Competition and profitability in the groceries sector

26 July 2024

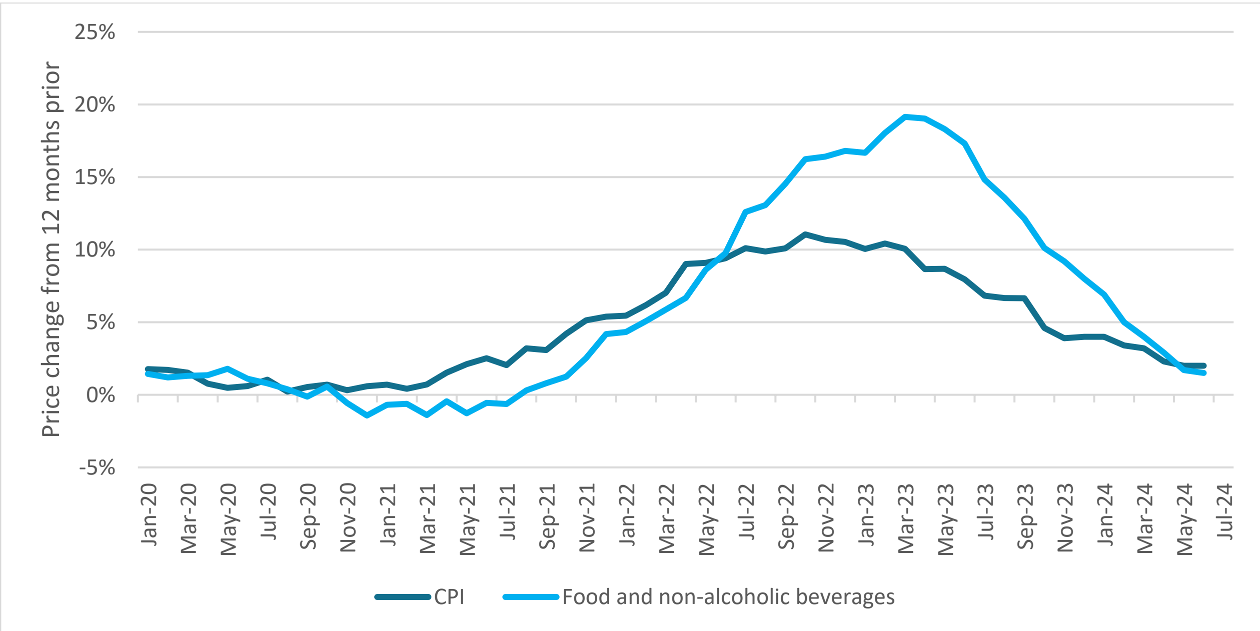
Contents

1. Overview

1.1 The Competition and Markets Authority (CMA) set out an initial analysis of supermarket profitability in our July 2023 '*Competition, choice and rising prices in groceries*' report. At the time of that report, the price of food and some other groceries in the UK had risen sharply in the period since the COVID-19 pandemic, and this was adding pressure on household finances that were also being stretched by rising energy, road fuel, and housing costs.

1.2 Aggregate food price inflation has since fallen consistently, from a high of 19.1% in March 2023 to 1.5% in June 2024 (Figure 1.1). However, the level of food prices remains substantially elevated relative to average earnings,[1] meaning that the average person would now be paying out a higher proportion of their income for the same basket of groceries.

Figure 1.1: CPI and Food & Non-Alcoholic Beverage 12-month inflation rate, January 2020 to June 2024



Source: Office for National Statistics (CPI All-Items and CPI Food and non-alcoholic beverages).

1.3 Our July 2023 report analysed supermarket profitability as part of our assessment of whether weak or ineffective competition between retailers had been contributing to high prices. It looked at 11 grocery retailers and found that operating profits and average operating margins fell in financial year (FY) 2022/23 – indicating that grocery retailers had not 'passed through' to consumers all of the cost increases that they had incurred. Overall, we didn't find widespread evidence of weak competition: profit margins were historically low; consumers were switching to get the best deals; and the lowest-price retailers were gaining market share from others.

[1] For example, in May 2024 whole economy average earnings (source: ONS) were 15.0% higher than in January 2022, whereas food prices (source: ONS) were 25.4% higher.

1.4 However, we noted that retailers were looking to increase their groceries profit margins above the historically low levels seen in FY 2022/23. We said we would monitor this in the months ahead particularly as input costs fell, so that people could continue to have confidence that retail competition issues were not contributing to the level or persistence of groceries price inflation. It has been important for the CMA to monitor retail price competition in this way, given the critical importance of this market to consumers and the detrimental impact rising food prices have had on many households.

1.5 This report updates our retailer profitability analysis in line with this commitment. We find that grocery retailer revenues, profits, and margins have increased slightly in aggregate in the most recent year (FY 2023/24), as inflation has eased. However, operating profits and margins remain broadly at or below FY 2019/20 to FY 2021/22 levels, while margins remain below the levels seen in the early 2010's.

1.6 Most retailers are planning to increase their operating margins in the current year (FY 2024/25), but only to levels which would bring average aggregate operating margins back to FY 2019/20 to FY 2021/22 levels, while there is mixed evidence on whether retailers will be able to achieve this.

1.7 Overall, consistent with our July 2023 update, this update does not find evidence that groceries inflation is being driven at an aggregate level by weak competition between retailers. This should provide consumers with reassurance that effective competition is ensuring continued pressure on retailers to pass on cost savings to their customers. However, we recognise that the prices of groceries for consumers have increased, and are likely to continue to remain elevated. Furthermore, not everyone benefits in the same way from competition between retailers; for example the discounters do not offer online shopping, meaning those who cannot visit one will not have access to some of the best deals, while those who cannot access online shopping or travel to larger stores may be reliant on convenience stores where prices are generally higher.

1.8 This update concludes our work monitoring profitability in the groceries market at this time. Our work on loyalty pricing and our market study on infant formula are ongoing:

- We launched our infant formula and follow-on formula market study on 20 February 2024, following publication of our November 2023 update on the groceries sector. That update highlighted concerns that weak or ineffective competition in the infant formula market might be keeping prices higher than they might otherwise be. We highlighted that consumers might not always be equipped to make well-informed choices, and that suppliers may face insufficient incentives to offer infant formula at competitive prices. In our market study we are closely examining the regulatory framework and its enforcement in influencing market outcomes, consumer behaviour and the drivers of choice and decision-making, and supply side features of the market.

- Since January 2024 we have been undertaking a wide-ranging review into loyalty pricing in the groceries sector. A key focus to date has been on whether any aspect of loyalty pricing offered by some grocery retailers could mislead shoppers, and in particular whether there are pricing practices that indicate that the non-loyalty (or non-member) price may have been artificially inflated to make the loyalty price appear misleadingly attractive. Our analysis – involving tens of thousands of loyalty price promotions – is ongoing, but the results to date suggest we are unlikely to identify widespread evidence of loyalty promotions that mislead shoppers in this way. We have commissioned a consumer survey to understand the impact of loyalty pricing on how we shop, including how much people shop around and compare prices.

1.9 We will report on the conclusions from our loyalty pricing analysis in November, and intend to publish our interim findings from our infant formula market study in the autumn.

2. Update on retailer profitability

2.1 This section sets out an update to our analysis of supermarket profitability published in July 2023. 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.

2.2 In summary:

- There has been overall growth in revenues, profits and margins for retailers in the most recent financial year (FY 2023/24). However, operating profits and margins remain broadly at or below FY 2019/20 to FY 2021/22 levels.

- Operating margins for three (Tesco, Sainsbury's and Morrisons) of the four major supermarkets increased in the most recently reported financial year from public accounts, although margins are still below the levels that were seen in the early 2010's.

- Retailers generally continue to cite inflationary cost pressures, such as for energy and labour, although they also say inflationary pressures have eased somewhat during the latest year. Achieving sales volume growth has also been a key driver for some of the retailers that have increased operating margins in the latest year.

- Aggregate gross margins in FY 2023/24 remained below FY 2019/20 to FY 2021/22 levels, and forecasts for this year (FY 2024/25) show retailers expect these to remain stable or decline – which suggests that grocery prices charged to consumers should broadly move in line with any changes in the cost of goods being incurred by retailers.

- In contrast, most retailers are planning to increase their operating margins in the current year, which would bring weighted average aggregate operating margins back to FY 2019/20 to FY 2021/22 levels. However, reflecting the broadly stable or declining outlook for gross margins, retailers generally intend to achieve this via cost savings programmes.

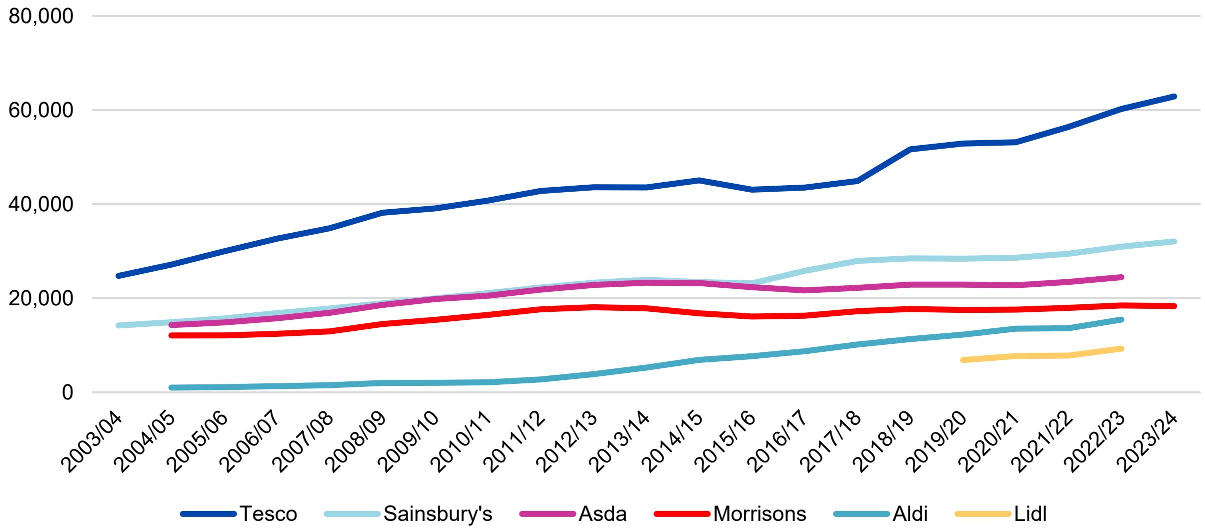
Analysis of supermarkets' financial statements

Revenue

2.3 We have analysed the financial statements of the four largest supermarkets[2] and the two discounters[3,4] in the period from 2003 to 2024. Collectively, these six retailers account for over 80% of the grocery market in Great Britain.[5]

2.4 Figure 2.1 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 (e.g. clothing), wholesale distribution businesses and fuel.

Figure 2.1: Comparison of the retail revenues reported by the major supermarkets and the discounters in the period from FY 2003/04 to FY 2023/24 (£m)



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 2023/24.

2.5 In our previous analysis we identified that growth in retail revenues between 2003 and 2023 broadly splits into three periods, and our updated analysis continues to be consistent with this:

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[2] Tesco plc (financial accounts up to 24 February 2024), Sainsburys plc (financial accounts up to 2 March 2024), Asda Group Limited (financial accounts up to 31 December 2022) and Wm Morrison Supermarkets Limited (financial accounts up to 29 October 2023).
[3] Aldi Stores Limited (financial accounts up to 31 December 2022) and Lidl Great Britain Limited (financial accounts up to 28 February 2023).
[4] 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.
[5] [Grocery Market Share - Kantar (kantarworldpanel.com).](kantarworldpanel.com)

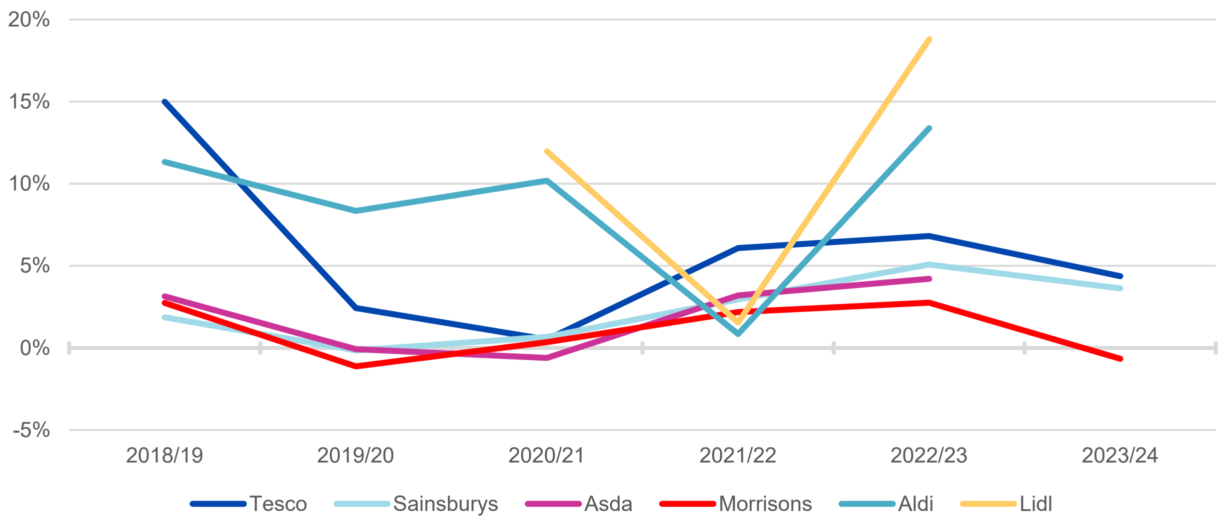
- From FY 2003/04 to FY 2011/12 the major supermarkets reported steady growth, with annualised revenue growth rates of between 5.6% (Morrisons) and 7.1% (Tesco). In this period Aldi grew at an average rate of 18.9%.[6]

- In the period from FY 2012/13 to FY 2017/18 supermarket retail revenues slowed and in one instance decreased.[7] At the same time Aldi's revenue increased by 19.9% year on year, reflecting the continued rapid increase in discounter market share.

- Since FY 2018/19, the supermarkets and the discounters have all reported growth in retail revenues,[8] albeit the discounters' revenues have continued to grow faster than the supermarkets.

2.6 Figure 2.2 below compares the year-on-year growth of retail revenues since FY 2018/19 reported by the major supermarkets and the discounters in their financial statements.

Figure 2.2: Comparison of the year-on-year growth in retail revenues reported by the supermarkets and the discounters in the period from FY 2018/19 to FY 2023/24



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 2023/24.

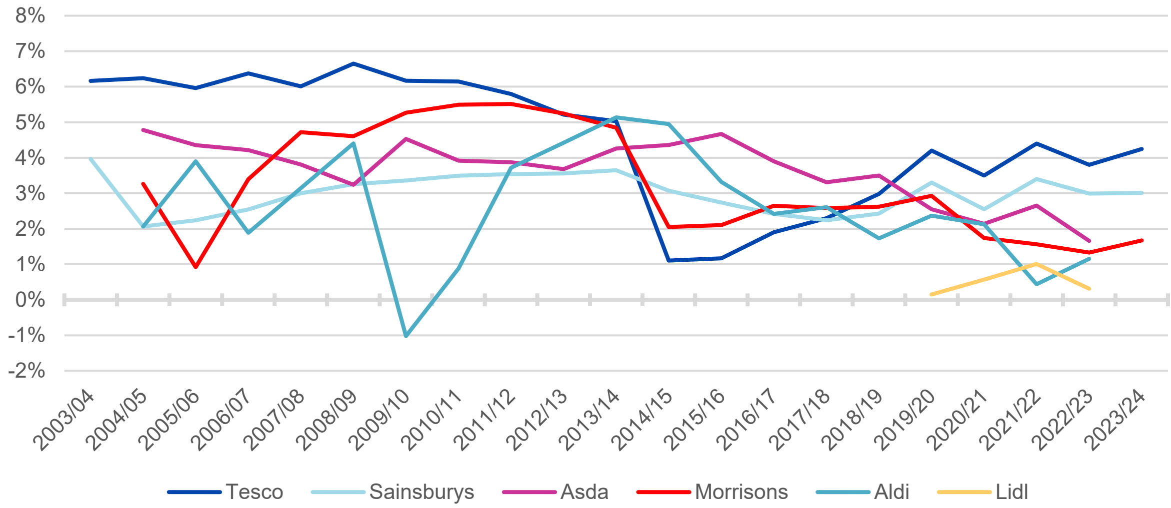
2.7 In the most recent financial year (FY 2023/24) Tesco's and Sainsbury's revenues increased while Morrisons' revenues decreased, however all had lower revenue growth compared to the prior year (FY 2022/23).

[6] Lidl only started reporting its UK operations separately in FY 2019/20.
[7] Morrisons had an annualised rate of growth of -0.3% in the period from FY 2012/13 and FY 2017/18.
[8] Average annual revenue growth rates for the supermarkets in the period from FY 2018/19 to FY 2022/23 ranged from 1.0% (Morrisons) to 5.9% (Tesco). Average annual revenue growth rates for the financial years available in the same period were 8.2% for Aldi and 10.8% for Lidl.

Profitability

2.8 Figure 2.3 below compares the operating margins[9] 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 2.3: Comparison of the operating margins reported by the supermarkets and the discounters in the period from FY 2003/04 to FY 2023/24



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 2023/24.

2.9 In the most recent financial year (FY 2023/24) Tesco, Sainsbury's and Morrisons each increased operating margins, with the average across the three retailers increasing from 2.7% in FY 2022/23 to 3.0% in FY 2023/24. In Asda's most recently reported financial year (FY 2022/23), operating margins fell from 2.7% to 1.7%. Overall, the major supermarkets' retail operating margins remain broadly in line with margins over the previous five years, and below the margins achieved in the period up to FY 2013/14.

2.10 The operating margins for the discounters continue to be lower than the supermarkets, averaging 0.7% in FY 2022/23 (consistent with the prior year).

[9] 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.

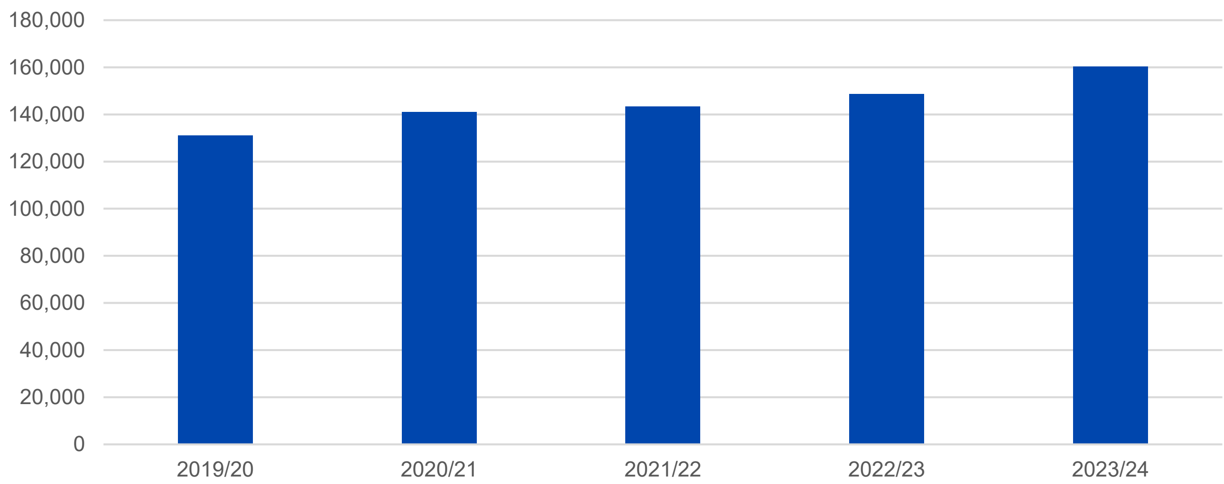
Updated analysis of information supplied in response to our request for information

2.11 To gain a more up to date and detailed understanding of the performance of the retailers' grocery businesses, we requested updated 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

2.12 Figure 2.4 shows the aggregate revenues for retailers' grocery businesses between FY 2019/20 and FY 2023/24. Revenues increased by 7.9% in FY 2023/24 (the most recent year). This was slightly higher than the CPI rate of inflation of 7.3% for 2023, but lower than the food and non-alcoholic beverage rate of inflation of 14.5%. In comparison, aggregate revenue growth of 3.6% in FY 2022/23 was below both the CPI rate of inflation of 9.1% for 2022 and food price inflation of 10.9%.

Figure 2.4: Aggregate revenues for the retailers' grocery businesses between FY 2019/20 and FY 2023/24 (£m)



Source: RFI responses from retailers, CMA analysis.
Note: The data in this chart excludes fuel.

2.13 Some retailers explained that revenues continue to be impacted by:

- consumers purchasing a reduced volume of goods, although some retailers had sales volumes improvement;
- a consumer trend to 'trade down' from the retailers' core ranges to their value ranges, which are cheaper, and/or shop more at discounters, with less frequent visits to traditional supermarkets to 'top up' shopping; and

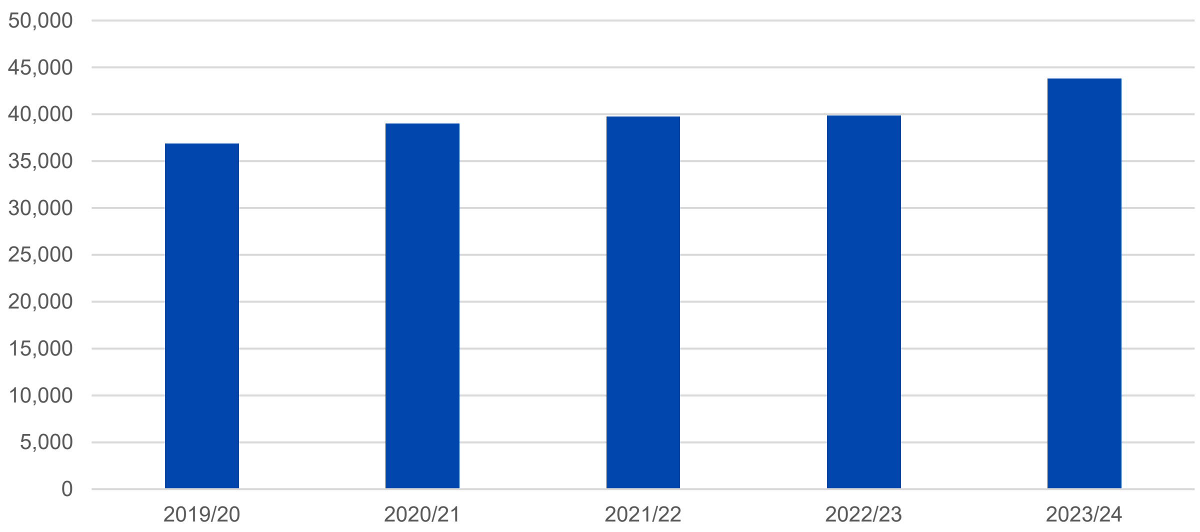
- pressure on grocery prices from discounters, and other retailers matching prices.

2.14 The extent to which each retailer had sales volume growth in the most recent year has been a key driver for the level of revenue growth achieved.

Gross profits

2.15 Figure 2.5 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.

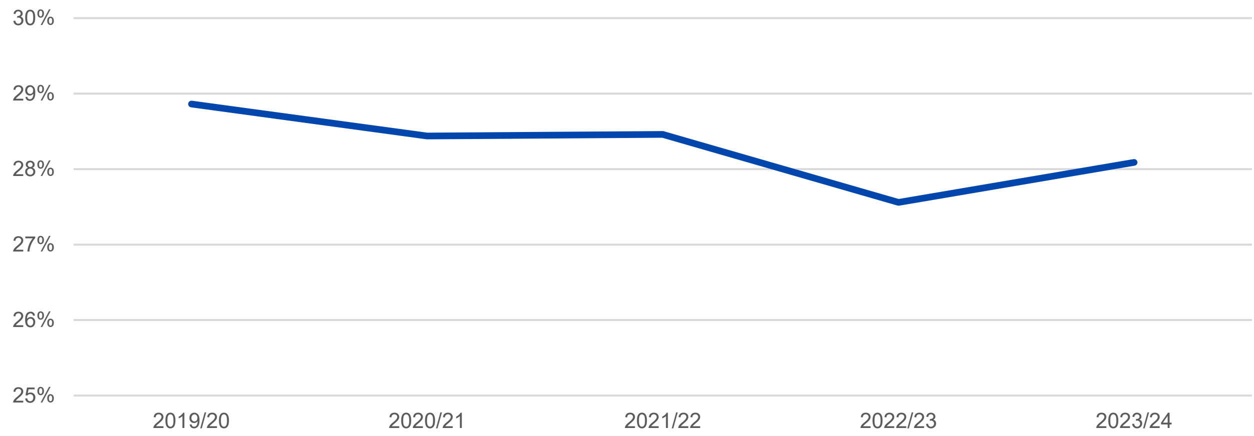
Figure 2.5: Aggregate gross profit for the retailers' grocery businesses between FY 2019/20 and FY 2023/24 (£m)



Source: RFI responses from retailers, CMA analysis.
Note: The data in this chart excludes fuel.

2.16 Aggregate retailer gross profits increased by 10.0% in FY 2023/24. This is more than the increase in aggregate revenues (7.9%), meaning that the average cost of goods has increased at a lower rate than average selling prices. As a result, the weighted average gross margin – calculated as aggregate gross profit as a proportion of aggregate revenue – has increased, as set out in Figure 2.6 below.

Figure 2.6: Weighted average gross margin for the retailers' grocery businesses between FY 2019/20 and FY 2023/24



Source: RFI responses from retailers, CMA analysis.
Note: The data in this chart excludes fuel.

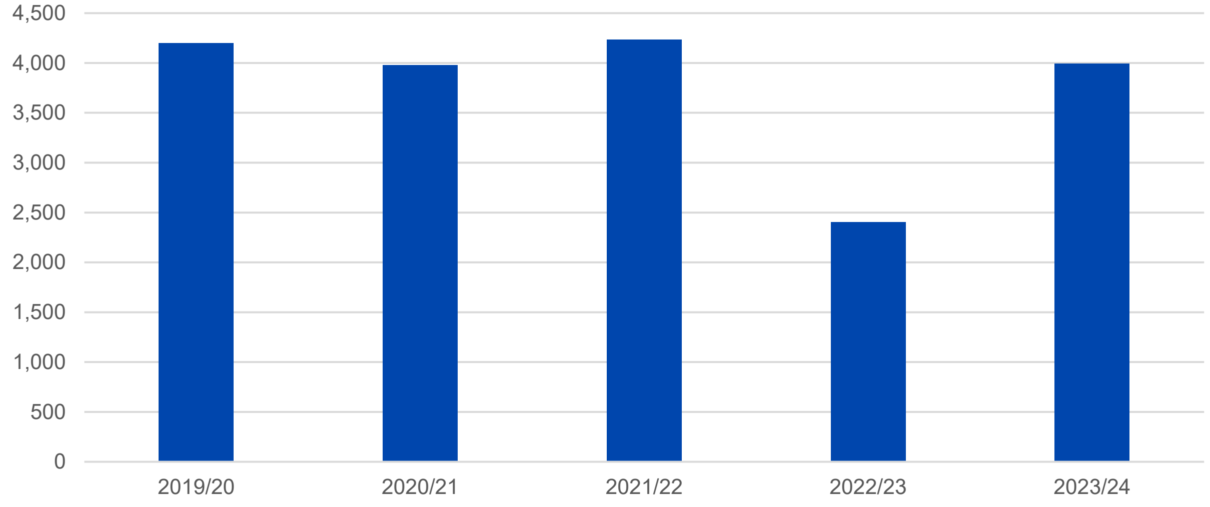
2.17 While the weighted average gross margin has increased in FY 2023/24, having fallen in the previous year, it has not reached the previous gross margin level of FY 2021/22. Much of the gross margin increase in the most recent year comes from two retailers with higher margin improvement.

2.18 Retailers explained that they continued to face inflationary pressures in the most recent year, though many also recognised that input price inflation had been easing during the year. Some retailers also said that gross margins were impacted by improving arrangements with suppliers or investments in grocery price reduction programmes.

Operating profits

2.19 Figure 2.7 below summarises the aggregate operating profits for the retailers. The main operating costs for retailers' grocery businesses are labour costs, property costs, energy costs, distribution costs (mainly fuel costs), marketing costs, information technology costs and central administrative costs.

Figure 2.7: Aggregate operating profit for the retailers' grocery businesses between FY 2019/20 and FY 2023/24 (£m)

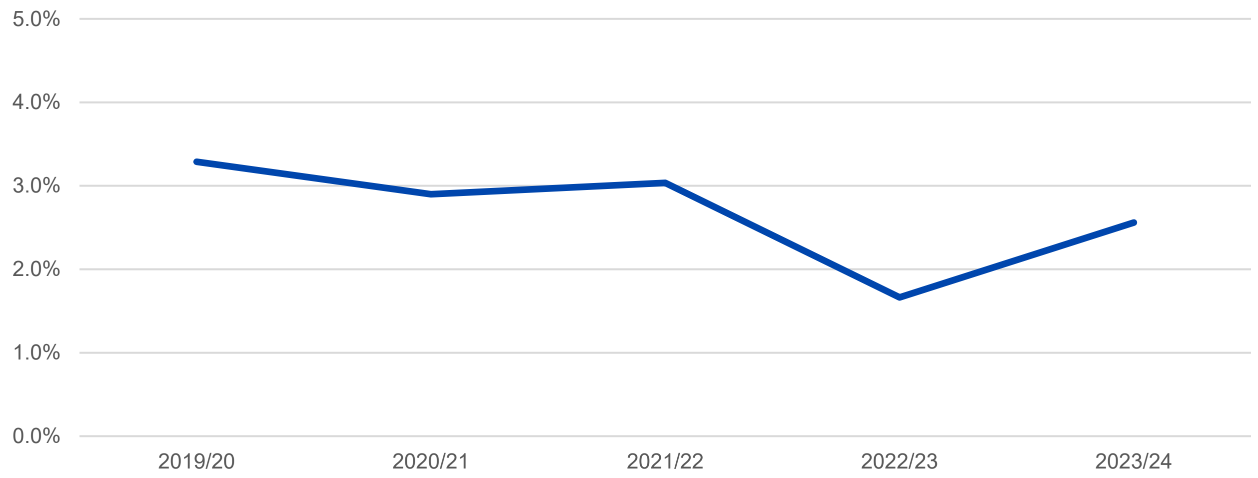


Source: RFI responses from retailers, CMA analysis.
Note: The data in this chart excludes fuel.

2.20 Aggregate operating profits for retailers' grocery businesses increased 66% in the most recent year (FY 2023/24), after declining by over 40% in the previous year (FY 2022/23). However, aggregate operating profits are still below the FY 2021/22 level.

2.21 As aggregate operating profits have grown at a higher rate than revenues in the most recent year, the weighted average operating margin (aggregate operating profits as a proportion of aggregate revenues) has increased, as shown in Figure 2.8 below. However, it remains below the weighted average operating margin in FY 2019/20 to 2021/22.

Figure 2.8: Weighted average operating margin for the retailers' grocery businesses between FY 2019/20 and FY 2023/24



Source: RFI responses from retailers, CMA analysis.
Note: The data in this chart excludes fuel.

2.22 The retailers explained that the increase in operating margins was driven by the implementation of cost saving and efficiency programmes, and easing of inflationary pressures on costs, both in operating costs (such as energy and labour) and through the cost prices paid to suppliers.

2.23 For some retailers, the increase in operating margins was also attributed to increased sales volume share, allowing margin improvement over their fixed cost base. Conversely, some retailers' margins have been negatively affected by reduced sales volumes. As a result, the extent to which operating margins have increased in FY 2023/24 varies between retailers.

2.24 In summary, in FY 2023/24 the retailers' aggregate operating profits have increased in both absolute and percentage terms but have not reached the level of the FY 2019/20 to FY 2021/22 period. The increase in the aggregate operating margin but continuation of margins being below prior peaks is consistent with the retailers' explanation that there has been some easing of inflationary pressures and that cost savings programmes have been implemented, but that there continues to be higher costs for inputs such as labour and energy.

Forecast margins

2.25 As part of our update, we asked the retailers to provide details of their financial performance in the most recent months and their forecast margins for the current year (FY 2024/25). Most retailers provided some information for this request.

2.26 The forecasts show that most retailers are planning to increase their operating margins in groceries in the current year. If the retailers achieve their planned operating margins (or, where a forecast wasn't provided, if performance for their most recent months is indicative of performance for the year), it would broadly return the average operating margin for these retailers to the level achieved between FY 2019/20 and FY 2021/22.

2.27 However, given that retailers had broadly forecast to return to this level of operating margins in the most recent year (FY 2023/24), this recovery could continue to be somewhat slower than expected. The financial performance data for the most recent months (generally up to April 2024) indicates that there is somewhat mixed evidence on whether retailers will be able to achieve their forecast increase in margins: some retailers are achieving their forecasts, while others are underperforming against them.

2.28 The forecasts also show that most retailers are planning for their gross margins in groceries to remain at current levels or decline over the current financial year (FY 2024/25). This suggests that grocery prices charged to consumers should broadly move in line with any changes in the cost of goods being incurred by retailers. The broad trend of forecast stable or declining gross margins and increased operating margins is consistent with retailers' explanation that they are continuing to focus on operating cost savings and efficiencies.

Retailers continue to seek cost savings to protect margins

2.29 In our July 2023 analysis we noted that several retailers told us that they were looking for efficiencies and other cost savings to protect against higher costs. This continues to be a trend in the market. For this update, most of the retailers noted that they continued to face cost pressures and had been implementing cost savings programmes. A number of the retailers continued to cite increased labour and energy costs as a challenge.