

GROCERIES MARKET INVESTIGATION: REMITTAL OF THE COMPETITION TEST BY THE COMPETITION APPEAL TRIBUNAL

Provisional decision

Published: 16 July 2009

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Groceries market investigation: remittal of the competition test by the Competition Appeal Tribunal

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Summary

1. On 9 May 2006, the Office of Fair Trading (OFT) referred the supply of groceries by retailers in the UK to the Competition Commission (CC) for investigation, under section 131 of the Enterprise Act 2002. In its final report (the Report) published on 30 April 2008, the CC recommended to the Government that a competition test (the Test) be applied to grocery retail planning applications as part of a package of remedies to address the adverse effect on competition (AEC) that it had found.
2. Tesco PLC (Tesco) challenged the lawfulness of the CC's decision to recommend the Test. The Competition Appeal Tribunal (the Tribunal), in its judgment published on 4 March 2009, upheld Tesco's appeal on two grounds. It found that the CC had:
 - (a) not properly assessed the economic costs of the Test, ie the risk that the application of the Test might have adverse effects on consumers in terms of leaving consumer demand unmet. Further, it had not established how long any such unmet demand might persist; and
 - (b) failed sufficiently to address proportionality and effectiveness.
3. The Tribunal referred the matter back to the CC. We undertook to make a new decision by 5 October 2009.
4. To address the Tribunal's judgment, we assessed: (a) the effects of the Test on market structure; (b) the benefits and costs that may arise as a result of the Test; and (c) the effectiveness and proportionality of the Test.
5. We provisionally concluded that the Test would (together with the controlled land remedies that we are introducing) facilitate and encourage entry and expansion in areas of high concentration by preventing a strong incumbent from reducing its competitors' incentives and ability to enter or expand in such areas. By doing so, the

Test would not only limit the future creation or strengthening of areas of high concentration but would also help to break down existing areas of high concentration over time. As a result of the Test, we expected there to be fewer areas of high concentration than there would otherwise have been, leading to an improved retail offer and more competitive outcomes for consumers.

6. We estimated the amount by which consumers might benefit each year as a result of greater competition arising in a highly-concentrated local area where the Test would prevent a strong incumbent from expanding and a new entrant comes in or an existing competitor expands. Such benefits would continue over the lifetime of the alternative development. We also estimated the economic costs that the Test might impose on consumers by preventing the incumbent from expanding, a cost that persists only until a competitor enters or expands.
7. We used a market model to estimate the size of this benefit and cost that the Test would produce, in any particular year, for any particular development in a local area, for different market structures. It combines an economic model of competition with data from our groceries market investigation to indicate how much consumers would benefit in various local market structures. We also assessed the number and proportion of developments in the period 2000 to mid-2006 that would have been blocked by the Test, as well as the market structures in those local areas. Finally, we analysed the likelihood and length of any delays we could expect before alternative developments took place.
8. We used a net present value (NPV) model to combine our quantitative estimates of the welfare effects of the Test at the local level and our assessment of the administrative costs to assess the NPV of the Test. It combines all the costs and benefits that we could quantify and takes into account when we expect they will arise,

to produce a figure for the net benefit we expect the Test to cause. We provisionally concluded that the Test would deliver a positive value to consumers when the reduction in consumer welfare in the short term is set against the longer-term benefit of increased competition when entry or expansion occurs, using a wide range of likely assumptions.

9. We also found that the Test could bring significant benefits to consumers: by facilitating greater inter-store variety in any given highly-concentrated local area (though it might limit intra-store variety); by diverting investment by retailers from highly-concentrated areas where a retailer already had a strong presence towards those areas where it could lead to additional competition; and through a national effect on prices. However, we were unable to quantify these effects and did not include them in our calculation. We therefore consider that we have significantly underestimated the benefits of the Test in financial terms.
10. Accordingly, our provisional conclusion is that the Test would act together with the controlled land remedies to facilitate and encourage entry and expansion in areas of high concentration by preventing a strong incumbent from reducing its competitors' incentives and ability to enter or expand. The impact of the Test was likely to be substantially positive in terms of our quantitative assessment of benefits and costs in particular local areas. We expected the benefits which we have been unable to quantify to be significant. We did not expect the costs of the Test to be significant or to outweigh the benefits that we have not been able to quantify. We therefore provisionally concluded that the benefits of introducing the Test were likely substantially to outweigh the costs.
11. Accordingly, we provisionally concluded that the Test would be effective in addressing and proportionate to the AEC we found in relation to highly-concentrated

local markets, taking into account our previous conclusions relating to the controlled land remedies as set out in the Report.

Provisional decision

1. The remittal of the competition test to the CC

1.1 On 9 May 2006, the OFT referred the supply of groceries by retailers in the UK to the CC for investigation, under section 131 of the Act. In the Report published on 30 April 2008, the CC recommended to the Government that a competition test (the Test) be applied to grocery retail planning applications as part of a package of remedies to remedy the AEC that it had found.

1.2 Tesco challenged the lawfulness of the CC's decision to recommend the Test. The Tribunal, in its judgment published on 4 March 2009,¹ upheld Tesco's appeal on two grounds. It found that the CC had:

- (a) not properly assessed the economic costs of the Test, ie the risk that the application of the competition test might have adverse effects on consumers in terms of leaving consumer demand unmet.² Further, it had not established how long any such unmet demand might persist; and
- (b) failed sufficiently to address proportionality and effectiveness.³

1.3 The Tribunal concluded that the CC had failed properly to consider certain matters which were relevant to its recommendation that the Test be imposed as part of a package of remedies to address the existing AEC. It held that none of those matters could be dismissed as incapable of affecting the CC's recommendation. It also said that the deficiencies in the Report's analysis, although material, were within a narrow compass, and left the vast majority of the Report and its findings unimpugned.⁴

1.4 On 3 April 2009, the Tribunal made an Order:

¹www.catribunal.org.uk/237-2053/1104-6-8-08-Tesco-Plc.html.

²Paragraph 111 of the judgment.

³Paragraph 165 of the judgment.

⁴See paragraphs 169 to 172 of the judgment.

- (1) that the decision of the Commission contained in the Report to recommend the establishment within the planning system of a competition test, as described in, inter alia, paragraphs 43, 11.12 to 11.16, and 11.437 to 11.441 thereof, as one of a package of remedies to address the AEC and its detrimental effects identified in the Report, was quashed;
- (2) that the matter be referred back to the Commission and that the Commission is directed to reconsider and make a new decision in accordance with the Tribunal's ruling.

- 1.5 We undertook to make a new decision within six months, a period expiring on 5 October 2009.
- 1.6 We published our general approach to reconsidering the Test on our website for consultation on 24 April 2009 and published our framework and technical model on 5 June 2009.⁵ We took into account the responses to these documents, as well as information gathered during our groceries market investigation and subsequently, both in writing and orally, in reaching our provisional decision.
- 1.7 We have not parsed the Report to identify precisely the elements that were quashed as a result of the Tribunal's decision, nor have we attempted to rewrite the Report in light of its judgment. Instead, we have considered further the issues related to the two grounds upheld by the Tribunal (see paragraph 1.2) and taken these into account in this provisional decision.

⁵See www.competition-commission.org.uk/inquiries/ref2009/groceries_remittal/index.htm.

2. Description of the AEC and the Test

The AEC

2.1 Section 10 of the Report sets out the findings and features of the groceries market that we identified during our groceries market investigation which prevent, restrict or distort competition. With regard to highly-concentrated areas, we found that, as set out in paragraph 10.2:

consumers are adversely affected by local markets being highly concentrated rather than more competitive. Weak competition in local markets allows a grocery retailer to worsen the store-specific retail offer at its stores in those markets and earn higher profit margins at those stores. In addition, a grocery retailer with a number of stores in local markets where competition is weak is able to weaken that part of its retail offer, such as pricing, that it applies uniformly, or near uniformly, across its stores nationally and thereby earn high profits across all of its stores.

2.2 Paragraph 10.9 of the Report sets out the features of certain local markets for the supply of groceries by larger grocery stores which, alone or in combination, prevent, restrict or distort competition in connection with the supply of groceries by larger grocery stores in those markets:

- (a) A significant number of local markets have high levels of concentration, and these high levels of concentration have in many cases persisted over a number of years.
- (b) The planning regime (in particular, PPS6 in England, SPP8 in Scotland, PPS5 in Northern Ireland and MIPPS 02/2005 in Wales) and its application by Local Planning Authorities (LPAs) in accordance with the policy objectives of the planning regime necessarily act as a barrier to entry or expansion in a significant number of local markets:

- (i) by limiting construction of new larger grocery stores; and
 - (ii) by imposing costs and risks on smaller retailers and entrants without pre-existing grocery retail operations in the UK that are not borne to the same extent by existing large grocery retailers.
- (c) The control of land by incumbent retailers through land bank sites, restrictive covenants (RCs), exclusivity arrangements (EAs), and landsites that are leased or sub-leased to third parties in highly-concentrated local markets acts as a barrier to entry, by limiting entrants' access to potential sites for new larger grocery stores.

2.3 Paragraphs 10.14 and 10.15 of the Report set out our findings as to the scale of the detriment arising from these features. We estimated that the effect of weak competition on store-level profit margins allows large grocery retailers to earn an additional £105–£125 million in profits a year at their larger grocery stores. We also said that the scale of the impact on national price levels arising from weak local competition, while difficult to measure, was potentially very substantial.

The remedies

2.4 In accordance with our duty under section 134(4) of the Act, we considered whether action should be taken to remedy the AEC. We proposed two principal remedies to address the issue of highly-concentrated local areas where the planning system and controlled landsites create barriers to entry:

- (a) the Controlled Land Order. This seeks to lift RCs or EAs in areas of high concentration that can act as barriers to entry. It also generally prohibits larger grocery retailers from imposing new RCs or EAs that may restrict grocery retailing;⁶ and

⁶See paragraphs 11.136 to 11.20 of the Report. We are currently consulting on the Order.

(b) the Test.⁷ This is essentially forward looking, aiming to prevent the emergence of certain areas of high concentration in the future, and to facilitate the dissolution of others.

2.5 We recommended that the Test should be applied to all grocery retail planning applications (extensions and new stores) that resulted in stores with a net sales area of over 1,000 sq metres. We recommended that the OFT should be made statutory consultee to the LPA. The OFT would advise the LPA whether a planning application passed or failed the Test.

2.6 As set out in paragraph 11.14 of the Report, the OFT would:

- (a) assess concentration across an area defined using a 10-minute drive time isochrone (calculated using a standard, readily available software package) around the store that is to be developed;
- (b) count the number of fascias (including that of the retailer that might operate the developed store) operating stores with net sales area over 1,000 sq metres within the isochrone. The fascias would include all full-range grocery store operators;
- (c) (where the number of fascias is three or fewer) calculate the share of groceries floor space within the isochrone that the grocery retailer operating the developed store would have after the development had been implemented; and
- (d) provide advice to the LPA on:
 - (i) whether the applicant, being a large grocery retailer, had passed or failed the Test; or,
 - (ii) where a planning application was submitted by a third party, which grocery retailers would fail the Test.

⁷See paragraphs 11.12 to 11.122 of the Report.

- 2.7 A retailer would pass the Test for a development within a particular local area (ie within a 10-minute isochrone around the development) if:
- (a) it is a new entrant in the local area;
 - (b) the total number of fascias in the local area is four or more; or
 - (c) the total number of fascias is three or fewer but the grocery retailer operating the development would have less than 60 per cent of groceries sales area in the local area.
- 2.8 A retailer would fail the Test if:
- (a) the grocery retailer is not a new entrant in the local area;
 - (b) the total number of fascias in the local area is three or fewer; and
 - (c) the retailer would have 60 per cent or more of groceries sales area (including the new development) in the local area.
- 2.9 A development that did not result in an increase in groceries sales area would still be subject to the Test, since planning conditions would be required to prevent an increase in groceries sales area in the future, but would pass it automatically.
- 2.10 In order to ensure the effective working of the Test, we also recommended that:
- (a) the Department of Communities and Local Government (CLG) and the devolved administrations take such steps as are necessary (including changes to planning policy) to ensure that when an LPA gave open A1 planning permission (which would allow any type of retail development), it should limit the grocery sales area in the development to less than 1,000 sq metres (as an anti-avoidance provision);
 - (b) CLG and the devolved administrations take such steps as are necessary to ensure that LPAs should take account of the OFT's advice on the result of the Test and should only approve applications that fail the Test in exceptional circumstances, defined as:

- (i) the particular development would produce identified benefits for the local area that would clearly outweigh the detriment to local people from the area becoming or remaining highly concentrated in terms of grocery retailing; and
- (ii) the development, or any similar development, would not take place without the involvement of a large grocery retailer that had failed the Test.

2.11 In addition, we said that we would require grocery retailers to:

- (a) provide information about sales areas when requested to do so by the OFT; and
- (b) notify the OFT of all acquisitions of existing stores of more than 1,000 sq metres.

3. Our approach to reconsideration of the Test

3.1 In the light of the Tribunal's judgment, we carried out our further analysis by reference to the Test as set out in our Report, rather than starting afresh.

3.2 Our additional work builds on the analysis that we conducted and the data that we gathered during our groceries market investigation, including using the database that we constructed based on retailers' stores at mid-2006.⁸ This ensures consistency with the original investigation and is also, in our view, more practical in the time available than updating our database (given the time taken to compile the original database). Where more recent information was submitted to us, we took this into account and used it, as appropriate, to corroborate our findings.⁹

3.3 We did not attempt to predict the outcome of the Test on a site-by-site basis. We did not consider this to be a practicable exercise. Such an exercise would necessarily rely to a large extent on a judgment about the individual likelihood, timing, location

⁸We used retailer strategy documents (store development plans and market priority area reports) updated as at May 2009, rather than asking the retailers to give us plans as at summer 2006 (ie at the time the retailers submitted other data in response to our initial market questionnaire).

⁹Tesco, for example, submitted its assessment of the impact of the Test, had it been in place, on developments completed by all major retailers between mid-2006 and end 2008. In order to update our database of developments, however, we would have needed details from all retailers. We used Tesco's analysis to corroborate our findings based on 2000 to 2006 data.

and size of entry or expansion by a particular fascia in a particular local area. Further, any consideration of current circumstances may not reliably represent situations that might arise once the Test is in force. We therefore chose, instead, to take representative market scenarios based on observed facts in order to forecast likely outcomes.

3.4 In order to assess the costs and benefits that are likely to arise as a result of the Test, we assess how it may affect concentration in local areas, and the effect that any such changes in concentration might have on the various aspects of the retailers' offer to consumers. During the groceries market investigation we found that some elements of quality, range and service levels were set locally, while prices were set uniformly, or near uniformly, across retailers' stores nationally. We consider how the Test may affect both such local and national parameters. We did, however, use the database to identify representative likely market scenarios (see paragraphs 5.31 and 5.35) which were then used, as we explain in Section 5, when applying the model we developed.

3.5 In order to address the Tribunal's judgment, we therefore assess:

- (a) how the Test affects market structure (see Section 4);
- (b) the benefits and costs that may arise as a result of the Test (both those that we could quantify and those that we could not) (see Section 5); and
- (c) the effectiveness and proportionality of the Test (see Section 7).¹⁰

¹⁰We note that in paragraph 137 of the Tribunal's judgment reference is also made to two other principles of proportionality: that the measure concerned must be no more onerous than is required to achieve that aim; and that it must be the least onerous, if there is a choice of equally effective measures. We addressed these principles in our Report and they were not subsequently challenged. We have not, therefore, returned to these questions in this provisional decision.

4. Effects of the Test

Object and rationale

- 4.1 The Test is designed to address the AEC deriving from the features identified in paragraph 10.9(a) of the Report. In doing so, it is intended both to:
- (a) prevent the emergence or strengthening of certain highly-concentrated local areas;¹¹ and
 - (b) facilitate and encourage the reduction in concentration in existing highly-concentrated local areas.
- 4.2 In assessing the effects of the Test, we focus in particular on the way in which it would facilitate and encourage new entry or expansion. Such entry directly affects the reduction in concentration in existing highly-concentrated local areas (see paragraph 4.1(b)), but is also relevant to preventing the emergence or strengthening of highly-concentrated local areas (see paragraph 4.1(a)).
- 4.3 The Test would prevent the expansion of strong incumbent retailers, ie those with a share of 60 per cent or more of groceries retail space within a 10-minute isochrone of a planned development.¹² Where it applies, the Test would therefore prevent a highly-concentrated local area from becoming more concentrated. We aim to achieve this result because we found during our groceries market investigation¹³ that the greater the degree of local competition faced by a store, the lower the store's variable profit margin. This reflects the fact that stores facing greater competition at the local level will generally need to incur greater cost to improve their offer to consumers

¹¹Some highly concentrated areas are not prevented by the Test—see paragraph 4.8.

¹²We note that, with the exception of a single store area, the Test leaves significant room for growth of at least one competitor already present in the local area. Where two competitors each have 50 per cent of grocery sales area, for example, either competitor could expand by up to 50 per cent and still satisfy the Test. For example, if two competitors each have 1,000 sq metres grocery sales area and one increases by 500 sq metres, the market share of the larger retailer would be $(1,500/2,500) = 60$ per cent. In the case of three equal sized competitors, the size of any competitor can increase by 150 per cent without being blocked by the Test.

¹³See, for example, Appendices 4.4 and 6.2.

relative to those that face less competition.¹⁴ Conversely, where a grocery store faces little competition, we found that on average it earns a higher variable profit margin, since it will be able to provide a less attractive offer to consumers and therefore incur lower costs. Accordingly, consumers would benefit where the Test prevents increased concentration or reduces current concentration.

- 4.4 Absent the Test, an incumbent grocery retailer with a strong market position in a local area with sufficient consumer demand may expand (by building a new store or extending an existing store), in order to protect its market position and reduce competitors' incentive and ability to enter or expand in the same area. We received several submissions from retailers during our groceries market investigation which confirmed that expansion by an incumbent can act to prevent potential entrants from entering a local area.¹⁵
- 4.5 By building a new store or by extending an existing store, a strong incumbent can reduce the *incentive* that a prospective entrant has to enter or a competitor to expand in that local area. Prior to its expansion, the strong incumbent's offer may have been constrained by its capacity, forcing it to incur higher costs in supplying customers. An expansion by the strong incumbent will reduce its costs, thereby making it less profitable for a competitor to enter or expand. Accordingly, by expanding, the strong incumbent may have the effect of pre-empting entry or expansion by a competitor.
- 4.6 Moreover, by expanding through a new store or an extension, a strong incumbent can also reduce a competitor's *ability* to enter or expand since:

¹⁴This may include, for example, greater stock availability, improved management and service levels, store refurbishments, or local vouchering campaigns.

¹⁵For example, Sainsbury's said in its initial submission in August 2006 that '*the number and scale of the stores present in a local market can act as a barrier to further entry into that market. In particular, if a store is built or expanded to such a scale that it meets a sufficiently large share of local demand, then subsequent entrants may find that no profitable entry opportunity exists in that market, even though it would have profitably sustained two stores had the original store been at a smaller scale...Consumers are therefore deprived of choice...*'. Asda said in its initial submission '*The planning regime thereby allows incumbents to use extensions and town centre developments to soak up capacity ('need') and frustrate potential competitive entry.*'

- (a) the expansion by the strong incumbent reduces the likelihood of a new large store passing the need test within the planning system;¹⁶ and
- (b) the building of a new store deprives a potential entrant of a suitable site for entry.

4.7 Where a strong incumbent retailer can pre-empt entry or expansion by competitors, by expanding in a highly-concentrated area, that highly-concentrated area is more likely to persist over time. The analysis that we carried out during the groceries market investigation showed that highly-concentrated areas tended to persist over time.¹⁷

Creation of some new highly-concentrated areas

4.8 The Test does not, however, prevent all new highly-concentrated areas from forming. For example, a new large store built more than 10 minutes drive time from any existing large store would create a new highly-concentrated area, but would pass the Test. In doing so, the Test allows new entry and the greater choice this brings to consumers.

How the Test will work

4.9 The Test does not directly increase competition: it prevents certain developments by strong incumbents. While such incumbent developments might have brought some benefits to consumers, developments by competitors would benefit them to a greater extent. Accordingly, for the Test to deliver pro-competitive results, there must be sufficient, and sufficiently timely, entry or expansion by competitors for the benefits of

¹⁶The need test is described in paragraphs 7.35 to 7.44 and Appendix 7.2 of the Report. The Government is presently consulting on a draft of a new planning policy statement which incorporates planning policy concerning retail development. The Government plans to publish a summary of responses to the consultation by autumn 2009. The draft proposals include removing the need test for considering planning applications (but not for the preparation of development plans) and replacing the need test with an impact test which assesses the social, environmental and economic impacts of a development if it does not accord with an up-to-date development plan and is in an out-of-centre location.

¹⁷See paragraph 7.10 and Table 7.1 of the Report. In 2000, there were 186 stores larger than 600 sq metres in Great Britain belonging to Asda, Morrisons, Safeway, Sainsbury's and Tesco which faced no or only one competitor in their local markets. In 2006, 86 per cent of these stores continued to face no or only one competitor.

increased competition to outweigh the detriment that preventing the strong incumbent's development may cause.

- 4.10 As we explain in paragraphs 5.15 to 5.17, we expect the Test to alter the incentives and ability that retailers have to invest in different areas. We cannot predict precisely which local areas would attract development as a result of the Test, nor the identity of the retailer that will enter, but the evidence we have shows that retailers actively seek to invest in a large number of areas, including those that are highly concentrated (see paragraph 4.13). Accordingly, where development by one retailer is prevented, we expect competitors to undertake replacement developments. We therefore expect the Test to change the overall pattern of investment by retailers and to deliver greater competition, thus benefiting consumers.
- 4.11 Similarly, we see no reason to expect retailers to reduce their overall levels of investment significantly once the Test is in force even if, as strong incumbents in some local areas, they are prevented from investing in particular areas. We would expect retailers to divert much of this investment to other areas where they are not strong incumbents. We would expect such diverted investment to improve competition and provide additional consumer benefits in those areas.
- 4.12 During proceedings in the Tribunal and more recently, various arguments have been raised as to why competitors might not enter or expand in a highly-concentrated local area where the strong incumbent is prevented from expanding by the Test despite there being sufficient local demand to merit an alternative development. These include: remaining planning barriers (for new stores); possible restrictions on retailers' budgets for expansion; the finding in paragraph 7.25 of the Report that retailers rarely compete head-to-head for new sites in auction-type processes; the

fact that different retailers may be more suited to certain demographic areas than others; and the fact that few larger stores are built each year.¹⁸

4.13 We note, however, that, in general, there is competition in any particular segment of the market. We reviewed the retailers' existing development plans which demonstrated considerable appetite for expansion.¹⁹ In addition, in most cases, the retailers had expressed interest in expanding into areas of high concentration (see paragraphs 5.57 and 5.60). We found that retailers devote considerable resources to exploring possible development opportunities and much of the data on which investment decisions are taken is publicly available. We did not think that the lack of many examples of auction-type processes where grocery retailers competed head-to-head indicated a lack of competition between retailers for sites, since we believe that competition for sites will take place in a variety of ways of which auction-type processes are only one example. To the extent that there are planning barriers, these would be likely to apply as much to the strong incumbent as to the new entrant. We therefore found that, where a strong incumbent seeks to expand through building a new store, a competitor would be likely to enter or expand within the same timescale.

Routine and facilitated entry

4.14 Tesco submitted that we should distinguish between 'routine' and 'facilitated' entry.²⁰ Routine entry was defined as entry that would happen in any event, whether or not the Test was in operation; facilitated entry only occurs as a result of the Test. It was

¹⁸See paragraph 97 of the Tribunal's judgment and [§].

¹⁹The six largest grocery retailers responded to our request for their development plans at the start of the groceries remittal:

- (a) Asda gave us a list of [§] store developments, a list of more general plans for each of its existing stores over the longer term, and a list of [§] target areas for new stores.
- (b) M&S provided a list of [§] 'full line' store developments for 2009 to 2012, [§] of which have capital allocated. As at mid-2006, it had approximately [§] target locations (of which approximately [§] per cent were for developments to existing stores).
- (c) Morrisons told us of [§] locations for planned developments (comprising new stores, extensions, refurbishments), and approximately [§] market priority areas.
- (d) Sainsbury's planned [§] new-build store developments and [§] extensions, [§] slightly longer-term new-build store developments and [§] slightly longer-term extensions. It said that it would seek to enter [§] markets.
- (e) Tesco had [§] specific store development plans and [§] key market areas.
- (f) Waitrose gave us a market development plan showing [§] proposed supermarket developments. Waitrose appeared to target around [§] new [§] stores a year.

²⁰[§]

suggested to us that we should only take account of facilitated entry in our assessment of the effects of the Test.

4.15 We agree that, in principle, it would be helpful to distinguish between the two and we recognize that there has been some entry into highly-concentrated local areas in the past that has reduced concentration.²¹ However, in practice, it is not easy to identify entry or expansion that might occur absent the Test, and entry or expansion that is facilitated by the Test. In particular it would not be clear whether a development would have taken place in the same form in the absence of the Test, or whether the scale or nature of the development would have been adjusted to take account of the fact that the entrant knew the incumbent would be deterred from developing by the Test. In addition, we did not find a substantial overlap between areas where there were developments that would have been deterred by the Test, and those where we observed entry between 2000 and 2006.²²

4.16 Accordingly, we thought it unlikely that routine entry would be a significant factor. Nevertheless, we take routine entry into account in our sensitivities in our NPV model by adjusting the number of developments, our delay assumptions, and the probability of entry or expansion (see paragraphs 5.82 to 5.85).

Specific considerations for extensions

4.17 We considered how entry or expansion might replace extensions that were deterred by the Test. We considered whether, given the relatively smaller size of extensions compared to new store developments, there may not always be sufficient demand to support a new competitor store in the place of an incumbent's extension. However,

²¹We note that the persistence analysis detailed in Appendix 7.3 of the Groceries Market Investigation report showed there had been some entry into the monopoly and duopoly areas detailed.

²²We found that the level of entry into highly concentrated areas was similar to that reported in the persistence analysis detailed in Appendix 7.3 of the Report. Our analysis also showed that between 2000 and 2006 there was competitor entry into around 10 per cent of the areas where the strong incumbent retailer would have been deterred from developing a new store or extension by the Test.

we note that the average size of an extension during 2000 to mid-2006 was around 1,400 sq metres, of which around 40 per cent was groceries sales area (see Table 2).²³ This would, in many cases, warrant the building of a new large store. Moreover, a new store would be in a different location from the existing store and hence likely to attract new customers. Of those extensions that would have been blocked by the Test, we found that around half were in single store areas. Where the extension was in an area which included at least one other fascia, rather than attracting new entry, the strong incumbent's proposed extension could also be replaced with an extension by a weaker incumbent.²⁴

- 4.18 This indicated to us that, in the case of extensions deterred by the Test, a competitor would often have the incentive and ability to build a new store or extend an existing store within the same isochrone. In the small number of cases where demand is insufficient to support a new store and no weaker incumbent stores are present which might satisfy the demand through an alternative extension, unless the exceptional circumstances clause were to apply, there may be ongoing costs associated with the Test in that particular local area (see paragraph 5.8). We build this into our assessment of the effect of the Test (see Section 5).

Conclusion on effects of the Test

- 4.19 In summary, we therefore expect the Test to act together with the controlled land remedies to facilitate and encourage entry and expansion in areas of high concentration by preventing a strong incumbent from reducing its competitors' incentives and ability to enter or expand. By doing so, it will not only limit the future creation or strengthening of areas of high concentration (see paragraph 4.3), but would also help to break down existing areas of high concentration over time. As a

²³If we consider only those extensions that would have been blocked by the Test, the average size was 1,420 sq metres of which just over 50 per cent was groceries sales area.

²⁴We use the term 'weak incumbent' throughout to refer to a competitor in a local area with a share below 60 per cent, and 'strong incumbent' to refer to a competitor in a local area with a share of 60 per cent or more.

result of the Test, we expect there to be fewer areas of high concentration than there would otherwise have been, leading to an improved retail offer and more competitive outcomes for consumers.

5. The benefits and costs of the Test

5.1 In this section we:

- (a) set out the framework for our assessment of the benefits and costs of the Test;
- (b) describe the analysis that underlies our quantification of the effects of the Test on the structure of local competition; and
- (c) use a standard NPV model to estimate the overall impact of the Test in financial terms and the robustness of our findings given various different assumptions.

This combines all the elements that we quantified, and takes into account when we expect that they will arise, to produce a net estimate of the value of the Test.

The framework for our assessment of the benefits and costs of the Test

5.2 In addition to the benefits and costs that are likely to arise as a result of the effect of the Test on the structure of local competition, we identified several other benefits, arising from:

- (a) increased variety;
- (b) diverted investment; and
- (c) national effects.

5.3 We also considered administrative costs and submissions put to us on various other possible costs.

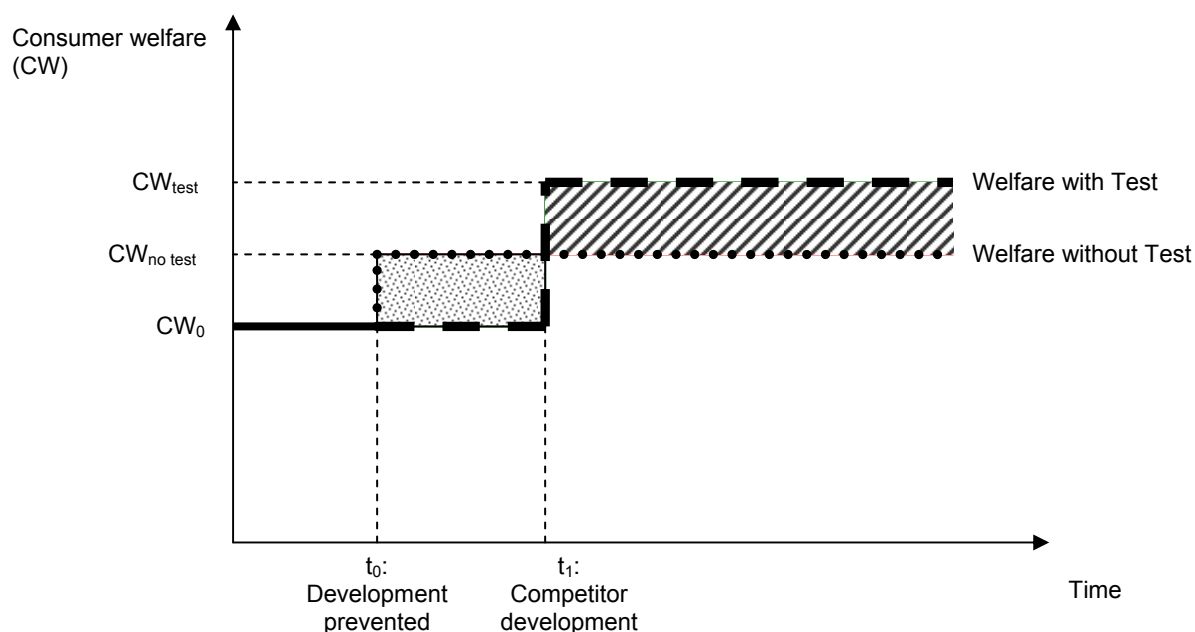
Effect on structure of local competition

5.4 The Test works by deterring certain developments by strong incumbents, thereby creating opportunities for competitors to enter or expand. While those incumbent

developments would have increased consumer welfare, a development by a competitor would produce greater benefits for consumers. This is illustrated by Figure 1.

FIGURE 1

Consumer welfare in a highly-concentrated local area with and without the Test



Source: CC analysis.

5.5 Figure 1 shows how consumer welfare develops over time in a highly-concentrated area. It shows the Test preventing an incumbent development that would otherwise have opened at time t_0 . Without the Test, the incumbent development would go ahead and would increase consumer welfare from CW_0 (the level of consumer welfare in the highly-concentrated area prior to any development) to $CW_{no\ test}$ (as shown by the dotted line).

5.6 By preventing this incumbent expansion, the Test provides an opportunity for a development by a competitor. Figure 1 shows the competitor development opening at time t_1 . This increases consumer welfare from CW_0 to CW_{test} (as shown by the bold

dashed line). The competitor development increases competition in the local area and consumer welfare is therefore higher than it would have been had the incumbent development gone ahead.

5.7 The striped area shows the benefits consumers in a local area derive from the Test. Such benefit may be in the form of increased quality and service. It could also be in the form of increased range of goods and reduced prices, although our model does not quantify this effect. The Test delivers a welfare benefit starting from when a competitor development opens. It therefore depends on three factors.

- (a) the annual consumer welfare gain through increased competition, ie the size of the difference between the bold dashed and the dotted line ($CW_{\text{test}} - CW_{\text{no test}}$);
- (b) the length of time during which consumers enjoy the benefits from increased competition (ie time t_1 onwards); and
- (c) the probability of a competitor development occurring.

5.8 The speckled area shows the 'cost' that consumers in a local area might suffer from the Test. The Test causes a delay cost for as long as an incumbent development prevented by the Test is not replaced by a competitor development. It depends on two factors:

- The annual foregone welfare consumers would have derived from the incumbent's development, ie ($CW_{\text{no test}} - CW_0$); and
- The length of time during which consumers are deprived of an additional store, ie $t_1 - t_0$.

5.9 With regard to new stores, the delay cost may take the form of consumers in that area suffering greater travel times and expenses than they would have done had a more convenient store opened nearby or, perhaps, a smaller range of goods than the expanded incumbent might have provided across its original and new stores. With

regard to extensions, consumers in that area might be offered a smaller range of goods or a lower level of service (eg fewer check-outs increasing queuing times) compared with the one that they would have been offered had the extension been allowed. These economic costs have also been referred to as 'unmet demand'.

5.10 We set out in detail in paragraphs 5.22 to 5.65 how we have sought to quantify these effects on the structure of local competition produced by the Test.

5.11 We have identified other benefits of the Test arising from increased variety, diverted investment and national effects, which we consider in paragraphs 5.12 to 5.18. While we expect them to be significant, we have not been able to find robust methodologies for quantifying them. We therefore expect that we have significantly underestimated the benefits of the Test in financial terms. We take them into account, however, in reaching our provisional conclusions on effectiveness and proportionality in Section 7. In paragraphs 5.19 to 5.21 we discuss the administrative costs of the Test and various other possible costs that have been put to us.

Increased variety

5.12 The Test would bring significant benefits to consumers by facilitating greater variety in any given local area. If the Test facilitates an increase in the number of fascias in a local area, consumers would have access to a greater variety of stores and products since retailers differ in the selection of products that they offer.²⁵

5.13 In general, whenever consumers have different tastes, the addition of new products can bring significant benefits to a group of consumers. We have not identified a methodology that could robustly quantify the size of the effect of either increased

²⁵For instance, retailers earn a significant proportion of their turnover from own-brand goods (over one third of total food and drink sales). Different fascias within 10 minutes drive of each other would therefore offer consumers two competing ranges of own-brand goods, which we expect to be a broader range of goods than an incumbent expansion would have offered but for the Test.

inter-store ranges as a result of new entry, or of increased intra-store ranges (that might be offered but for the Test), and so have excluded this effect from our quantification.

- 5.14 However, we expect the addition of variety represented by the introduction of a new fascia in the area, thus increasing inter-store variety, to exceed the increase represented by an incumbent expansion (thus increasing intra-store variety).²⁶ On balance, we therefore expect that we have considerably underestimated the benefits of the Test by not quantifying the positive welfare consequences from greater inter-store variety.

Diverted investment

- 5.15 We expect the Test to alter the retailers' investment patterns in a way that will deliver significant net benefits. The Test is designed to limit strong incumbents from further strengthening their positions in areas of high concentration. This creates opportunities for other competitors to enter or expand in such areas. In addition, investment by strong incumbents would be directed away from areas of high concentration and towards those areas where it can lead to additional competition.
- 5.16 The evidence that we have on retailers' investment strategies shows that, in general, retailers have significant plans for expansion. They set their growth plans by setting high level financial targets and translating these into lower level growth plans. If a particular development is prevented by the Test, we would expect the retailer in question to develop its store portfolio in some other way in order to achieve their

²⁶Research by Hausman (1997, 1999, 2002 and 2005) and by Brynjolfsson, Jeffrey and Smith (2003) suggests that, while efficiency gains from increased competition significantly enhance consumer welfare, increased product variety can be a significantly large source of consumer welfare gains. A study by the Advanced Institute of Management Research (AIM) on consumer satisfaction with local grocery retailing also suggested that consumers valued store variety (see paragraphs 3.55 and 3.56 of the Report).

financial targets. In some cases, this may result in store refurbishments;²⁷ in others, a retailer may be able to respond by bringing forward another development that would be permitted by the Test in response, in particular, to the opportunities created as the Test prevents the strong incumbent from expanding in a local area.²⁸

5.17 Any investment that would be deterred by the Test and is then redirected will deliver greater consumer benefits in terms of competition than would have been the case had the original development proceeded. These types of benefits are captured in our analysis to the extent that such redirected investment translates into competitive entry in areas where other retailers would have been prevented from expanding by the Test. Any redirected investment over and above that incorporated in our analysis and that might, for example, be turned to new large stores in other highly-concentrated areas, can be expected to generate significant additional benefits. We expect that excluding these additional benefits from our calculation underestimates the benefits deriving from the Test.

National effects

5.18 For the most part, retailers set grocery prices uniformly, or near uniformly across stores nationally (see paragraph 2.1), the level at which they are set depends ultimately on how consumers react to any given change in price. Consumers' responsiveness to price changes in turn depends on how easily they can access more competitive alternatives. By facilitating and encouraging new entry or expansion to reduce areas of high concentration and hence providing more competition at the local level, the Test will therefore not only create incentives for retailers to improve their offer by adjusting locally-determined competitive variables,

²⁷For example, Tesco, in its 2006/07 business plan, said that it would be possible to increase like for like sales growth by [§] at a cost of £[§] million. Similarly, Waitrose planned to upgrade its existing branches through a store improvement programme [§].

²⁸For example, Tesco, in its response to our market questionnaire, told us that there were many sites available for development in the UK. In its 2006/07 business plan, Tesco referred to additional, as yet unidentified, stores that had been added to the plan to close any sales gaps and meet UK sales growth plans.

but will also provide more opportunities for consumers to switch between retailers in response to price changes by any individual retailer. This will provide greater incentives for retailers to charge lower prices. We have not quantified this and therefore expect that we have underestimated the benefits of the Test by not taking into account the effects of the Test on national grocery prices.

Administrative costs

5.19 In our Report, we identified the administrative costs that the Test would be likely to generate (see paragraphs 11.382 to 11.389). These amounted to £6–8 million each year.²⁹ Since this cost was not disputed before the Tribunal we have used these figures in our assessment of the quantifiable costs and benefits arising from the Test.

Other possible costs

5.20 It was put to us during the remittal process that there were several costs that we should take into account, including the costs of additional complexity and delay in the system, and the costs of data collection. We addressed these in our Report (see paragraphs 11.385 to 11.389). We thought that the Test would not result in additional delays to the planning system and that our estimate of administrative costs was realistic. We also considered in our Report the possibility of retailers gaming the Test but felt that the incentive to do so would be limited because retailers have preferred store formats, from which they may be unwilling to deviate (see its paragraph 11.81). It was also put to us that there might be a spillover cost of the Test into non-food provision. We aim, however, to limit the impact of the Test on non-food provision by specifying that developments that did not result in an increase in groceries sales area would be allowed by the Test.

²⁹As set out in paragraphs 11.387 and 11.388 of our Report, we do not believe that the Test will result in more time being required to consider or determine planning applications.

5.21 We therefore do not think that such additional non-quantifiable costs are significant, nor that they outweigh the benefits that we have not been able to quantify, in our overall assessment of the Test.

Quantification of effects of the Test on the structure of local competition

Introduction and framework

5.22 We carried out modelling to assess the impact of the Test at the local level by comparing consumer welfare for different outcomes under different representative market scenarios (the market model—see Appendix A). This allowed us to estimate the annual consumer welfare from a competitor development and an incumbent development whenever each arise (as illustrated in Figure 1).

5.23 On their own, these figures do not determine the outcome of our assessment. The timing of competitor development is key, as it affects the duration of both the economic cost, and of the subsequent benefit. Accordingly, we looked at the time taken for developments to occur and formed a view on the likelihood and length of delays that might arise if the Test prevented a development in a particular local area by a strong incumbent.

5.24 We used our database of stores and developments during the period 2000 to mid-2006 to identify the market structure of those areas where developments would have been affected and used this to inform our modelling scenarios. We also used this database to estimate the number of local areas that the Test might affect. We used the retailers' development plans and investment strategies to help us to assess the likelihood of new entry. We assessed the impact of the Test on the construction of new stores and, separately, on extensions.³⁰ We used an NPV model to look at the

³⁰For the purpose of our analysis, we consider off-site replacement stores as new stores and on-site replacements which are bigger than the existing store as extensions. We did not include acquisitions of stores as new stores.

total quantifiable benefits and costs that would be likely to arise as a result of the Test.

5.25 We carried out three analyses to help us to generate the inputs necessary for our quantitative assessment of benefits and costs. We discuss in turn, for both new stores and extensions:

- (a) the size of the benefits that consumers may enjoy and the delay costs that consumers may suffer in any particular year for any particular development in a local area, for different market structures;
- (b) the number of developments in the period 2000 to mid-2006 and an estimate of the proportion that would have been blocked by the Test, as well as an analysis of the market structures in each of those local areas where developments would have been blocked; and
- (c) the likely delays before alternative developments take place.

5.26 Establishing these three elements allows us to estimate whether, overall, the Test will provide benefits from increased competition in those highly-concentrated areas where the Test would prevent an incumbent from expanding that will outweigh the economic costs (see paragraphs 5.66 to 5.88). We can then form a view as to the overall effectiveness and proportionality of the Test, taking into account the other benefits of the Test that we could not quantify and the effects described in Section 4.

5.27 We note the effect of the ability of LPAs to override the Test (see paragraph 2.10). LPAs may permit a development to proceed where it would produce identified benefits for the local area that would clearly outweigh the detriment to local people from the area becoming or remaining highly concentrated in terms of grocery retailing and the development, or any similar development, would not take place without the involvement of a large grocery retailer that would be prevented by the Test. This

ability serves to limit the extent of any economic costs that might arise as a result of the Test. However, we have not taken this into account in estimating the costs and benefits of the Test, so our estimate of economic cost is to that extent overstated.

Benefits and costs in different market structures

- 5.28 We built a market model of how retailers and consumers might behave and used observed data to calibrate the model so that it predicted outcomes correctly in situations that we have observed. We used the calibrated model to simulate the effect of the Test in those situations where we expect it to apply.³¹
- 5.29 To estimate the benefits and costs for consumers that may arise as a result of the Test, we first considered a store development that the Test would deter. By comparing consumer welfare with and without that additional development, we produced an indicator of the annual 'cost' of the Test in terms of its impact on consumer welfare (ie $(CW_{no\ test} - CW_0)$ in Figure 1). However, competitors may respond to the opportunities presented for entry and expansion that occur as a result of the development being prevented in different ways. For example, a new large store might be built by a new entrant; a new store could be built by a weaker incumbent; or a weaker incumbent might extend an existing store; and we modelled each of these. By assessing the effect that a competitive, rather than a strong incumbent, development would have on consumer benefit we estimate the annual benefit (ie $(CW_{test} - CW_{no\ test})$ in Figure 1). In order to estimate the total quantifiable impact of the Test, we then used our estimates of how often and for how long we expect each of these annual measures to occur (see paragraphs 5.37 to 5.65).
- 5.30 In paragraphs 5.37 to 5.48 we set out our analysis of developments in the period 2000 to mid-2006. We looked at the market structure in those areas where the

³¹This is a standard approach in counterfactual analysis.

developments would have failed the Test. We found that the majority of the developments were in single store areas or two store areas.³² We therefore used these two market scenarios in our market model. In our analysis, we derive the determinants of consumer welfare under various scenarios and compare them to evaluate the appropriate benefits and costs. We outline the analysis that we did for new stores and extensions in paragraphs 5.31 to 5.36. Full details of our market model and the results that we obtained from it are set out in Appendix A.

New stores

- 5.31 In order to estimate the annual *benefits* that arise as a result of the Test facilitating increased levels of competition, we considered three scenarios:
- (a) A competitor enters to challenge the incumbent monopolist retailer. We compare the consumer welfare in this case with the consumer welfare that would be realized if it were the incumbent that expands by building a large store to estimate the benefits from the Test in that local area in a year.
 - (b) Two retailers are already competing in the local area and a third retailer enters. We compare this scenario with one where one of the two incumbents builds a new large store instead. The difference in consumer welfare between the former case and the latter gives us an estimate of the benefits from the Test in that local area in a year.
 - (c) The strong and the weak retailer are already competing in a local area and the weak retailer builds an additional store. We compare this scenario with one where the strong incumbent builds a new large store instead. The difference in consumer welfare between the former case and the latter gives us an estimate of the benefits from the Test in that local area in a year.

³²According to our analysis, out of a total of 133 developments, there were 61 developments in areas where there were no competing fascia, of which 57 were single store areas. Another 61 developments were in areas where there was one competing fascia (of which the strong incumbent had a single store in around two-thirds of cases).

5.32 In order to estimate the annual costs (in terms of lower consumer welfare) of preventing a new store development in a local area, assuming no alternative development, we also consider three market scenarios, which together account for the majority of existing highly-concentrated areas in terms of the number of competing fascias.³³

(a) A strong incumbent retailer that operates one large store in an area with no other large stores builds a second large store, increasing consumer welfare. We compare the consumer welfare in the two-store case and in the one-store case to estimate the cost of the Test arising from preventing a store development in that local area in a year.³⁴

(b) One retailer already competing with another retailer in a local area (each having 50 per cent share), builds another large store that takes its share over 60 per cent. We compare the consumer welfare in the three-store case and in the two-store case to estimate the cost of the Test arising from preventing a store development in that local area in a year, if no other retailer enters at the same time.

(c) A strong incumbent (with a market share of between 60 and 70 per cent) already competing with a weaker incumbent, builds another large store in a local area. We compare the consumer welfare in the three-store case and in the two-store case to estimate the cost of the Test arising from preventing a store development in that local area in a year, if no other retailer enters at the same time.

5.33 We estimated annual 'costs' of £3.2 million arising from the Test when a new store is prevented and there is no alternative development under assumptions likely to overestimate such 'costs'. However, if there is an alternative development, then there is a gross annual benefit of between £3.5 million (in the case of expansion by a weak

³³The areas with only one fascia or with two competing fascia for new store developments together represent 80 per cent of highly concentrated areas (33 per cent and 47 per cent respectively).

³⁴To reiterate the importance of duration and timing of entry in our estimates, this cost occurs only if no other retailer enters at the same time as the strong incumbent would have opened the second store.

incumbent) and £3.8 million (when a new fascia enters the local area) compared with a situation in which there is no development. This means that the additional or net annual benefits of increased competition (above the benefits of development by the strong incumbent) vary between £0.3 million when a weak incumbent develops a store and £0.6 million when a new fascia enters the local area. As noted, in order to estimate the quantifiable cost and benefit of the Test, we also need to form a view on the probability and timing of a competitor development.

Extensions

- 5.34 We also modelled the effect of the Test on proposed extensions to existing stores. In order to do this, we started from the assumption that a store would incur progressively higher marginal costs in order to satisfy levels of demand greater than those it could comfortably meet given its size. This might involve, for example, employing extra staff to help pack groceries at the check out in order to increase the flow of customers or restocking aisles more frequently.
- 5.35 We used the same market scenarios as for the new stores. We distinguished between three possible responses to the Test preventing an incumbent's extension: new entry by another retailer, a second store by a weaker incumbent, or an extension by a weaker incumbent. The benefits in a particular local area were estimated by comparing these outcomes to a situation where the strong incumbent is allowed to extend its store.
- 5.36 We estimated annual 'costs' of between £0.6 million and £0.8 million arising from the Test when an extension is prevented and there is no alternative development, depending on the initial market structure, under assumptions likely to overestimate such 'costs'. Our estimate of long term additional annual benefits of increased

competition arising from the Test depends on the response to an extension prevented by the Test:

- (a) When a new store is developed we estimate that the annual benefits associated with that store vary between £1.2 million and £1.6 million depending on whether the new store is developed by a weak incumbent or a new entrant, so that the additional or net benefit associated with competitive development relative to development by the strong incumbent is between £0.6 million and £0.8 million.
- (b) When an extension by a weak incumbent is developed we estimate the annual benefits associated with that development to be between £0.8 million and £1.0 million, so that the additional or net benefit associated with competitive development relative to development by the strong incumbent is £0.2 million.

Again, in order to estimate the quantifiable cost and benefit of the Test, we also need to form a view on the probability and timing of a competitor development.

Number of developments each year and proportion that might be deterred by the Test

5.37 We assessed the number and market structure of local areas where the Test would have deterred strong incumbents from expanding.³⁵ These areas comprise both areas where concentration is already high and those where concentration would become high should one or more of the incumbents seek to expand. We used this analysis to develop views on the likely future impact of the Test.

5.38 We analysed data provided by the parties on developments (both new stores and extensions) relating to the period 2000 to mid-2006 gathered during the groceries

³⁵In our approach document, published on 24 April 2009, we said that we would also consider assessing whether there were likely to be significant differences between the offer of stores that would be blocked by the Test and that of any stores that competitors would build instead. However, in practice, we have not been able to do this.

market investigation to assess the number of developments that would have been blocked had the Test been in operation during that period.³⁶

5.39 We recognize that this is historic data which may not accurately predict the likely future impact of the Test. For instance, analysing such data would not take into account the degree to which we might expect retailers to ‘redirect’ developments deterred by the Test to alternative locations (see paragraphs 5.15 to 5.17). Similarly, such analysis does not take into account the operation of other parts of our remedies package (for example, in relation to controlled land). Nor does it take into account any changes in the market since that period that might affect the likely rate of retailer developments. However, in the absence of alternative information, we believe that this historic data provides us with the best guide that we have to the number of proposed developments that are likely to be affected by the Test.

Existing areas which are already highly concentrated

5.40 Table 1 shows the nature of the market in mid 2006 for each of the 2,508 stores over 1,000 sq metres in the UK. 607 stores (24 per cent of all stores over 1,000 sq metres) were in highly-concentrated areas. Of those, 415 were monopoly areas. The 607 stores would not be able to extend with the Test in place and the strong incumbent would not be able to build a new store in the same area. There are also likely to be additional stores in local areas of fewer than four fascia where an extension would be likely to increase a fascia’s share of groceries sales area above 60 per cent, which would also fail the Test. We note, for example, that there were a

³⁶Our calculation did not account for stores which closed between 2000 and 2006. We did not have details of the closed stores and they were not entered on our mapping system. However, we understand that the majority of stores were closed because they had been resited close to the location of the original store:

- (a) All of the stores Asda identified as closed were either rebuilt on site or re-sited in the local area.
- (b) Excluding Slough, Tesco identified 12 closed superstores—only three of which we were unable to match up with the opening of a nearby store.
- (c) Morrisons closed 30 stores, 7 of which were rebuilt. Of the remaining 23 stores, it is feasible that a grocery store of greater than 1,000 sq metres could have operated on 18 of them. This is based on the supposition that at least 2,000 sq metres is needed to operate a store of such size. Only 7 of these closed stores were on sites of greater than 5,000 sq metres and they never traded as Morrisons.
- (d) Sainsbury’s closed [redacted] stores on sites with the capacity to support a 1,000 sq metres grocery sales area store. Of these, [redacted] can be directly linked with newly built stores or rebuilds.

We therefore believe that this would not significantly affect the results of our analysis.

further 242 stores with a share of 50 to 60 per cent in areas with fewer than four fascia.

TABLE 1 UK stores over 1,000 sq metres by groceries sales area (GSA) share and number of fascia at mid-2006

Number of competing fascia	GSA share 0–10%	GSA share 10–20%	GSA share 20–30%	GSA share 30–40%	GSA share 40–50%	GSA share 50–60%	GSA share 60–70%	GSA share 70–80%	GSA share 80–90%	GSA share 90–100%
0	0	0	0	0	0	0	0	0	0	415
1	0	5	50	119	198	184	116	48	9	0
2	2	84	136	185	144	58	12	6	1	0
3	20	134	153	102	46	7	4	0	0	0
4	26	58	64	32	8	0	0	0	0	0
5	16	15	14	4	5	0	0	0	0	0
6	4	7	7	1	0	0	0	0	0	0
7	4	3	1	1	0	0	0	0	0	0

Source: CC analysis.

Note: Highly-concentrated areas are shaded in the table.

The effect that the Test would have had on developments completed by retailers between 2000 and mid-2006

5.41 We used information provided by five of the largest groceries retailers during the groceries market investigation on their developments completed between 2000 and mid-2006.³⁷ We assessed each completed development to see whether it would have passed the Test had it been in force.³⁸

5.42 There were a total of 681 developments completed during the period 2000 to mid-2006 by these five retailers, of which 416 were extensions and 265 were new builds.

TABLE 2 Average size of new developments, 2000 to 2006

Development	Initial GSA	Initial non-GSA	Initial net sales area	GSA Increase	Non-GSA Increase	Net sales area increase	GSA Final	Non-GSA Final	Net sales area Final	% increase in GSA	% increase in non-GSA	% increase in net sales area
All extensions	2,548	635	3,183	598	794	1,393	3,146	1,430	4,576	23	125	44
All new build	N/A	N/A	N/A	2,392	874	3,267	2,392	874	3,267	N/A	N/A	N/A
Extension fails	2,258	504	2,762	741	683	1,424	2,999	1,187	4,186	33	135	52
New build fails	N/A	N/A	N/A	2,173	1,114	3,286	2,173	1,114	3,286	N/A	N/A	N/A

Source: CC analysis.

³⁷These retailers provided the most comprehensive information and their stores account for around three-quarters of stores over 1,000 sq metres.

³⁸In addition to information on completed developments, we also received details of retailers' planning applications. However, since we did not know how many of these would have gone through the planning process successfully, we did not use this information in our estimates.

- 5.43 Of these developments, the Test would have blocked 15 new stores (6 per cent of total new stores) and 118 extensions (28 per cent of total extensions). Overall 20 per cent of developments would have failed the Test.
- 5.44 Table 2 shows that the new-build stores that would have been prevented by the Test were all large stores, with an average net sales area of 3,300 sq metres and a minimum size of grocery sales area over 1,000 sq metres. Five of the new stores that would have failed the Test were in monopoly areas,³⁹ seven had one competing fascia and three had two competing fascia.
- 5.45 The average size of extensions that would have been prevented by the Test is 1,400 sq metres, representing 34 per cent of the final size of the store. Some of the extensions included relatively small additions to grocery sales area. Of the 118 extensions that would have been prevented by the Test, 13 added less than 300 sq metres of grocery sales area. 56 extensions (around half of total extensions) that would have failed the Test were in monopoly areas. Of the remainder, 54 were in areas with one competing fascia and eight were in areas with two competing fascias.
- 5.46 We have used our 2000 to mid-2006 data to estimate the total number of developments that would have been blocked each year. As set out in paragraph 5.39, we recognize the difficulties in using historic data to produce estimates of how many developments the Test will deter in future. We necessarily assume that these years are representative of the future and that the figures for five of the largest retailers are typical and applicable for all retailers.
- 5.47 As set out in Table 3, we estimated that the Test would deter 26 extensions and three new stores each year that would otherwise have formed, or have strengthened,

³⁹These were in areas where the store had been resited in the same isochrone and increased in size.

highly-concentrated areas.⁴⁰ We use these estimates in our NPV model (see paragraphs 5.66 to 5.88). We model various sensitivities to account for the possibility of the impact of the Test reducing highly-concentrated areas over time.

TABLE 3 Estimate of how many developments would have been prevented by the Test

	<i>Extensions</i>	<i>New stores</i>	<i>Total</i>
Asda, Morrisons, Sainsbury's, Tesco and Waitrose stores	416	265	681
Total stores	547	349	896
Stores a year	91	58	149
% failures of the Test	28	6	20
Number of failures a year	26	3	29

Source: CC analysis.

5.48 During the remittal process, several retailers provided us with their own analysis of the impact of the Test on their developments that they had performed either during the groceries market investigation or shortly afterwards.⁴¹ In addition, Tesco provided us with details of an analysis that it had performed on all grocery retail developments between 2006 and end 2008. It calculated that over that period 2 per cent of new stores and 35 per cent of extensions would have been prevented by the Test. Tesco estimated that 43 per cent of on- and off-site replacements would also have been prevented.⁴² On an annual basis Tesco calculated that 26 developments a year would be prevented by the Test. Tesco also found that approximately the same number of developments would have been blocked each year from 2000 to 2006. These estimates appear broadly to support our analysis based on developments between 2000 and mid-2006.

⁴⁰This does not necessarily mean that all of these stores would not be built. In some cases, they might be built with a smaller grocery sales area than initially planned.

⁴¹The retailers provided us with the following estimates:

- (a) In March 2008 Asda calculated the impact on their development plans as being able to build more stores but there were [§] existing stores where extensions would be blocked. Overall, Asda calculated that it would be able to add [§] sq metres of groceries sales area with the Test in place assuming a total new-build store size of [§]. Asda also analysed the impact of the test on Tesco. It calculated that [§] per cent of Tesco's current planning applications or planning permissions for new stores and [§] per cent of Tesco's current planning applications or planning permissions for extensions would fail the test. Asda calculated that [§] per cent of Tesco's existing stores were already in highly concentrated area and would not be able to extend.
- (b) Sainsbury's suggested that the Test would have [§] impact on its store development plans. Sainsbury's planned to mitigate the effect of the Test by [§]. Sainsbury's believed that [§] of its new-build store planned developments and [§] of its planned extensions would pass the Test; a further [§] new stores planned by 2012 would pass and [§] further extensions planned by 2012 would pass.
- (c) Tesco calculated that, based on our provisional decision on remedies published in February 2008, the Test would impact on [§] Tesco development sites.

⁴²Note that in our calculations we treat on-site replacements as extensions and off site replacements as new-build stores.

Likely delays

- 5.49 We also formed a view as to when costs and benefits arising from the Test would be likely to occur.⁴³ As noted, the cost runs from when the incumbent's new store or extension would have opened but for the Test, and continues until the competitor new store or extension opens.
- 5.50 We make two initial points. First, following any decision to implement the Test, there is likely to be a period of time before the Test comes into force. We believe that this period would allow retailers the opportunity to adapt their commercial strategies to take account of the application of the Test.
- 5.51 Second, the Test is designed to be predictable. Retailers need to know which stores are within the development's isochrone as well as the sales areas of those stores in order to make an informed decision as to whether an incumbent that wished to expand would pass or fail the Test. We intend to recommend that the OFT adopt a standard, readily-available package to construct the isochrones so that retailers can predict which stores are within a particular isochrone. When we spoke to retailers there was a variety of opinions about the accuracy with which retailers can estimate competitors' sales area. However, based on the discussions that we had with retailers in relation to individual local areas in the context of our controlled land remedies, we believe that in practice retailers will be able to measure competitor size sufficiently accurately to predict the outcome of the Test successfully. They will have strong incentives to do so in borderline cases.
- 5.52 We recognize that the 'exceptional circumstances' provision also introduces an element of uncertainty in terms of predicting the outcome of the Test. However, given that we only expect this to apply in limited circumstances (see paragraph 11.53 of the

⁴³We discounted those costs and benefits occurring in the future using an appropriate rate. We have used a discount rate of 3.5 per cent based on the Green Book recommendation (see Appendix B).

Report), that uncertainty is small. We did not, therefore, consider it necessary to allow for this in our quantitative analysis.

- 5.53 Accordingly, the Test will be sufficiently mechanistic and transparent for retailers to anticipate with confidence the decision that would be taken by the OFT. In practice, this means that the Test is unlikely to lead to a high number of rejected planning applications and significant delay. Rather, the process is likely to be ‘internalized’, so that retailers will, instead, direct their efforts towards entering or expanding in those areas in which they are not strong incumbents.

Delays for competitors opening new stores

- 5.54 We found that it was likely to take a considerable time to assemble a site and open a new store. As set out in our Report, the development process includes site identification, site assembly, post assembly holding time (between assembling the site and applying for planning permission—HT1), achieving planning approval and post planning holding time (between obtaining planning permission and site opening—HT2), although these do not necessarily take place sequentially.
- 5.55 During our groceries market investigation, we looked in particular at HT1 and HT2. We found that the median time for HT1 was –1 year and the median figure for HT2 was 1 year. Following the Tribunal’s remittal, we also looked at the data that we received on site assembly and found that the median duration of site assembly was 0.75 years. The grocery retailers also gave us their views of how long the total process takes to assemble a site and develop a store.⁴⁴ We found that, in total, an

⁴⁴In response to the market questionnaire in our groceries market investigation, several retailers estimated the time period from site identification to store opening:

- (a) Asda told us that the period typically varied between 2 and 6 years although it could be as long as 10 years or even longer.
- (b) Morrisons said that it would be between 3 and 13 years, with an average of 5 to 6 years.
- (c) Sainsbury’s said that 3 years was considered the norm, although the range could vary enormously.
- (d) Tesco said that the site acquisition process varied considerably from one store to another but for larger stores this period was usually measured in years, and periods of 2 or more years were not unusual. Tesco said that a total development time of 4 or 5 years often resulted.
- (e) Waitrose said that the range was usually between 3 and 6 years, but occasionally longer.

average period of 5 years would be a conservative estimate for the time taken by a retailer to assemble a site and construct a store.

- 5.56 However, this was likely to be as much the case for the strong incumbent as for a competitor. As set out in paragraph 4.13, we thought that both incumbent and potential entrant were in a similar position in terms of identifying the need for a development and acquiring and developing a suitable site in any given area. A potential entrant might have an advantage over the incumbent in identifying a site since an incumbent might not wish to develop a site that was too close to an existing store for fear of cannibalising that store's sales.
- 5.57 We looked at the likelihood of competitors entering or extending in a local area where a new store development by a strong incumbent retailer would have been prevented by the Test. Asda, Morrisons, Sainsbury's, Tesco and Waitrose provided us with (i) lists of their existing planned developments for their stores and (ii) a list of the areas they would be interested in entering if an opportunity arose.⁴⁵ Around 70 per cent of planned new builds are in areas where there are already one or more competitors in the area. In 73 per cent of planned new builds there is a competitor interested in entering the area. Overall there are competitors either already present or interested in entering in 95 per cent of areas.
- 5.58 We therefore found that, in the longer term, there was unlikely to be significant, if any, additional delay from the Test in relation to the opening of new stores by a competitor rather than a strong incumbent. Our base case in the NPV model assumes that there will be no additional delay from the Test following a short transition period.

⁴⁵These were provided in response to our initial request for information during the Groceries Remittal. Note that these areas are where the retailer would like to enter. Retailers will not generally have identified sites in the area and will not yet have subjected specific opportunities to a full economic evaluation.

Extensions

- 5.59 The position is more complex for extensions. Again, we believe that a potential entrant is as able as the incumbent to identify the need for a development (see paragraph 5.56). A replacement development could, however, result either from a new store developed by a competitor or from a weaker incumbent extending an existing store. We consider these alternatives in more detail in paragraphs 5.60 to 5.64.
- 5.60 We compared retailers' planned extensions with (i) existing stores at mid-2006 and (ii) retailers' lists of areas they would be interested in entering, in order to assess the likelihood of competitors entering or extending in a highly-concentrated local area where an extension would have been blocked by the Test (see paragraph 5.57). Around 85 per cent of planned extensions were in areas where there was already a competitor fascia in the isochrone and around half of these areas also had another retailer that was interested in entering the area.⁴⁶ The remaining 15 per cent of planned extensions took place in isochrones where no competitor fascia was present. In two thirds of these cases we found that another competitor was interested in entering the area. We recognize that this does not mean that retailers would necessarily, in practice, enter these areas. We also recognize that we were comparing 2009 planned extensions and lists of possible future development areas with market data from mid-2006. The results of this analysis show that, in the majority of cases where the Test limited the strong incumbent's extension, a competitor would be likely to enter or expand.
- 5.61 We note that if a strong incumbent's extension is replaced by a competitor building a new store, the competitor will have to identify and acquire a suitable site and obtain

⁴⁶Note that we can not always show whether the other retailer would be interested in entering within the isochrone around the incumbent store since the other retailer has generally not identified a particular site; however, in the majority of cases it is likely.

planning permission. We observed in the groceries market investigation⁴⁷ that, in the absence of the Test, it was easier to gain planning permission for store extensions than for new stores, as evidenced by the number of store extensions that we observed. We found that this could provide incumbent retailers with an advantage over new entrants in providing new grocery retailing floorspace in a local area. In addition, the incumbent may not always need to acquire land for an extension.⁴⁸

5.62 However, there are several reasons why a retailer seeking to build an extension may not have a substantial advantage compared with a competitor seeking to build a new store. Retailers noted several potential problems that could arise with building extensions, but where a retailer had a strong incentive to build an extension the problems did not generally appear to us to be likely to prevent the extension being built:

- (a) the incumbent would not always have site assembly advantages compared with a competitor. If space is limited, it may have to build a more complex development than would otherwise be the case;⁴⁹
- (b) a new entrant may have more options available in the selection of sites, as it is not limited to land adjacent to an existing store; and
- (c) the incumbent would have to construct an extension in a way that minimized damage to existing trade.⁵⁰

⁴⁷Report paragraph 7.64.

⁴⁸For example it may decide to build a mezzanine extension or may already have spare land available.

⁴⁹For example, it may need to build a decked car park.

⁵⁰Retailers provided us with information on extensions in response to the main party questionnaire sent to the grocery retailers in July 2006:

- (a) Asda said that the timescales for implementing an extension scheme depended on local circumstances, but extensions would generally be quicker to prepare, get planning permission and build than new-build stores.
- (b) Morrisons said that the requirement to keep a store open and minimize customer disruption during the construction phase placed constraints on the construction work which could mean relatively small extensions taking a long time to complete.
- (c) Sainsbury's considered that adjacent land would be required 'in a few cases', normally to maintain car park provision.
- (d) Tesco said that site identification is less of an issue in the cases of extensions as the location of the store will dictate which parcels of land need to be acquired. Tesco said that the price of land for an extension is likely to be higher than for a new build because the buyer is known and the buyer would also be more likely to have to pay for the existing occupier of the land to relocate. Tesco pointed out that it had other methods of building the store including building decked car parking or sitting the store on stilts.
- (e) Waitrose cited the requirement to maintain existing trade at the store, which has to remain operational.

5.63 We recognize that there might be site-specific reasons which might affect the likelihood of a weak incumbent extending to replace a strong incumbent's extension that would be prevented by the Test. However, based on the evidence that we received from retailers (see footnote to paragraph 5.62(c)), we thought that, if the weaker incumbent had the incentive to extend, they would be likely to have the ability to do so.

5.64 We therefore assumed that, in areas with two or more fascias, there would, in most cases, be little or no additional delay resulting from the operation of the Test since a weaker incumbent could expand to replace the stronger incumbent's extension. However, where there is no possibility of this taking place (single store areas), we assume that the delay caused by the Test where the incumbent would otherwise wish to extend would be four years.⁵¹ (We note that in such circumstances, the LPA override might apply). In addition, we assumed that small extensions (less than 300 sq metres) that would be prevented by the Test would not be replaced by an alternative development in a single store area, and considered the possibility that in some cases a weaker incumbent would not replace an extension blocked by the Test (see paragraph 5.83) even if the extension were greater than 300 sq metres. In paragraph 5.74 and Appendix B, we set out the sensitivities that we have modelled.

Developments already planned

5.65 We note that all retailers have developments in various stages of completion. Were the Test to come into force unannounced, it might cause significant disruption to these development plans, as competitors took into account the new opportunities the Test presented. This might lead to significant delays in their ability to replace incumbents' planned expanded capacity. However, as noted in paragraph 5.50, we

⁵¹The incumbent is prevented from developing a store at the planning application stage so construction of the store has not started. Although we found the average period for site assembly and store construction to be five years (see paragraph 5.55), we deducted the period for store construction, which usually takes around one year, from our delay since this would not have taken place when the Test is assumed to have been failed.

anticipate that there will be a lead time for the Test to come into force which will allow competitors to react sufficiently rapidly for it not to cause significant transitional delays. We therefore assume only a short transitional period for retailers to adjust to the operation of the Test.

NPV model

5.66 We used an NPV model to combine our quantitative estimates of the costs and benefits of the effect of the Test on the structure of competition at the local level. This combines all the elements that we quantified, and takes into account when we expect that they will arise, to produce a net estimate of the value of the Test. We note again that this takes no account of the benefits set out in paragraphs 5.12 to 5.18 that we have not been able to quantify.

5.67 The NPV model uses the results derived from our market model and combines these with a number of other estimates derived from the analysis set out in paragraphs 5.37 to 5.65, from our groceries market investigation and from publicly available data. It sets out the costs and benefits that would occur as a result of the implementation of the Test over the life of the model. The aim is not to generate a single figure for the quantifiable elements of the costs and benefits, but rather to understand the NPV of the Test under a range of reasonable assumptions. We therefore established a base case, representing conservative but realistic assumptions, as well as a wide range of sensitivities. We set out the high level assumptions and results in paragraphs 5.69 to 5.87. Further details are set out in Appendix B.

5.68 In particular, we established estimates for the:

- (a) number of developments and associated market structures;
- (b) length of delay;
- (c) benefits of entry or expansion and costs of delay;

- (d) discount rate;
- (e) administrative costs; and
- (f) period of the model.

We discuss each of these in turn.

Number of developments and associated market structures

- 5.69 The analysis that we undertook using data from 2000 to mid-2006 indicated that 26 extensions and 3 new stores would have been blocked by the Test each year had it been in operation. These estimates were supported by Tesco's analysis (see paragraph 5.48).
- 5.70 We note that there are a number of factors that might affect our estimate of the number of developments that are likely to be deterred by the Test in the future. These might include, for example, the general economic climate, the impact of the exceptional circumstances clause, and the number of extensions contemplated that add only a small amount of groceries sales area (and that might go ahead in modified form). However, for our base case, we assumed that the number of developments impacted remains constant over the life of the model. We conducted sensitivities which assume decreases in the number of developments affected by the Test.
- 5.71 We estimated the number of developments according to market structure, based on the market structures we had identified from our analysis of store developments between 2000 and mid-2006. This allowed us to vary our assumptions on delays, benefits and costs, depending on the market structure. These scenarios are set out in detail in Appendix B. We looked separately at new stores and extensions. We looked at sensitivities associated with varying the assumed threshold beneath which an extension would not be replaced, either by another extension or by a new store.

Length of delay

- 5.72 In paragraphs 5.49 to 5.65 we set out our analysis of the likely length of delay for a competitor to enter or expand in a local area if the strong incumbent development was deterred by the Test. We identified different delay assumptions, depending on the type of development that was deterred and that was developed in its place:
- (a) a new-build store is built instead of the strong incumbent's new-build store;
 - (b) a new-build store is built instead of the strong incumbent's extension; and
 - (c) an extension by a weaker incumbent is built instead of an extension by a strong incumbent.
- 5.73 In the base case, we assumed that in the longer term a new competitor store would replace a strong incumbent's new store, or a weaker incumbent's extension would replace a strong incumbent's extension without delay, although we allowed a transition period of one year during which time there would be a delay of one year. We assumed that it would take longer for a new-build store to be built instead of an extension to an existing store and allowed four years for the first four years after implementation of the Test, falling to one year thereafter once retailers are able to anticipate the effect of the Test.
- 5.74 We also carried out a number of sensitivities to look at the impact of assuming greater delays before a competitor entered or expanded, or to take account of the possibility that a replacement extension may, or may not, in practice take place. In particular, we modelled the impact of there being a four-year delay to replace any extension prevented by the Test (whether through entry or extension), both for a transition period, and in perpetuity.

Benefits of entry or expansion and costs of delay

- 5.75 In Appendix 4.4 of the Report we estimated that an additional competitor fascia reduces a store's variable profit margin by 3.79 per cent. However, we note that the 3.79 per cent refers to the entry of an additional fascia into all areas rather than just highly-concentrated areas. We would expect the effect of an additional fascia to deliver a greater benefit in highly-concentrated areas.
- 5.76 Accordingly, our market model, described in detail in Appendix A, estimates annual benefits which vary according to the type of development and the market structure. These vary from relatively small annual benefits, in the case of a small extension being replaced by an extension by a weaker incumbent, to much greater figures for new entry. We also used the market model to estimate the annual costs associated with each different market structure scenario. The base case of our model conservatively uses high cost assumptions. If we were to use lower cost figures, our NPV value would be significantly higher.

Discount rate

- 5.77 We applied a discount rate to future benefits and costs in order to estimate their NPV. We used a discount rate of 3.5 per cent, in line with the figure specified by HM Treasury in its guidance on economic assessments (the Green Book) as the Social Time Preference Rate. We set out an explanation of the constituent elements of this discount rate in Appendix B.

Administrative costs

5.78 In the Report we estimated the administrative costs of the Test as £6–£8 million each year.⁵² As set out in paragraph 5.19, we have not reassessed these costs. In the model we therefore used a mid-point of our estimate—£7 million each year.

Period of the model

5.79 We modelled projected NPVs over a 25-year period, in line with the lifetime of a store. However, we recognize that it is difficult to project the likely impact of the Test over such a timescale. We therefore also considered sensitivities which assessed each development over 25 years but only included those developments that were likely to take place over shorter timescales—10, 15 or 20 years.

Summary of the results

Base case

5.80 In the base case, as described in paragraphs 5.69 to 5.79, we estimated the NPV of the benefits and costs that would arise as a result of the Test, after including administration costs, to be £1.9 billion.

5.81 We conducted various sensitivities analyses to test the robustness of the Test to varying assumptions.

Probability that not all developments that were deterred by the Test would result in new entry

5.82 As noted in paragraph 4.9, the Test depends on there being timely replacement entry for it to increase competition with resulting benefits for consumers. However, we undertook one sensitivity that allowed for the possibility that not all developments deterred by the Test would result in new entry. We thought this more likely to happen for extensions than for new stores. When an extension does not result in a

⁵²Paragraph 11.382.

competitor development, the costs that would be incurred from a competitor not building a development persist over the period of the model. We estimated that, based on our conservative assumptions, approximately 40 per cent of the extensions that were prevented would have to result in no competitor response before the costs outweighed the quantitative benefits of the Test (see Table 4, Appendix B).⁵³

- 5.83 We also looked at the impact of using different assumptions with regard to the threshold beneath which extensions would be prevented but not replaced. Our base case used a threshold of 300 sq metres grocery sales area; we also assessed the impact of thresholds of 500 and 700 sq metres grocery sales area. In all cases, the NPV remains strongly positive (see Table 9, Appendix B).

Reduction in the number of development affected by the Test

- 5.84 We looked at sensitivities that reflected reductions in the number of developments affected by the Test, either as a constant reduction from the historical numbers, or as a reduction over time. Tables 6 and 7 in Appendix B show that the NPV remains positive with sensitivities in which the number of stores is reduced significantly.

The effect of different assumptions on delay

- 5.85 We also looked at sensitivities around delay, particularly with regard to the replacement of proposed extensions. We found that whilst increased delay reduces the NPV significantly, in all cases the NPV was still strongly positive (see Table 8, Appendix B).

⁵³Note all extensions to stores in single fascia areas below the threshold of 300 sq metres are also assumed not to be replaced.

Shorter time period for the model

- 5.86 The final sensitivity concerns the impact of shortening the timeframe of the model from 25 years to 20, 15 or 10 years. We found the NPV to remain strongly positive over all durations (see Table 10, Appendix B).

Combined downside sensitivity

- 5.87 We also looked at combining a number of sensitivities to produce a substantial downside sensitivity. We calculated the impact of a 2 per cent decline a year in the impact of the test; a probability of entry for extensions reduced to 90 per cent,⁵⁴ all extensions having a permanent delay of one year after the first four years of operation of the Test; and a timeframe for the model reduced to 15 years. The NPV for this scenario is £808 million.

Conclusion on the sensitivities

- 5.88 With regard to those elements that we have been able to quantify, we conclude that the Test will deliver a substantially positive value to consumers when the costs of delayed entry are set against the benefit of increased competition using a wide range of likely assumptions.

6. Tesco's alternative model

- 6.1 Tesco proposed an alternative approach to quantifying the costs of the Test. It suggested that we looked at the gross profits of the developments that would have been blocked had the Test been in place to produce an empirical estimate of costs to set against the benefits derived from our margin concentration analysis.
- 6.2 While Tesco's approach is useful and captures parts of the costs and benefits of the Test that we consider relevant, we have important concerns about certain aspects of

⁵⁴Note all extensions to stores in single fascia areas below the threshold of 300 sq metres are also assumed not to be replaced.

its methodology and assumptions, in particular regarding its assessment of costs and benefits, and the probability of, and time taken for, competitor entry or expansion.

Tesco's approach may yield results broadly in line with ours when our concerns are taken into account.

- 6.3 We are still considering this model but our current thinking is set out in more detail in Appendix C. However, on the basis of the information currently available to us, we think that our market model, while in part based on similar principles, arrives at more realistic estimates of the welfare consequences from the Test.

7. The effectiveness and proportionality of the Test

- 7.1 We set out in paragraph 4.19 our provisional conclusion that the Test would act together with the controlled land remedies to facilitate and encourage entry and expansion in areas of high concentration by preventing a strong incumbent from reducing its competitors' incentives and ability to enter or expand. We therefore found that we could expect there to be fewer areas of high concentration than there would otherwise have been, leading to an improved retail offer and more competitive outcomes for consumers.
- 7.2 In Section 5, we assessed the benefits and costs that were likely to arise as a result of the Test. Paragraph 5.88 sets out our provisional conclusion that the impact of the Test was likely to be substantially positive in terms of our quantitative assessment of benefits and costs in particular local areas. We expected the benefits which we have been unable to quantify to be significant (as set out in paragraphs 5.12 to 5.18). We did not expect the costs of the Test to be significant or to outweigh the benefits that we have not been able to quantify (as set out in paragraphs 5.20 and 5.21). We therefore provisionally concluded that the benefits of introducing the Test were likely substantially to outweigh the costs.

- 7.3 In the Report we considered several other remedies, including remedies to address current and future land bank sites, but for reasons explained in paragraphs 11.231 to 11.268 of the Report decided not to pursue these. We decided that the gravity and prevalence of our AEC finding in relation to areas of highly-concentrated markets was not sufficient to justify a divestiture remedy. Having regard to the additional analysis contained in this provisional decision we continued to believe that removing barriers to entry in highly-concentrated markets and ensuring that store developments do not exacerbate high concentration would be sufficient over time to address the AEC we found, and that in comparison with divestment, it was the more effective and proportionate remedy.
- 7.4 We therefore provisionally concluded that, together with the controlled land remedies (set out in the Report) and the notification requirement (referred to in paragraph 2.11 above), the Test would be a remedy effective in addressing and proportionate to the AEC we found in relation to highly-concentrated local markets.