Structure of the uk supermarket sector

ASSIGN BUSTER

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Introduction:

On this report we have been asked to analyse the supermarket industry in the UK in the past 10 years. We are going to analyse the structure of the market in the UK supermarket sector. In the first part of the report, we showed how market share relates to the supermarket. We showed the different type of market structure exists

We also explained the recession and the credit crunch, in relation to how it affects the supermarkets; in addition, we also showed their response in that time and the way that this relates to the market structure. We explained the necessity of competition policy needed in the UK with the theories, relative to this matter we showed a case where they investigate and gave their statement about the situation.

In the final part of this report excluding the conclusion, we had to analyse the supply and demand related to the elasticity. In the second of the question, we had to explain the oil prices between July 2007 to July 2009, and state that they increased from July 2007 till 2008 but they decreased again in July 2009. This also showed the change on the impact in oil prices in the supermarkets.

Section 1: Structure of the UK supermarket sector.

The four firm concentration ratios for supermarkets in the UK is Tesco (31. 6%), Asda (17%), Sainsbury’s (15. 9%), and Morrison’s (11. 1%). This makes for a four – firm concentration is a little > 75%. The market is food retail and the dominant is Tesco.

Market Structure

“ In economics, market structure (also known as market form) describes the state of a market with respect to competition.”

The different market structures that exist are; monopoly, oligopoly monopolistic competition and perfect competition. These four market structures are for the purpose of the organisation.

Monopoly means a market in which there are many buyers but only one seller; “ a monopoly on silver”; “ when you have a monopoly you can ask any price. For example would be to say if Comcast was the only cable television provider in your area. If you want cable, you have no choice but to go to Comcast and because of this they can charge anything they want.

Oligopoly means a market dominated by a small number of participants who are able to collectively exert control over supply and market prices. An example may include the markets for petrol in the UK (BP, Shell and a few other firms) and soft drinks (such as Coke, Pepsi, and Cadbury-Schweppes).

Monopolistic competition is a common market structure where many competing producers sell products that are differentiated from one another. The best examples of monopolistic competition come from retail trade, including restaurants, clothing stores, and convenience stores.

Perfect competition in neoclassical economics and microeconomics, perfect competition describes the perfect being a market in which there is many small firms.[1]

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Kinked demand curve

An oligopolistic structure faces a descending sloping demand curve but the elasticity may depend on the result of competitors to changes in price and output. Assuming that firms are going to preserve a high level of profits and their market share it possibly will be the case that:

(a) Competitors will not chase a price increase by one firm – consequently demand will be moderately elastic and a increase in price would lead to a fall in the total revenue of the firm

(b) Competitors are more probable to equal a price fall by one firm to steer clear of a loss of market share. If this happens demand will be more inelastic and a fall in price will also lead to a fall in total revenue.[3]

The kink in the demand curve at price P and output Q means that there is a discontinuity in the firm's marginal revenue curve.

f we believe that the marginal cost curve in is cutting the MR curve then the firm is maximising profits at this point.

In the diagram below, we see that an increase in marginal costs will not essentially lead to higher prices providing that the new MC curve (MC2) cuts the MR curve at the identical output. The kinked demand curve theory proposes that there will be price stickiness in these markets and those firms will rely more on non-price competition to increase sales, revenue and profits.

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Section 2: Recession and Credit crunch.

Recession can be defined as a general and continuous in time underperformance of economy. Generally, the usual symptom is a drop in GDP (Gross Domestic Product) over a period of time higher than two months . Stock exchange crash , decrease in employment and decline in housing market are also typically tagged along with the recession according to NBER (National Bureau of Economic Research) , which is the official body that issued a recession warning in the USA . In their reports, they define recession as " a broad – passed economic decline that lasts more than few months" (Recession definition 2008, 1st March).

t takes six to eighteen months of monitoring to consider a recession to be over in economic terms. Anyway, watching the Federal Reserve handling this

matter (In USA is not a common practice that any federal authority takes control of economic issues related to private corporations) gives us a clear clue of an economic crisis. The last two recession periods before 2008 remained only for eight months both together.

According to a BBC's blog, recession happens when any country trade and wealth decreases, having also a massive impact on employment figures (many workers are made redundant). E. g. when recession strikes a country, factories will not get any help from financial investors, leading, eventually, to their closure. History Channel website defines recession as " when business downfall activity remains for more than a few months, causing country output to fall by higher than 1% a year causing a serious damage to economic structure of the country" . In BBC's documentary about Lehman Bros. we witness why recent crisis has hit globally. Lehman Bros. Was the 4th largest investment company in the USA. It also used to be one of the most widespread corporations in the world. Eventually, they started giving away loans to not qualifying applicants. This risky practice made it reach the highest profit in the shortest time in their history, although soon a massive debt start to build up due to customers failing to pay out their loans. Soon after that issue was spotted their stock value fell dramatically. Last minute actions were taken to tackle this bankruptcy threatening situation. But in the end the only viable solution turned to be accepting a buyout offer from British giants Barclays. Obviously, Barclays expected guarantees of viability for this takeover from the government of the USA. But in this particular case, due to political scenario of elections close in date to the incident, the government refused to take any risk by getting involved in this matter.

As a global corporation, Lehman Bros. used to invest huge amounts of money worldwide. Although because of bankruptcy threat flying around they had to start cutting employments.

Therefore, many countries where this corporation was operating started to experience the first signs of recession.

Sometimes, because of bad political decisions, recession effects can fall upon population too. This sort of situation is usually known as " man-made recession". In 1981, the United States faced this kind of issue under the leadership of Ronald Reagan. It is also remarkable that oil changing price also has a huge impact on recession by boosting its effects on a country. This particularly can be applied to that 1981 recession.

Credit crunch can be defined as a sudden drop in the capacity of issuing loans by a bank or other financial capital market agent. The first consequence of this is that requirements for a loan become harder to comply with for customers. Reviewing the story of our " home" credit crunch, when economy was healthy and stable, banks and investors gave away mortgages to low income people without previous credit checks. Those people then bought houses using these financial low interest aids. Money lenders relied on the strength of the housing sector. But eventually this sector came to a big crash after many people failed to pay back their loans because of the interests growing in the same proportion as sales dropped. To sort this out , the next step taken by money lenders was to drastically cut loans and try to get their the debts paid out . Then, landlords had to face what has been called credit crunch, which is something as simple as overspending.

Most of profits banking corporations enjoy come from business that have nothing to do with those customer focused activities we are used to see in our local branch. These businesses often involve huge spending amounts of money taken from loans and mortgages. These activities also require high level of commitment (deadlines and payments), and that is the reason why banks put pressure on landlords and tenants to pay back their loans so the cash is available for these other high profile activities banks are investing in.

Sainsburys and Tesco

The impact on recession is not very good for important supermarkets like Tesco or Sainsbury because consumers panicked on this time, so they decided to spend money as less as possible, especially low earning consumers. They are the people the most affected by the recession. The people who survive on the basic or cheap items found out alternative resources where they can spend less money. So, that is how the big supermarkets lose a big part of customers. As a consequence, the small competitors like Aldi or Lidl start getting their demands because they are the alternatives. The other impact is cutting down the employment caused by the decreasing spending on supermarkets. Stores sell less so this may lead them to fire some employees. Therefore, unemployment gets higher in the economy.

Recently, Tesco and Sainsbury took a new step to improve their situation. They started expending their business by establishing new stores and offering new jobs. It is a good way to start the money cycle again. They are

also frequently using different promotions for a period of time like “ Buy one get one free” or “ Two for one pound”… to bring the customers back.

Basically, UK supermarkets’ structure is based on a monopolistic competition because all of them use different schemes and methods to sell their products and influence the consumers. It is a way to be different, attractive and competitive.

Section 3: UK Competition Policy.

In economic theory, firms may collude or using their monopoly power to get rid of competitors unfairly in a way that would benefit them; and the government may have to act to stop this. John Sloman (2008) has highlighted that in the UK, the Office of Fair Trading (OFT) has been established to ensure that the prohibitions under the 1998 Competition Act and the 2002 Enterprise Act are conducted. The OFT supervises company conduct and for further investigation, it can refer suspected individual companies to the Competition Commission (CC) (Sloman 2008: 262). The CC is in charge of determining whether the firms’ practices such as supplying more than 25 per cent of the total market, various collusive practices of oligopolies, or the abuses of a firm’s monopoly power are detrimental to competition (Sloman 2008: 262). If the Competition Commission decides that firm is guilty then it would introduce appropriate remedies, for example, forbidding many firm’s practices.

If firms abuse their monopoly power by trying to refuse producing products, enforce unfairly trading conditions or trying to produce less with higher prices; then it would result to market failure, because there is no fair

competition in the market. The consequences in the market would be high prices products as dominant firms determine the prices and lower quantity of productions – almost there are only their goods in the market as other competitors are being eliminated. Thus, the consumers do not have many choices, people with high income or average income might be still afford the high price goods, however those with low income or unemployment would find it difficult. The firms did not make maximising efforts to provide goods and services at lowest prices so there is no efficiency, on the contrary, it is a waste of resources. If there is competition in the market and it is fair, then there will be opening for all players who benefit from perfect information on prices and availability of goods and services, and they will do all their best to compete with each other. Hence, the result will be lower prices and increasing more innovation with new products variety and quality. Therefore, the need for Competition Policy and especially in the UK is necessary.

To be able to advocate above conclusion and to understand more deeply how Office of Fair Trading (OFT) is working, the next part of this section will discuss about a case where the grocery market has been investigated. The OFT had decided to investigate on four largest supermarkets (Asda, Tesco, Sainsbury's, Morrisons) about their supply of groceries on 2006 (OFT 2006). The OFT suspected that the big supermarkets have colluded with each other, and made it difficult and costly for other new stores to entry and compete in the market. It also thinks that the four largest supermarkets' buyer power have increased, and pricing conducts (for instance, the suppliers prices introduce to big supermarkets have increased in the differences from the wholesalers and buying groups, price flexing) would distort the competition

in the market, and harm the consumers choices in products (Crown copyright 2006). However, that is only the OFT suspecting and they were still investigating until 30th April 2008 that the Competition Commission published its final report (Peter Freeman 2009). In 2009, the government has basically agreed to OFT and their remedies. In summary, an investigation in such large supermarkets take a lot of time (few years) and it is also take quite a number of time to obtain the government agreement and impose the remedies to the firms.

Section 4: Oil Prices between July 2007 and July 2009:

Oil prices have increased significantly between July 2007 and July 2008 (from $72. 81 to $147. 49). On the contrary, after the peak price since July 2008 to July 2009, the oil prices had decreased considerable to $65. 63. To be able to explicate what happened to oil prices between July 2007 and July 2009, the assistance of supply and demand analysis is necessary.

Supply and demand analysis is defined as an evaluation of a good or service on the basis of factors affecting its supply and demand. Supply-demand analysis is supposed to determine if an imbalance exists or will exist between supply and demand for a good or service. For example, if the supply of a good is expected to exceed demand, its price can be expected to decline. Supply-demand analysis incorporates information on manufacturing capacity, currency exchange rates, consumer incomes, interest rates, and many other factors that influence availability and purchases (LoveToKnow, Corp. 2009).

According to the figure 1, from July 2007 to July 2008, there had been a substantial rising in demand for fuel, oil from the developing countries (such as Asia: China, India) and especially US, Japan, Western Europe (the demand curve shift to the right). Because of the price elasticity of demand of oil is fairly inelastic (PED <1), the consumption of oil did not change much (fuel-oil is necessary for people life so they cannot easily cut its consumption back). As the result, consumers have to reduce their spending on clothes and cinema, food, etc to be able to afford the increasing in fuel consumption; hence, there is a fall in contribution to consumption (C) during 2007 and 2008. In addition, higher oil prices also lead to increasing in the costs of production and shortage in oil; it eventually causes firms to reduce its supply or go bankruptcy (the supply curve shifts to the left). For those reasons, the rising in oil prices during 2007 and 2008 has cause recession.

From July 2008 to July 2009, there was a decline in demand after the peak in July 2008 ($147. 49) thus there a fall in price (the demand curve shift to the left). The reason may be very simple is because the price was too high and the consumers had to adjust their spending on fuel to decrease the cost of living. In summary, the changing in oil prices have a large impact on people whether the producers or the customers.

Conclusion:

According to our research, we believe that the market share does increase because for example, Tesco have remained at the top of the market for the last couple of years and as each month goes by they start making more shares, especially during the peak season such as Easter and Christmas. On the other had there are also downfalls such as the second highest in the

market is Asda, so they would be wanting to make promotional schemes to attract customers and catch up to Tesco.

If the economy doesn't face any recessions or credit crunch, there is a positive future for the supermarkets in the UK, because when recession hits customers start panicking and the staff start spending their money. In the last few years, the UK has suffered a few recessions continuously. I can relate to this because in the War we can predict a future recession, we also know that the expenditure for the war is expensive; so therefore, the government in one way or another have to pay them. If the government focus on their payment then there will be quite difficult to keep the economy stable and secure. This is a positive way for the supermarkets in the UK to have a brighter future.