounters has generally reduced, consumers are switching in ever higher numbers to Aldi and Lidl in search for the lowest prices, suggesting that consumers are highly price sensitive in aggregate.

(c) Within the group of the major four retailers, it appears that changes in relative prices lead to changes in market shares, suggesting that consumers are aware of changes in relative prices and respond by switching to retailers that they consider to offer better value.

(d) Market shares have also changed over time; pricing strategies are not passive tracking and market shares are not static but have changed as a result.

The role of convenience stores

3.73 The CMA has previously defined convenience stores as stores under 280 square metres.[177] They typically fall into three categories, each comprising around a third of the total number of stores:

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[177] CMA, Sainsbury's/Asda Final report, p.65.

(a) independent convenience stores (of which 80 to 90% will operate one store only);

(b) convenience multiples (eg McColls) and symbol group-affiliated franchises (eg Costcutters); and

(c) supermarket convenience stores (eg Tesco Express).

3.74 Convenience stores offer a 'broad but shallow' range of products (at about 4,300 stock-keeping units per store)[178] with a focus on availability and accessibility. The products sold can vary based on location and customer need: a rural convenience store may stock more non-food items compared to a city-centre convenience store offering more food on-the-go.

3.75 There are almost 50,000 convenience stores in the UK.[179] The sector has expanded considerably in the last 10 to 15 years, primarily due to supermarket entry and expansion in this sector, but the majority (around 70%) of convenience stores are independently owned or operating under a symbol group like Nisa, though these stores represent a lower share of sales volume.

3.76 In general, for a given level of sales volume, it costs more to run a convenience store. It requires more deliveries, of lower volumes, greater staffing and rents may be higher for a given sales volume. The prices in convenience store outlets of the major supermarkets tend to be around 10% higher than a large store of the same brand.[180] Other convenience stores will vary in their price premium, depending on their costs and the local competitive conditions (local customers may have few alternatives) but will tend to be higher still than the supermarket convenience stores because they lack the buyer power and economies of scale of the supermarkets. Independent retailers also need to buy from wholesalers, which adds in another layer of margin.

3.77 Although more expensive and with a much smaller range than major supermarkets, convenience stores offer a useful local service and allow people to shop without making a long journey. They often serve more of a 'top-up' shop, enabling people to shop 'little and often'. The ACS found that the average basket size for convenience stores is 3 items and the average spend is £7.27.[181] The local option was particularly valuable during the

[178] Meeting with Association of Convenience Stores.
[179] The Local Shop Report | ACS
[180] Is it more expensive to shop at Tesco Express and Sainsbury's Local convenience stores? - Which? News
[181] ACS, Local Shop Report 2022.

pandemic, when neighbourhood stores saw volumes increase (though city centre convenience stores saw reduced volumes).

3.78 Convenience stores are particularly important in more rural areas – where consumers have a smaller choice of retailers and larger stores are more difficult to access – and are often strongly supported locally-owned businesses acting as 'community lifelines'.[182]

3.79 The ACS told us that their members source products in a number of ways. Those which belong to a major supermarket chain will be part of the supermarket's own buying process. Independent retailers, including some of the groups, either source with a delivery from a wholesaler or visit a cash and carry, and many retailers operate a mix of the two. Some retailers closely monitor pricing offers from wholesalers and regularly switch some business between them.

3.80 Location is important: a convenience store on the outskirts of London may have a choice of hundreds of wholesalers and cash and carry outlets for sourcing products, whereas a rural store in Wales will be reliant on a small number of national wholesalers. Unaffiliated stores do not tend to have contracts with wholesalers and can switch quickly depending on prices available. Symbol groups, such as Costcutter, may have volume commitments to certain wholesalers.

3.81 We heard that convenience stores tend to have a gross margin of around 20 to 30%. The largest single cost is wages, which tends to be around 10 to 15% of the retail price. Other material costs include energy, business rates and licences. The ACS told us that during the peak of energy prices, all margin would have been swallowed up by higher energy costs. Operating margins are typically 2 to 3% for the convenience sector. The ACS said that, like larger retailers, convenience stores have also seen declines in volumes due to cost of living pressures.

3.82 Brands tend to be more important for convenience stores, though there are some own-label products. For example, Co-op supplies its own label range to other stores. Convenience stores have a much smaller range than large stores, with around 4,300 SKUs on average[183] compared to at least 7 to 8 times that in a large supermarket. As a result, they tend to only offer one or two versions of a particular product (eg flour) and may not stock the most budget versions of these lines. One retailer said limited space constraints may give more power to bigger brands due to fewer opportunities to accommodate

[182] Discussion at roundtable of stakeholders, Edinburgh, 27 June.
[183] Stock Keeping Units, individual unique products.

a wider range of brands. This tends to push consumers towards more expensive purchases, often the branded versions.[184] Which? has highlighted the problem of customers reliant on convenience stores not being offered a sufficiently large range of cheaper, own label products at supermarket-run convenience stores,[185] though we note that Morrisons has said it will commit to displaying its value range in its convenience stores.[186] It is also the case that convenience stores do not have to display unit prices, according to the legislation,[187] which could make it harder for people who rely on convenience stores to compare products, though there is often a smaller range to compare.

Previous CMA work on retail groceries

3.83 Competition in the retail supply of grocery in the UK has previously been the subject of various merger investigations by the CMA (and its predecessors, the OFT and the Competition Commission), including most recently the CMA's review of *Tesco/Booker* (2017),[188] *Sainsbury's/Asda* (2019),[189] *Bellis/Asda* (2021),[190] *CD&R/Morrisons* (2022),[191] *Morrisons/McColl's* (2022),[192] and *Asda/Arthur (Co-op)* (2023).[193]

3.84 In previous cases the CMA considered that grocery stores compete locally as customers will consider options in their local area. The CMA also found that national dimensions of competition exist as certain aspects of offerings are centrally set and uniformly applied on a national level. These aspects include price setting, supplier relationships and general promotional activities.[194] The CMA further found that some parameters can and are flexed locally in response to competition.[195]

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[184] Supermarkets fail to make cheaper food ranges available to most at-risk shoppers - Which? News
[185] Trust in supermarkets drops to a nine-year low as shoppers feel ripped off, Which? research finds – Which? Press Office
[186] Morrisons to stock 'Savers' products in its convenience stores (morrisons-corporate.com)
[187] That is, a shop where the internal area used for retail purposes is not more than 280 square metres.
[188] See Tesco/Booker merger inquiry.
[189] See Sainsbury's/Asda merger inquiry.
[190] Focussed on the retail supply of convenience groceries. See Bellis/Asda merger inquiry.
[191] Focussed on the retail supply of convenience groceries. See CD&R / Morrisons merger inquiry.
[192] Focussed on the retail supply of convenience groceries. See Morrisons/McColl's merger inquiry.
[193] Focussed on the retail supply of groceries at mid-size stores and convenience stores. See Asda/Arthur (Co-op) merger inquiry.
[194] Sainsbury's/Asda, Final Report, paragraphs 8.320-8.322; the CMA found that Asda operates consistent pricing across its supermarkets and its convenience stores, Asda/Co-op, footnote 10. MFG/MRH, paragraph 43, Bellis/Asda merger inquiry, paragraph 81.
[195] Sainsbury's/Asda merger inquiry, Final Report, paragraph 7.124.

3.85 The CMA's past merger practice distinguishes three broad product markets according to the size of the store. Large stores or one stop shops,[196] mid-size stores[197] and convenience stores.[198]

3.86 With regard to **large and mid-size stores** the CMA's past investigations found that the main factors that affect customers' choice of convenience groceries at a local level are location, size/range of products, and brand.[199] The competitive constraint is strongest from major supermarkets and varies by brand. Mid-sized stores to a certain extent constrain the larger stores. Aldi, Lidl and (to a lesser extent) Iceland despite their different offering, also exert some competitive pressure on large and mid-size stores.[200]

3.87 In past merger investigations, the CMA has found that the main factors that affect customers' choice of **convenience stores** at a local level are location, size and brand[201] and that other factors such as price and range were less relevant.[202] In particular, the CMA has found that customers generally seek to minimise the time and distance they travel to and from a convenience store. The CMA also found that a wide range of stores (ie major supermarkets, mid-size stores and independent retailers) have the potential to act as effective competitors for convenience groceries. The CMA found that stores of different brands exert different levels of constraint. For example, in *Tesco/Booker*, the CMA found that Tesco convenience stores exerted a stronger competitive constraint on symbol group retailers and (especially) independent retailers, than vice versa. [203]

3.88 The key point relevant to this assessment from these past cases is that, whilst there is a wide range of grocery retailers in the UK, large and mid-size stores are important for most consumers. The big four (together with Co-op, Waitrose, and M&S) compete closely. Over recent years discounters have challenged the big four and while their proposition is quite different, this has increased the competitive constraint on the big supermarkets. Other grocery retailers exert varying degrees of competitive pressure.

3.89 Retailers argued that there had been no significant changes since these enquiries, and that the market had, if anything, become more competitive in

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196 Supermarkets with a net sales area of 1,400 sq meters or above.
197 Supermarkets with a net sales area of less than 1,400 sq meters but above 280 sq meters.
198 Stores with a net sales area of less than 280 sq meters.
199 Asda / Arthur (Co-op) merger inquiry - GOV.UK (www.gov.uk) para 117.
200 Sainbury's Asda 7.44.
201 *Morrisons/McColl's* (2022) para 47, Bellis/Asda ; CD&R/Morrisons, para 14, para. 92
202 Bellis/Asda para 195.
203 Bellis/Asda merger inquiry, para 81 Para 195.

recent years: few stores had closed and many more had opened, especially in the convenience estate, and online shopping had expanded.

Some people may not experience the full benefits of competition in the grocery market

3.90 Not everyone will benefit to the same extent from competition between grocery retailers. A range of inter-related characteristics will affect the extent to which consumers are able to access, assess and act to get the best deals (see para 3.53), and hence the benefits they get from competition. For example, people on low incomes, who are digitally excluded, and who have no access to private transport, are likely not to benefit to the same extent as others.

3.91 The discounters generally offer the lowest groceries prices, but they do not offer online shopping. Those who cannot visit an Aldi or Lidl will not have access to some of the best deals. Aldi and Lidl currently have fewer stores than Tesco and Sainsbury's (though more than Morrisons and Asda), and Aldi is not present at all in Northern Ireland.

3.92 Some places are poorly served by large retailers generally. 'Food deserts' can be in rural areas, where the lower population density means that there are fewer large supermarkets; but they can also exist in urban areas, where people do not live within easy walking distance of a large store, and have poor public transport options and no private car (for example in housing estates on the edge of towns and cities).[204]

3.93 Online shopping is a solution for many who cannot easily visit a large retailer. Online prices are the same as in the large stores, and deliveries are available for the vast majority of UK residents.[205] However, online shopping is not suitable, or even possible, for everyone. Those who prefer or need to shop little and often (for example, to manage tight budgets) may not be able to meet the minimum spend requirements (usually £40 to £50 but less for some). Those who are not digitally literate, or do not have a bank account, will be unable shop online. Around 1.7 million households had no broadband or mobile internet access in 2021 and 2.4 million adults were unable to complete a single basic task to get online, such as opening an internet browser.

3.94 People who do not want to, or cannot, shop for groceries online and cannot easily access a large store are likely to need to do most or all of their

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[204] More than a million UK residents live in 'food deserts', says study | Food poverty | The Guardian
[205] Tesco delivers to more than 99% of UK postcodes;[205] Sainsbury's and Asda both deliver to 98% of UK households.[205,205]

shopping at convenience stores. As noted above, convenience stores have higher prices than larger stores and may not stock a full range of cheaper own-label products. Consumers who do more of their shopping at convenience stores will face higher prices and a much smaller range than people who can reach a larger store.

3.95 The 2022 ACS shop report shows that there was a higher proportion of convenience stores in Scotland and Wales compared to the UK overall.[206] The Consumer Council of Northern Ireland did some research about price and availability of food basket items and found that basket prices at national supermarkets were significantly cheaper than at any other retail outlets and that costs increased as store size reduced and as the area became more rural and that there were some problems with availability of items at smaller stores.[207]

3.96 We heard from Tesco and Sainsbury's that current new store growth is mainly convenience stores (rather than large stores) and that there are no market barriers to opening new convenience stores. Tesco said that, when deciding whether to open a new convenience store, the main considerations include: catchment size (number of households) and footfall; affluence level; competition presence and size within catchment area; visibility / frontage; car parking and traffic flow and achievable size of store. A retailer said that the planning system was a delay rather than a barrier, but also raised the concern that planned stores can be held up by planning objections or judicial reviews from rivals.

3.97 We consider that a lack of access to a full range of lower priced food can be exacerbated by a number of factors, for example:

(a) Poor public transport options (especially in rural areas);

(b) Barriers to doing online shopping, such as poor digital literacy or having no bank account; and

(c) Planning delays for new store openings.

3.98 In addition, comparing prices across retailers, and identifying the best deals for a range of essential groceries, can be complicated. Some people may struggle more than others to assess price differences.

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[206] The Local Shop Report | ACS
[207] Cost_and_affordability_of_minimum_food_basket_2022.PDF (consumercouncil.org.uk)

Conclusion on retail competition

3.99 We have examined indicators to assess the strength of retail grocery competition in aggregate. The evidence we have seen indicates that recent high price inflation for groceries to date does not appear to have been driven at an aggregate level by weak or ineffective competition between retailers. More specifically, we have found that:

(a) Throughout the last ten years the discounters (Aldi and Lidl) gained market share from the major supermarkets, and this coincided with a decline in major supermarkets' average operating margins (operating profits as a percentage of revenues), which fell from 4.4% in 2013/14 to 2.8% in 2020/21.

(b) In 2020/21 and 2021/22, the operating profits from the grocery businesses of the 11 retailers from which we requested information were broadly steady – in aggregate and as a percentage of revenues. However, operating profits fell by 41.5% in aggregate in 2022/23, compared with the previous year, while average operating margins fell from 3.2% to 1.8%. This occurred as a result of retailers’ costs (notably the cost of goods, labour and energy) increasing faster than their revenues, and indicates that they have not ‘passed through’ to consumers all of the cost increases that they have incurred.

(c) Retailers that have allowed their prices to become materially higher than their competitors have tended to lose market share. The lowest-price retailers – notably the discounters – have gained share from their competitors, and the magnitude of these gains has increased during the recent period of high price inflation. This suggests that retailers are constrained in their ability to raise prices without losing market share.

(d) Relatedly, consumers are shopping around: switching and going to multiple retailers to get the best deals. This behaviour exerts pressure on retailers to keep prices low in order to sustain and build market share.

(e) Large retailers pay close attention to their rivals’ prices and – particularly for commonly-purchased grocery items – respond competitively to price differences. In the context of other features we observe in the market – particularly consumer switching, changes in market shares and falling margins – these strategies appear to reflect price competition. The large retailers’ pricing strategies differ from those seen among supermarkets in our road fuel market study.

3.100 However, there are some consumers who will not receive the full benefits of strong retail competition:

(a) The discounters, which are typically the cheapest retailers, do not offer online shopping; and Aldi is not present at all in Northern Ireland. Consumers that cannot travel to these stores will not be able to access these lower prices, though they may benefit from the general price pressure the discounters put on other retailers.

(b) Those who cannot travel to a large store, and who are unable to shop online, may be reliant on convenience stores, where prices are generally higher, and value own-label ranges may not be available.

(c) Own-label products have seen higher inflation than branded goods, and discount stores have seen higher inflation than other supermarkets. Although we do not consider this to be an indicator of lower levels of competition for these products or retailers, it means that consumers who were already minimising their food spend will therefore have faced higher increases in the prices they pay and will have had fewer options to reduce their food spend as prices increased. Many in this group are likely to be on lower incomes, and already spending a higher proportion of their income on food.[208]

3.101 Retail competition may also be stronger in some groceries products than others. For example, the discounters sell a smaller range of groceries, and it is possible that competition may be less effective in keeping prices low for products that they do not stock. In the time available, we have not considered this question, or assessed the strength of competition within specific product categories. More detailed consideration of particular products will be a focus of the next phase of our work.

3.102 Looking ahead, we have been told that retailers are looking to increase their operating margins above the low levels seen in 2022/23. The evidence we have received to date on whether they will be able to do so – in the form of monthly profitability data from April 2023 – is mixed. The existing competitive environment is likely to put limits on the extent to which retailers can achieve higher margins without losing market share. However, consumers will understandably be looking for reassurance that effective competition will maintain pressure on retailers to pass on cost savings to their customers. This is something we will be monitoring carefully in the months ahead, particularly

[208] For the average household, 14.4% of total weekly expenditure went on food and non-alcoholic drinks in financial year (FY) ending 2022/23. This rose to over 18.3% for lower income households (those in the bottom fifth of the income distribution).

as the rate of food inflation slows, so that people can continue to have confidence that retail competition issues are not contributing to the level or persistence of groceries price inflation.

4. Upstream from the retailers: own-label and branded suppliers

Introduction

4.1 This section sets out briefly the evidence that we have seen to date about the food manufacturers that produce many of the groceries that retailers offer to consumers. As set out in Sections 5 and 6, our work on the wider supply chain will continue over the coming months. What follows is only an initial and partial picture.

4.2 A key feature of the groceries sector is the role played by brands. For some groceries – for example, raw ingredients, such as fruit, vegetables, meat and fish – brands play little or no role. For others – such as breakfast cereals and soft drinks – branded products are often offered alongside retailers' own-label alternatives. Competition in groceries at the retail end of the supply chain involves consumers shifting not only between retailers, but also between these different offerings within a retailer.

4.3 The presence and prominence of brands also affects upstream competition, and particularly the relationships between retailers and their suppliers. Some branded products are 'must stock' items for many retailers. The importance of including branded products within their range affects the bargaining power of retailers, and can make for different relationships with brands than those that exist with retailers' own-label suppliers.

Inflation rates, costs and margins for own-label and branded products

4.4 In their larger stores and online, most of the major retailers[209] offer three tiers of their own-label product (sometimes characterised as 'good, better, best') and also offer branded goods. The highest tier is an attempt to compete with branded goods, and the lowest tier offers the cheapest option to keep volume among price sensitive customers. The mix varies significantly between product categories, with fresh produce being mostly own label and brands having a higher share in processed and ambient groceries, eg tinned food, sauces and teas.

4.5 In its monthly price surveys of a basket of goods, Which? found that, on average, the annual rate of inflation was highest for the cheaper 'own-label budget' items than for branded goods in the 12 months to May 2023 (see

[209] For example, Sainsbury's, Tesco, Morrisons, Waitrose.

table 4 below).[210] This can be partly explained by the open book model, which allows for easier pass through of costs, and by the lower base for the starting price. It is also reflective of the fact that own label has more fresh produce than processed, and costs for fresh produce are more dominated by raw material costs than processed food. One retailer said that 'it has often been these lowest-margin, most cost reflective areas of own-brand and fresh categories where the cost increases have been highest and which have seen the highest price inflation as a result.'

Table 4: Annual Inflation for different categories of own-brand products

Range of groceries	Annual inflation for the 12 months to May 2023
Own-label budget	26.6%
Own-label standard	19.1%
Annual rate of inflation (ONS: food and non- alcoholic beverages)	18.3%
Own-label premium	12.9%
Branded	13.2%

Source: Which?

4.6 We understand that the retail margins on branded goods can be higher than those in own label, with very low margins on the entry tier products, though sometimes margins are higher only in cash terms than percentage terms (for example a 5% retail margin would be 5p on a £1 product and 2.5p on a 50p product). Our analysis of the information which some retailers provided on product margins suggests that gross margins and operating margins are lower on entry level ranges than core and premium ranges and, in some cases, loss making. The trading down from branded to own label was not seen as a disadvantage, however, despite the lower margins, because it builds up brand loyalty and trust for that particular retailer (whereas a large brand can be bought anywhere).

4.7 The FDF argued that since October 2021 UK food and drink manufacturers have faced 'substantial upward pressures on all cost elements facing their businesses'.[211] ONS data indicates that more manufacturers have absorbed rising costs than retailers: on average 72% of food and drink manufacturers absorbed a share of rising costs over the past year to February.[212] The FDF

[210] Supermarket food price inflation tracker from Which? - Which? The price inflation tracker is a different data set to the supermarket basket price comparison used elsewhere in this document.
[211] FDF written response.
[212] ONS, Business Insights and Conditions Surveys, March 2022 – February 2023, cited by FDF in their written response.

also highlighted the problem of insolvencies among food and drink manufacturers which doubled from 122 in 2021 to 244 in 2022, with 71 already recorded in the first quarter of 2023.

Retailers relationships with their suppliers

Own-label suppliers

4.8 Own-label products are important to retailers. Several supermarkets told us that they generally represent around half of all sales. Others, such as discounters and M&S, are primarily own-label. Kantar data suggests that branded goods represent around 52% of the market (in sales terms).[213] We asked retailers about their relationships with own-label suppliers, and how they assured themselves that the prices they paid to these suppliers were competitive.

4.9 One retailer said that ‘relationships with key suppliers have often become closer over the last two years; as we have sought to work together to mitigate the impact of cost rises for the customer’. However, one retailer said that its relationships with key suppliers ‘have become slightly more tactical during the last two years, focusing on managing cost prices, and protecting availability and managing disruption to supply due to various challenges such as Brexit and availability of raw materials.’

4.10 In negotiating with own-label suppliers, retailers face a trade-off between keeping costs low so that they are not pressured to reduce margins or increase prices (at the risk of losing volume), while ensuring their suppliers remain viable and that their supply base is not put at risk.

4.11 For example, Tesco said that: ‘It is critical for our own market positioning to strike the right balance between pushing back on requests for unjustified increases and allowing recovery of costs that are genuinely incurred. Failure to allow for recovery leads to long term damage to the supply base.’[214] Sainsbury’s also said: ‘We are mindful that the considerable cost pressures suppliers have experienced over the last 18 months, and continue to experience, could jeopardise retail supply of key products if suppliers are not financially resilient.’[215]

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[213] https://www.kantar.com/inspiration/fmcg/2023-wp-battle-for-shoppers-heats-up-as-grocery-price-inflation-hits-new-high
[214] Tesco response to RFI.
[215] Sainsbury’s response to RFI.

4.12 Many retailers said they had longstanding relationships with most of their own-label suppliers, lasting in some cases for decades and that it was important to maintain these.[216] One retailer told us that it prioritised forming long-term relationships with its own-label suppliers, as this allowed for greater security of supply and for suppliers to have the confidence to invest in expanding their production capacity. There is often a shared investment in developing a dedicated own-label product or building additional production capacity and both sides want security to justify the investment.

4.13 Retailers told us that inflationary pressures had led to a rising number of requests from suppliers to vary the price they were paid (within existing contracts) – so-called 'cost price increases' – with some retailers saying that they had seen an unprecedented number of these. The Groceries Code Adjudicator said that in a survey conducted in January/February 2022, 80% of direct suppliers reported having requested a cost price increase from at least one retailer in the preceding 12 months. In the 2023 survey (open from 16 January to 27 February 2023) this had risen to 91%.[217]

4.14 Retailers generally have access to good information from their own-label suppliers that enables them to determine whether a cost price increase is warranted. Some retailers have 'open book' models with a large share of the suppliers of their own label products. This means that the retailer has full visibility of the suppliers' costs, with suppliers charging the cost price, plus a negotiated margin. This protects suppliers from higher costs that they do not control and would not be able to absorb into their margins, and allows the retailer to better forecast and manage changes in retail prices. Correspondingly, cost decreases should be clearly visible under this model, and feed through into lower prices paid by the retailer.

4.15 For own-label suppliers that are not on an open book model, and for retailers that do not operate such models, requests for cost price increases are normally verified by the retailer on the basis of evidence submitted by the supplier. Some retailers have told us that they have started using a third-party commodity analyst to verify that cost price increases are justified by market movements. Some retailers also operate contracts with trackers, which may also include a pass-through mechanism. One retailer said that that had 'facilitated a clear, open and honest communication with key suppliers and ensured that cost increase requests were robustly validated prior to any prices being increased.' One retailer told us that around one fifth of their own-label supply contracts had commodity cost trackers. As well as a process of

[216] Submissions from Sainsbury's, Tesco, Morrisons.
[217] GCA written letter to CMA in a letter sent to David Stewart on 27 June 2023.

justifying and verifying the cost increase, we heard from many retailers that they will also have a conversation to see if any of the cost increase can be mitigated (ie through efficiencies). Retailers sometimes work in conjunction with their long-term suppliers to help find efficiencies and other cost savings, and especially in recent months to help mitigate the pressure of rising input costs.

4.16 Where an open book model or tracker is not present, a cost price decrease may need to be requested by the retailer. Similar processes are followed in respect of cost price decreases. One retailer told us that they would record the date of a cost price increase and the reason for it (ie the increase of a particular input cost) and then track whether that input cost had subsequently fallen and, if so, go to the supplier with a request for a cost price decrease. One retailer said that suppliers were less eager to enter into conversations on cost price decreases than increases, and that some had threatened to stop supplying if the retailer pushed for a cost price decrease.

4.17 Publicly available profitability data for some of the largest own-label suppliers suggests that margins in this sector are generally low. Suppliers such as Cranswick (meat), Bakkavor (fresh prepared food), Hilton Food Group (meat and fish processing and ready meals) and Boparan Holdings (poultry and ready meals) achieve operating margins of between 0% and 7%.[218,]

Branded suppliers

4.18 We also asked retailers about their relationship with suppliers of branded products. In general, these relationships are different from own-label suppliers. In particular:

(a) For the major supermarkets, and some other retailers, certain branded products are important to include in their range, and they may appear uncompetitive (and suffer a potential loss of market share) if they fail to stock them. For example, one retailer said that ultimately they needed the relationship with the major brands to be successful and that they would lose customers if they did not have the big brands which formed a large share of their sales.

(b) The price charged by branded suppliers to retailers (and hence by retailers to consumers) includes a brand premium that reflects a difference in quality (real, or perceived by some consumers), relative to the own-label alternative. The brand premium will vary depending on the

[218] We reviewed the financial statements of Cranswick plc, Hilton Food Group plc, Bakkavor plc and Boparan Holdings Limited from FY 2017/18 to FY 2022/23. Operating margins ranged from 0.2% to 7.0%.

strength of brand loyalty and the extent to which own-label products are seen as an attractive alternative by consumers. In some cases, the branded good has strong branded competitors within that product category (eg crisps); and in some cases the perception is that there is just one credible brand (eg baked beans).

(c) There is generally only one supplier of a particular branded good; by contrast, a retailer will often have a choice of several suppliers to meet its own-label requirements. Indeed, they often have two suppliers under contract for a particular product line, in case of supply failures.

(d) The large brands have significant scale compared to own-label manufacturers, and compared to some smaller retailers, as they typically supply all retailers (and many have significant global operations).

(e) Retailers generally have less ability to obtain information necessary to scrutinise the costs of branded suppliers. In some cases they can compare it to cost prices for own-label products and get a rough idea of the level of cost increases, but this will not take into account any brand premium.

(f) Branded goods are identical across all retailers and it is therefore easier to compare prices than for own-label products which may differ in quality.

4.19 Some of these differences mean that – while retailers control the retail price they set for branded goods – they may have limited ability to successfully negotiate with branded suppliers over cost price increases or decreases, and other terms and conditions including minimum volumes. Products including Heinz Beanz, Ketchup, and a number of pet food brands were temporarily not stocked in Tesco last year following pricing disputes between Tesco and Heinz and Mars Petcare.[219]

4.20 Analysis of publicly available financial information indicates that branded goods suppliers generally operate at higher margins than own-label suppliers. Associated British Foods (which produces various branded products, including Kingsmill bread, Silver Spoon sugar and Twinings tea) has achieved operating margins between 10% and 12%.[220] International branded suppliers, such as Mondelez, Unilever and Coca-Cola, do not report the performance of their UK businesses, so it is not possible to assess the performance of their UK businesses in isolation using publicly available information. However, at a consolidated level, these companies achieve operating margins in excess of

[219] Heinz and Mars won't beat Tesco in a PR battle over price rises | Comment and Opinion | The Grocer
[220] We reviewed the financial statements of Associated British Foods plc from FY 2017/18 to FY 2022/23. Operating margins ranged from 9.8% to 12.4%.

15%. For context, the retailers' operating margins have historically ranged from 1% to 5%.[221] We will look in further detail at metrics of financial performance of branded and own-label suppliers as part of the next phase of our groceries work.

[221] Between FY 2013/14 and FY 2022/23 operating margins for the major supermarkets ranged from 1.1% to 5.0%.

5. Choosing product categories for further assessment

5.1 As previously outlined, the evidence we have seen is consistent with previous findings that the groceries retail market is broadly competitive at a national level, and our assessment in the first phase of this work is that we do not see evidence that rising retail profit margins are contributing to food price inflation.

5.2 Overall, it appears that larger retailers have the information and bargaining power necessary to ensure that the prices they pay to own-label suppliers are competitive but may have less ability to bargain with large suppliers of branded goods. This is something we would like to explore more in the next phase of our project. However, we have not yet explored competition in other parts of the food supply chain in detail.

5.3 The food and drink industry is highly complex, and comprises thousands of businesses and supply relationships. In order to examine whether the wider supply chain is working well for consumers, while ensuring our work is timely and impactful, we have identified a number of indicative product categories that may merit further consideration over the coming months. We plan to examine in more detail supply chains, inflation drivers and the role of competition for these product categories.

5.4 We have not used a formal decision rule to select these products but have used our judgement and taken into account the following factors:

(a) The **rate of price inflation for individual grocery items** in the CPI basket from January 2021 to May 2023 and January 2022 to May 2023.[222]

(b) The extent to which price inflation for these same products, over the same periods, **differed from input and output inflation faced by producers**. Divergence between producer prices and consumer prices for a product may indicate that retail prices are rising above a competitive level.[223]

(c) The extent to which price inflation for these same products, over the same periods, **differed from inflation across their wider class of products**. Products within the same class may have similar input costs, and so

[222] We looked at two periods to allow for differing rates of pass through of cost increases. Item price indices were obtained using the ONS's Monthly Shopping Price Comparison Tool which tracks price movements of around 450 CPI basket items back to 2018. Shopping prices comparison tool - Office for National Statistics (ons.gov.uk)
[223] Here we compare the inflation rates of CPI items vs the rate of the most appropriate Output Producer Price Inflation (PPI).

significant divergence in the inflation rate between a product and its wider class may indicate that its price is rising above a competitive level.[224]

(d) **Importance to consumers**, judged by reference to the product's weight in the CPI basket, and a **qualitative assessment of its substitutability**. The higher the share of spend, and/or the less substitutable, the greater the importance to consumers of a given product, and hence the greater the likely impact from identifying and addressing any competition issues associated with its supply.

(e) The potential of the product to illustrate features and developments in the food supply chain, and/or consumer behaviour, that merit further exploration.

5.5 These product categories have been chosen to give us an initial sample, not because we think that the other product categories that we have not chosen are likely to raise fewer concerns, from a competition perspective. We have also not yet formed a view on whether competition issues exist in the product categories selected. The list is not definitive and we may alter our selection at a later stage. We may decide to look at some products in more depth than others, depending on the circumstances.

[224] The ONS categorizes CPI items using a hierarchical system, aggregating item by consumption type. For example, just under the whole basket sit 12 Divisions, including Food and non-Alcoholic Beverages (FNAB). The path to a tin of baked beans would then be: Group (Food), Class (Vegetables including potatoes and tubers), Subclass (Dried vegetables, other preserved or processed vegetables), Item (Baked Beans, 400-425g tin). We compare an items inflation rate vs the rate of its parent Class. In the example above, the parent Class of Baked Beans would be Vegetables including potatoes and tubers.

Table 5: Products selected for further assessment[225]

Product	Product Inflation (Jan 22 to May 23)	Product inflation exceeds relevant output PPI inflation	Product inflation exceeds class inflation	Importance to consumers as measured by CPI weight[226]	Comments
Baby formula	20%	✓		Low (but very important for some people)	Parents buying baby formula may be ‘locked in’ to using this product, without alternative sources of nutrition for young babies. Own-label versions are rare despite the fact that regulations mean that all products are virtually identical. One manufacturer (Danone) has over 70% of sales.[227]
Bread	20%	✓		High	Bread is an important household staple and, though own-label has a 38% share of sales, there are some strong brands (Warburton’s, Hovis and Kingsmill).[228] The rising prices of energy and wheat have contributed to a high level of inflation. Supply of speciality breads (eg gluten-free) is likely to be less competitive.
Pet food Represented by item: dog food can	51%	✓	✓	Low (but very important for some people)	62% of UK households owned a pet in 2021/22.[229] Pet owners are risk averse in switching away from a known brand, and research suggests that just 14% of people are willing to switch to cheaper products.[230] Brands owned by Mars and Nestle account for around a third of sales and smaller brands appear to have gained ground recently.[231] The costs of some inputs (eg beef) have increased, but it is unclear why retail price inflation has been so high.

225 Table 5 uses CPI and PPI price data to May 2023, published by the ONS on 21 June 2023. The ONS typically revises published PPI indices in the months following initial publication. Revisions from the July PPI release – published by the ONS on 19 July 2023 are not reflected in table 5.

226 Items within the CPI representative basket receive a weight to reflect the relative amounts households spend on them. Weights are largely calculated using household final consumption expenditure (HHFCE) data, which is supplemented by various other datasets, such as Living Costs and Food Survey (LCF) data. We have used CPI weights to assess the relative importance of products of groups of products to the average household. However, as total CPI weights sum to 1,000 and cover all representative goods and services consumed by households, the weight of any one product is usually relatively low. We have therefore used the following scale to assess the relative importance of products: High: weight>4; Medium: 4>weight>2; Low: 2>weight.

227 Mintel Based on Circana data, (Baby Food and Drink - UK - 2023 - Market Research Report (mintel.com))
228 Mintel based on Circana data, (Bread - UK - 2022 - Market Research Report (mintel.com))
229 Pet ownership in the UK 2022 | Statista
230 Kantar Profiles/Mintel, Pet Food - UK - 2022 - Market Research Report (mintel.com)
231 C10.920 Prepared Pet Food Manufacturing in the UK - MyIBISWorld

Poultry	22%	✓	✓	Medium	Chicken was often referenced by retailers as a staple product. Some inputs into the agricultural process (eg animal feed) are sold in a highly concentrated global market. The poultry processing market in the UK is fairly concentrated, though this may be due to economies of scale and it appears that margins are low.
Milk Represented by item: semi-skimmed milk	41%	✓	✓	Medium	Milk is another core element of the shopping basket. Retailers told us that the milk price in stores is a benchmark price for many consumers and hence they price in line with the market. Animal feed is also an important input. Muller and Arla collectively account for almost half of the milk and cream production market in the UK.[232] The price of milk also affects other dairy products such as cheese, which is also a core part of many shopping baskets.
Mayonnaise	57%	✓	✓	Low	High price inflation is likely to have been influenced by high prices for eggs and edible oils. Hellmans (owned by Unilever) is the most popular brand.[233] Heinz has a strong presence in sauces more generally (especially ketchup).
Baked beans	42%	✓	✓	Low	Heinz baked beans was frequently cited as a 'must stock' brand by retailers and it commands a strong brand loyalty.[234] Heinz said that price rises were due to rising energy, packaging and ingredient costs.[235]
Chilled Desserts	42%	✓	✓	Low	We heard from one retailer that there were few suppliers of own-label chilled desserts that could meet their specifications. Price rises are likely to be caused by increased costs of energy, milk/cream and sugar. Own-label products are important here but there are some strong brands (Muller, Cadbury).
Ready meals	24%	✓		Low	The production of ready meals involves inputs from a multiple number of businesses, including imported goods (such as tomatoes). We understand that a few suppliers make own-label ready meals for all retailers and that the products may be developed in conjunction between the retailer and the supplier. Own-label tends to be important here, though brands are also relevant, both small and large (Bird's Eye, Charlie Bigham). We have heard that people are replacing meals out with premium ready meals to eat at home.
Lemonade	43%	✓	✓	Low (high for all carbonated drinks)	Brands are very important in soft drink sales (principally Coca-Cola).[236] We heard that packaging costs have risen and are not yet falling back. The high costs of sugar and energy will have contributed to price rises in this category but it is unclear why lemonade prices have risen so much.

Source: CMA analysis of ONS consumer price inflation, ONS producer price inflation, ONS shopping price comparison tool

232 Milk & Cream Production in the UK - MyIBISWorld (March 2023)
233 IBISWorld Condiments & Seasoning Manufacturing in the UK (2022)
234 Canned goods 2022: Baked beans fall victim to price spikes | Analysis & Features | The Grocer
235 Heinz raises price of baked beans for second time in a year after Tesco row (telegraph.co.uk)
236 SP0.126 Soft Drink Production in the UK - MyIBISWorld (May 2023)