

REVIEW OF THE ECONOMIC IMPACT OF THE RETAIL CAP

*Report prepared for the
Departments of Enterprise,
Jobs and Innovation and
Environment, Community and
Local Government*

APRIL 2011

Executive Summary	i
1. Introduction	1
1.1 Objectives of the study	1
1.2 Structure of the report	2
2. Background	3
2.1 Policy and legislative framework for retail planning	3
2.2 Overview of the current retail caps	4
3. Overview of recent retail sector developments	6
3.1 Economy wide developments	6
3.2 Retail developments	8
3.3 Structure of the retail market	15
4. Factors driving costs and competition in retail	35
4.1 Impact of the retail caps on costs	35
4.2 Impact of the retail caps on competition	38
4.3 Other factors that impact competition/prices	41
4.4 Impact of the retail cap on suppliers	42
5. Conclusions and recommendations	44
APPENDIX: Terms of Reference	48

Executive Summary

One of the conditions of the EU-IMF Programme for Financial Support for Ireland is that '*the government will conduct a study on the economic impact of eliminating the cap on the size of retail premises with a view to enhancing competition and lowering prices for consumers and discuss implementation of its policy implications with the Commission services*'. This process must be concluded by the end of Q3 2011. Forfás was requested to undertake the study and worked closely with a steering group comprising officials from the Departments of Enterprise and Environment.

Comprehensive guidelines to control retail development came into effect on 1st January 2001. The retail caps form one part of the wider retail planning framework, which seeks to support the achievement of a range of social, cultural and economic goals. Any potential impacts of the retail cap will have to be balanced against broader societal benefits, and will be considered in due course as part of the wider review of the retail planning guidelines.

This study is focused on meeting the terms of reference as set out in the EU-IMF Programme. We acknowledge the wide range of other important retail policy issues - many of which have been of concern for a number of years. These include concerns over high consumer prices and high retailer profits, the extent of cross border shopping and the power of retailers over producers. These issues have been addressed in a range of studies - most recently by an Oireachtas report on retail matters. While these are important issues, it is not proposed to address them within the terms of this study as set out by the EU/IMF.

There are a number of retail caps in place in Ireland (see Section 2 for more detail):

- Large convenience store floorspace cap which is set at 3,500 square metres within the Greater Dublin Area and at 3,000 square metres in the remainder of the State. These limits apply to the total sales space of superstores (stores with a total size of at least 2,500 square metres) and to the sales space allocated to grocery goods in hypermarkets (hypermarkets are defined as stores over 5,000 square metres - there is no cap on the amount of non-grocery space);
- Retail warehouse cap which is set at 6,000 square metres and applies in all areas except those areas in the NSS gateways which are covered by the Integrated Area Plans under the Urban Renewal Act, 1998; and
- Petrol filling station cap which allows a shop of up to 100 square metres of net retail sales area when associated with a petrol station irrespective of location.

Analysis of the Irish retail market and the impact of the caps on store size is significantly hindered by a lack of timely and detailed data. In addition, most of the literature on the effects of such retail caps is based on international experience and is somewhat dated. However, given the increasingly internationalised nature of the retail sector, it is reasonable to assume that the key findings should also apply to the Irish market.

Review of the Economic Impact of the Retail Cap

The main report sets out the retail planning policy and legislative framework (Section 2) and provides an overview of recent developments in the wider economy and in the international and Irish retail sectors (Section 3). It also examines the impact of the cap on costs and competition in the retail sector and outlines other factors within the wider planning framework which can have an impact on competition and consumer prices (Sections 4.1 - 4.3). The impact of store size on producers is also discussed (Section 4.4).

Conclusions and recommendations

In assessing the economic impact of eliminating the retail caps on prices and competition, we need to acknowledge the wider context - the cap is but one element of the retail planning framework. Other elements of the planning framework also affect competition and prices. In addition, the objectives of the cap and the planning framework are not just economic - there are also important societal objectives.

The relationship between the retail cap, prices and competition is complex. Theoretically, the elimination of the retail cap could through economies of scale create greater cost savings for retailers which could, if strong competition existed, be passed on to customers. However, there is a risk that retailers could extend their scale advantages to create local monopolies. This is a particular issue in the grocery market where most consumers are generally unwilling to travel long distances to do their weekly shop.

In summary, Forfás believes that a sweeping removal of the caps would produce mixed results in terms of enhancing competition and reducing consumer prices (see sub-sections 4.1 and 4.2 for the detailed analysis):

- In large population centres which can support a range of large stores, facilitating greater economies of scale at the store level could result in new entry, more vigorous competition and price savings for consumers;
- In smaller population centres, it could lead to a greater concentration of retailers' power and potentially higher prices for consumers; and
- The cap is not the only element of the planning framework that has an impact on competition and consumer prices (Section 4.3). It is notable that the average size of grocery stores in Ireland is significantly below the current caps.

Forfás believes that the challenge is to enable retailers to leverage the benefits of scaling while avoiding the risks of embedding local monopolies. This requires changes to the retail caps and some aspects of the broader retail planning guidelines. Our recommendations are set out below.

Large convenience store floorspace cap

The cap on large grocery stores is set at 3,500 square metres within the Greater Dublin Area and at 3,000 square metres in the remainder of the State. There is no cap on the floorspace

allocated to non-grocery products (e.g. books, clothes, home-ware) within a hypermarket (store over 5,000 square metres).

Restrictions on store size may lead to higher costs. While there are economies of scale associated with larger stores, these decrease as store size increases. Research, summarised in section 4.1, indicates that economies of scale recede close to the current Irish limit for convenience stores (i.e. above 3,000 square metres). As the presence of economies of scale will vary by retailer, potential exists to increase the convenience limit to ensure that potential economies of scale are not constrained. It is outside the scope of this exercise to suggest what the level of the revised cap should be to take advantage of potential economies of scale. In 2007 Denmark, which has a similar population profile to Ireland, increased the cap on retail store size from 3,000 square metres to 3,500 square metres. It also made changes to other elements of the planning framework.

Our analysis also found that removing the convenience cap is likely to produce mixed results for competition. In Dublin and the other main cities, customers have a choice of at least six key grocery retailers and access to a wide range of outlets (Table 3) indicating that the market can accommodate a diverse range of stores sizes. In other towns, the choice of retailers tends to be more limited and the number of outlets is substantially lower. There is a strong risk that increases in store size in small population centres could over time, by reducing the number of stores, limit consumer choice further and lead to higher prices. While, national pricing policies by the large retailers may limit the risk of higher prices in local markets, consumer choice would be constrained.

Recommendations:

- Forfás recommends expanding the regional differentiation in the convenience cap. There are good reasons to differentiate the floorspace cap between Dublin and the other main cities and the remainder of the State:
 - The lower cap (currently 3,000 square metres) should be marginally increased in those areas outside of the five main cities to ensure potential economies of scale can be realised without limiting competition. Competition in the grocery sector is local in nature. Our research indicates that competition is already relatively limited in smaller centres; and
 - A larger increase in the level of the cap(s) in the main cities (Dublin - currently 3,500 square metres - and Cork, Galway, Limerick and Waterford - currently 3,000 square metres) is justified, given their greater size and density. Consideration should also be given to mirroring the approach adopted under the retail warehouse cap where no cap applies in some urban centres under specific conditions. This could through greater economies of scale and more vigorous competition lead to price savings for consumers.

Petrol filling station cap

A forecourt operator can build a shop of up to 100 square metres of retail space when associated with a petrol station. However, where the proposed shop attached to the petrol station is above the cap, the forecourt operator can apply for planning permission for a bigger store in the same way as any other retailer applying for planning permission to build a grocery store. A cap of 200 square metres has been proposed in Northern Ireland.

Recommendation:

Given that forecourt operators can make a planning application for shops above 100 square metres on the same basis as any other retailer, the merits of retaining a separate cap for petrol filling stations should be considered further within the review of the wider planning framework currently underway.

Retail warehouse cap

The cap on the size of retail warehouses is currently set at 6,000 square metres - excluding certain areas of the National Spatial Strategy (NSS) gateways¹. Following the revision of the guidelines in 2005, this cap does not apply in those areas of the NSS gateways which are covered by the Integrated Area Plans under the Urban Renewal Act, 1998.

Recommendations:

- Forfás recommends maintaining the current regime as it allows for significantly larger stores in the NSS gateways; and
- As Integrated Area Plans no longer exist, the way in which the exemptions to the cap are operationalised in the NSS gateways will need to change. Forfás recommends that the revised planning guidelines develop an alternative classification with certain criteria attached to replace the Integrated Area Plans. Criteria should be informed by market needs and spatial planning considerations such as the availability of space of the required size that is zoned and adequately serviced and the implications for traffic management/congestion.

Proposed amendments to the wider planning guidelines

In addition to the formal floorspace caps, a range of other factors can inhibit store size and the potential for greater competition and lower prices. It is notable that Competition Authority research indicates that new grocery stores opened in Ireland between 2001 and 2007 had an average size of 1,529 square metres. It is likely that any changes to or the elimination of the cap will have limited impact in the absence of other measures. These include reviewing the planning guidelines to (see Section 4.3 for more detail):

- ensure that planning authorities and An Bord Pleanála place minimal weight on projections of floorspace requirements when assessing planning applications, as recommended by the Competition Authority;

¹ The NSS gateways are Dublin, Cork, Galway, Limerick-Shannon, Waterford, Dundalk, Sligo, Letterkenny-Derry and Athlone-Tullamore-Mullingar.

- effectively reduce the level of importance that planning authorities place on trade diversion when considering the retail impact assessment process. Where this provision is used, the planning authority should be required to clearly state the rationale for doing so, as recommended by the Competition Authority;
- ensure a consistent application of the sequential approach to development across all planning authorities to ensure that it is not acting as a barrier to entry in the retail sector². The availability of suitable locations plays a significant role in determining entry;
- establish a central database to provide timely national and local data on key indicators to inform retail strategies and to ensure effective application of the guidelines; and
- review definitions of the different types of retail stores and goods and any potential overlap and/or ambiguity to ensure consistency in the application of the retail planning guidelines across planning authorities and to minimise uncertainty for investors/retailers.

We understand that these amendments to the wider planning framework are being considered as part of the Department of the Environment's ongoing review of the guidelines.

² Under the sequential approach to development, town centres are the preferred location for new retail developments that attract many trips, followed by edge of town sites and finally out of town sites. See Section 2.1 for more details

1. Introduction

One of the conditions of the EU-IMF Programme for Financial Support for Ireland is that the government will *conduct a study on the economic impact of eliminating the cap on the size of retail premises with a view to enhancing competition and lowering prices for consumers and discuss implementation of its policy implications with the Commission services*. It is to be completed by the end of Q3 2011. The EU/IMF agreement has positioned this in the context of encouraging growth in the retail sector.

Forfás was requested to undertake the study and has worked closely with a steering group comprising officials from the Departments of Enterprise, Jobs and Innovation (DEJI) and Environment, Community and Local Government (DECLG). We have also consulted representatives from the retail sector and the planning authorities.

1.1 Objectives of the study

This study is focused on meeting the terms of reference as set out in the EU-IMF Programme. We acknowledge the wide range of other important retail policy issues - many of which have been of concern for a number of years. These include concerns over high retailer profits, the extent of cross border shopping, the costs of doing business, and the perceived power of retailers over producers. These issues have been discussed in a range of studies - most recently by an Oireachtas report on retail matters³. While these are important issues, it is not proposed to address them within the terms of this study as set out by the EU and IMF.

As agreed with DEJI and DECLG, the specific objectives of this study are to:

- set out the economic impact of eliminating the cap on the size of retail premises;
- identify whether eliminating the cap on the size of retail premises would enhance competition; and
- identify whether eliminating the cap on the size of retail premises would result in lower prices for consumers.

The study will help inform the shaping of relevant policies in the wider review of the retail planning guidelines which is being carried out in parallel by DECLG and which must also take account of broader retail policy objectives including location and accessibility of retail developments, the retention of vibrant town centres, etc.

It should be noted that analysis of the Irish retail market and the impact of the caps on store size is significantly hindered by a lack of timely and detailed data. In addition, most of the literature on the effects of such retail caps is based on international experience and is

³ Joint Committee on Enterprise, Trade and Innovation, Matters Concerning the Retail Trade in Ireland, February 2011.

somewhat dated. This study has drawn heavily on research from the Competition Authority and Goodbody Economic Consultants as well as other studies on the Irish retail sector⁴.

1.2 Structure of the report

The report is structured as follows:

- Section 2 sets out the background to the study including the policy and legislative framework and the existing caps;
- Section 3 provides an overview of trends and recent developments in the wider economy, in the retail sector and in consumer prices;
- Section 4 examines the impact of the cap on costs and competition in the retail sector. It also outlines other factors within the wider planning framework, which can have an impact on competition and consumer prices. The impact of store size on producers is also discussed; and
- Section 5 sets out the study's conclusions and recommendations.

⁴ The Competition Authority, *The Retail Planning System as Applied to the Grocery Sector: 2001 to 2007 Grocery Monitor: Reports No. 1 to No. 3*, July 2008; Goodbody Economic Consultants, *The Impact of the Draft Retail Planning Guidelines on the Retail Sector Report* submitted to the Tánaiste and Minister for Enterprise, Trade and Employment and to the Minister for the Environment and Local Government, December, 2000; Consumer Strategy Group, *Make Consumers Count*, May 2005; Joint Committee on Enterprise, Trade and Innovation, *Matters Concerning the Retail Trade in Ireland*, February 2011.

2. Background

This section outlines the policy and legislative framework underpinning retail planning in Ireland and the existing caps on retail store size.

2.1 Policy and legislative framework for retail planning

Retail Planning Guidelines were first issued in 1982 under the Local Government (Planning and Development) General Policy Directive⁵. This Directive provided general advice regarding large scale additions to existing retail shopping capacity. The Local Government (Planning and Development) General Policy Directive (Shopping), which was introduced in 1998, placed an embargo on the granting of planning permission for any supermarket (or an extension to one) in excess of 3,000 square metres.

Following the introduction of the 1998 Ministerial Directive, comprehensive statutory guidelines to plan for and manage retail development were introduced. Retail planning guidelines for planning authorities were published in December 2000 and came into effect on January 1st 2001⁶. The retail cap and the broader retail planning guidelines seek to support the achievement of a range of social, cultural and economic goals. The principles that underpin retail development in Ireland (as set out in the retail planning guidelines) are:

- Competition to the benefit of the consumer should be maintained and enhanced in accordance with proper planning and sustainable development;
- Preferred locations for retail development should continue to be guided by considerations of sustainable land use, including access by public transport; in particular, new retail development should be encouraged to contribute to the vitality and vibrancy of town and village centres, to ensure that they retain retailing as a core function; and
- Realistic, regionally consistent and forward-looking strategies for plan-led retail development should be devised which can give clear guidance to planning authorities, developers and shop owners in formulating development or expansion proposals.

The guidelines were subject to a limited review in 2005. They introduced an amendment to cater for innovative types of large-scale retail warehouses which are capable of displaying a very wide range of goods under one roof, and which require a regional/ national population catchment area. Under the revised guidelines, such retail warehouses could be permitted - subject to certain criteria - in areas which were covered by Integrated Area Plans under the Urban Renewal Act 1998 in National Spatial Strategy (NSS) gateway cities and towns⁷.

⁵ This section on the policy and legislative framework is sourced from the Department of the Environment's recent consultation on the Retail Planning Guidelines.

⁶ The Retail Planning Guidelines are Ministerial guidelines under section 28 of the Planning and Development Act, 2000. Consequently, planning authorities and An Bord Pleanála must have regard to the provisions of the guidelines when exercising their planning functions.

⁷ Areas covered by IAPs were generally urban, and had the greatest concentrations of physical decay and social/ economic disadvantage. It also aimed to facilitate new operators that require large floorspace, such as IKEA, to enter the Irish market and to allow existing operators to develop larger formats thus assisting the promotion of competition in certain retail markets.

Integrated planning areas no longer exist, but we understand that the revised guidelines currently being drafted will clarify this provision.

In June 2010, the Department of the Environment, Heritage and Local Government announced a review of the 2005 Retail Planning Guidelines. It published a consultation paper inviting inputs from stakeholders on the issues that should be considered in the review of the existing guidelines⁸. The draft revised guidelines will be published for consultation in due course.

Sequential approach

One of the key policy objectives underpinning the retail planning guidelines is to support the continuing role of town and district centres as centres of social and business interaction in the community. These established centres should be the preferred locations for developments that attract many trips. In order to achieve this objective, the sequential approach to retail development applies – this means that:

- The preferred location for retail development should be within town centres, consistent with the requirement to achieve good access especially by public transport;
- If there are no development sites available within a town centre, then the next preference should be a location on the edge of the town centre; and
- Only where there are no sites, or potential sites, within a town centre or on its edge, or satisfactory transport accessibility (including park and ride) realistically cannot be ensured within a reasonable period of time, should out of centre development be contemplated.

2.2 Overview of the current retail caps

Caps on the size of retail stores were first introduced under the Ministerial Directive in 1998, which imposed a universal upper size limit on food-store development throughout the State. These were amended in the retail planning guidelines in 2001 and the revised guidelines in 2005.

There are a number of retail caps in place in Ireland:

- *Large convenience store floorspace cap* which is set at 3,500 square metres within the Greater Dublin Area and at 3,000 square metres in the remainder of the State⁹. These limits apply to the total net retail sales space of superstores and the grocery goods net retail sales space of hypermarkets¹⁰. Superstores are defined as stores with a total size of at least 2,500 square metres and the total size (i.e. for grocery and non-grocery goods) of a superstore is capped at 3,000/3,500 square metres. In hypermarkets (which are defined as stores over 5,000 square metres), the floorspace allocated to grocery

⁸ Department of Environment, Heritage and Local Government, Review of the Retail Planning Guidelines- Issues Paper, 2010.

⁹ Convenience goods include food, beverages and non-durable household goods.

¹⁰ The 2005 Retail Planning Guidelines define the net retail sales area as the area of a shop or store which is devoted to the sales of retail goods (including the area devoted to checkouts but excluding storage space etc).

goods is capped at 3,000/3,500 square metres - there is no cap on the amount of non-grocery space in hypermarkets¹¹;

- *Retail warehouse cap* which is set at 6,000 square metres and applies in all areas except those areas in the National Spatial Strategy (NSS) gateways which are covered by the Integrated Area Plans (IAPs) under the Urban Renewal Act, 1998¹². Retail warehouses are large shops selling big bulky goods like furniture, baths, fridges, washing machines, carpets etc¹³; and
- *Petrol filling station cap* which allows a shop of up to 100 square metres of net retail sales area when associated with a petrol station irrespective of location¹⁴.

Another consideration that arises in relation to the retail caps concerns so called 'discount food stores'. Discount food stores are described in the Retail Planning Guidelines as being single level, self service stores normally of between 1,000 square metres and 1,500 square metres of gross floorspace, selling limited range of goods at competitive prices and often with adjacent car parking. While there is no specific mention of a cap on the size of discount food stores, some planning authorities may have interpreted the description in the retail planning guidelines to mean that discount food stores can have a gross floorspace of no greater than 1,500 square metres.

While many of the goals of the caps are important from a broader economic perspective (e.g. creation/retention of vibrant town centres), the specific focus of this study, as required by the EU/IMF Programme, is to examine *the economic impact of eliminating the cap on the size of retail premises with a view to enhancing competition and lowering prices for consumers*. Any potential impacts of the retail cap will have to be balanced against broader societal benefits, and will be considered in due course as part of the wider review of the retail planning guidelines.

Finally, planning regulations in other countries include similar societal and sustainability objectives (e.g. ensuring the vibrancy of town centres, minimising congestion and journey times) though the measures to achieve them differ (i.e. some countries do not have quantified caps)¹⁵. It is notable that there is no cap on comparison (non-grocery) goods floorspace in Ireland.

11 Non-grocery goods (called comparison goods in the guidelines) include books, electrical goods, clothes, household-ware etc.

12 The NSS gateways are Dublin, Cork, Galway, Limerick-Shannon, Waterford, Dundalk, Sligo, Letterkenny-Derry and Athlone-Tullamore-Mullingar.

13 Retail warehouses are defined in the guidelines as large single-level stores specialising in the sale of bulky household goods such as carpets, furniture, electrical goods, and bulky DIY items, which cater mainly for car-borne customers in out-of-centre locations.

14 According to the guidelines, where retail space in excess of a 100 square metres of retail space area associated with petrol filling facilities is sought, it should be assessed by the planning authority in the same way as an application for a retail development without petrol filling facilities in the same location.

15 A summary of practices in some other countries can be found on the UK's Competition Commission's website at http://www.competition-commission.org.uk/rep_pub/reports/2000/fulltext/446a12.6.pdf (section 12.6).

3. Overview of recent retail sector developments

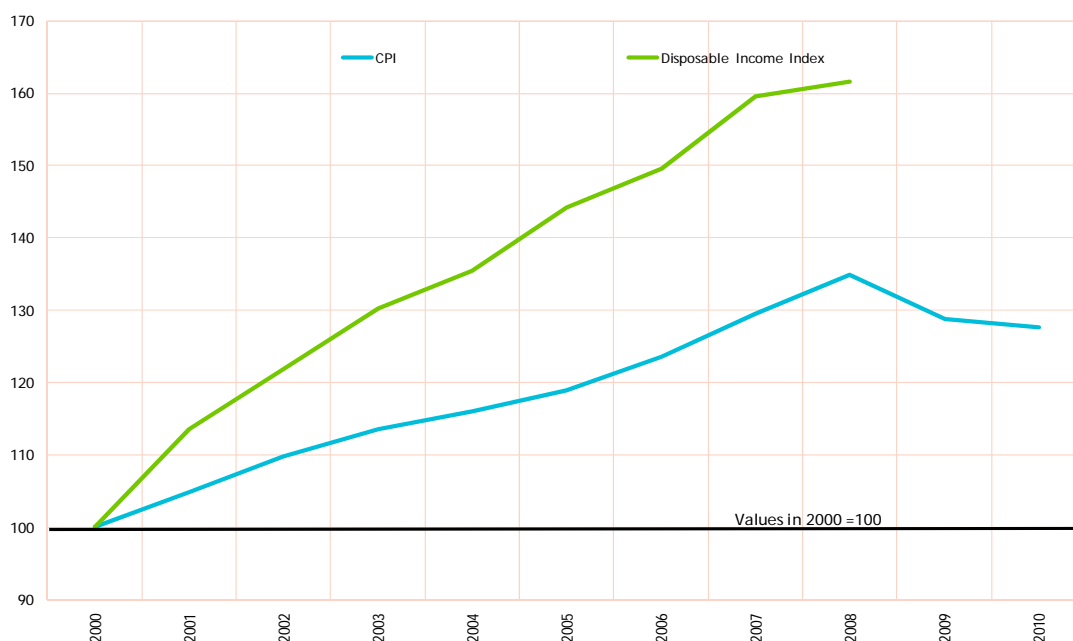
This chapter provides an overview of developments in the Irish economy since 2000 and their impact on consumers. It also provides a brief analysis of the leading international retailers and sets out the structure of the Irish retail market.

3.1 Economy wide developments

As a small, open and competitive economy, Ireland prospered from an export boom in the 1990s and early 2000s. However, in the years that followed strong growth in the domestic economy, driven by spending on housing and consumption, replaced exports as the key driver of growth. Growth derived from asset price inflation and reckless lending and borrowing, fuelled by low interest rates and pro-cyclical fiscal policy, has now been proven as unsustainable and damaging basis for growth¹⁶. The Irish economy is currently undergoing a severe adjustment to the bursting of the property bubble and the international financial crises. National income has declined rapidly and unemployment has risen sharply.

This section looks at changes in the Irish economy since 2000 and their impact on consumer spending.

Figure 1: Consumer Prices and Estimate of Disposable Income (excluding rent) Indexed to 2000, 2000-2010¹⁷



Source: CSO, County Incomes and Regional GDP, Consumer Price Index and Forfás calculations

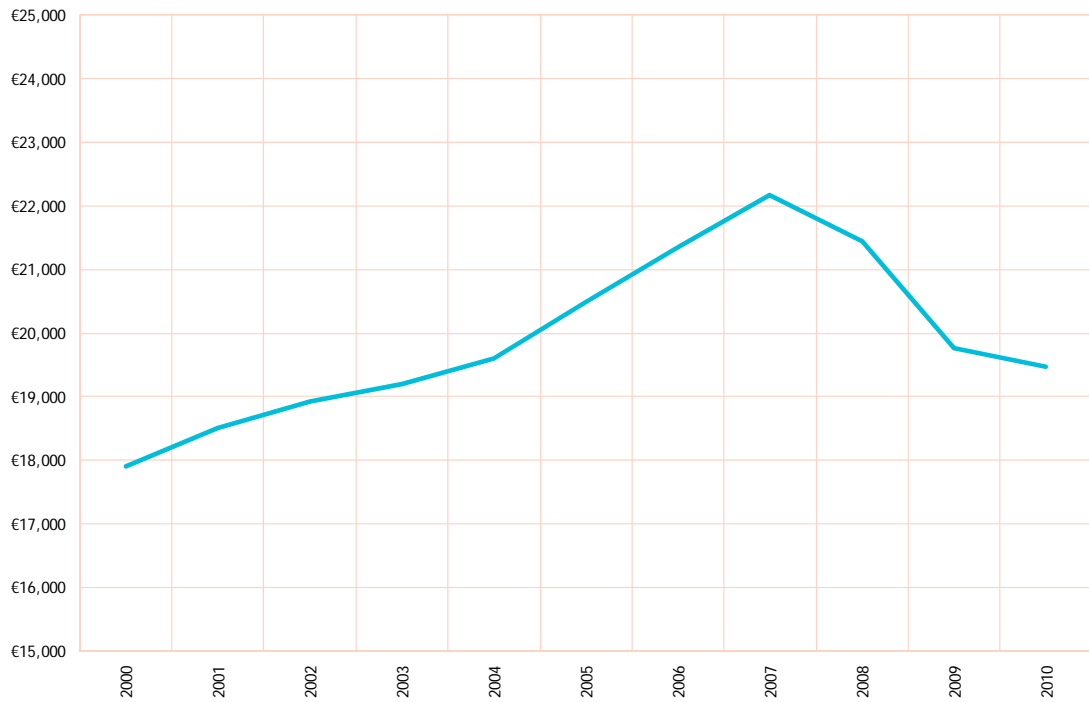
¹⁶ National Competitiveness Council, Annual Competitiveness Report 2010, Vol. 2: Ireland's Competitiveness Challenge, Forfás, 2010,

¹⁷ Disposable income data is only available as far as 2008.

Disposable income grew at a much faster rate than consumer prices during this period.

- Between 2000 and 2008, average disposable income per person (excluding rent) increased by 61.7 index points while the CPI increased by 34.9 points during the same period.

Figure 2: Per Capita Expenditure on Goods and Services at Constant Prices, 2000 - 2010



Source: CSO, National Income and Expenditure, Population Estimates

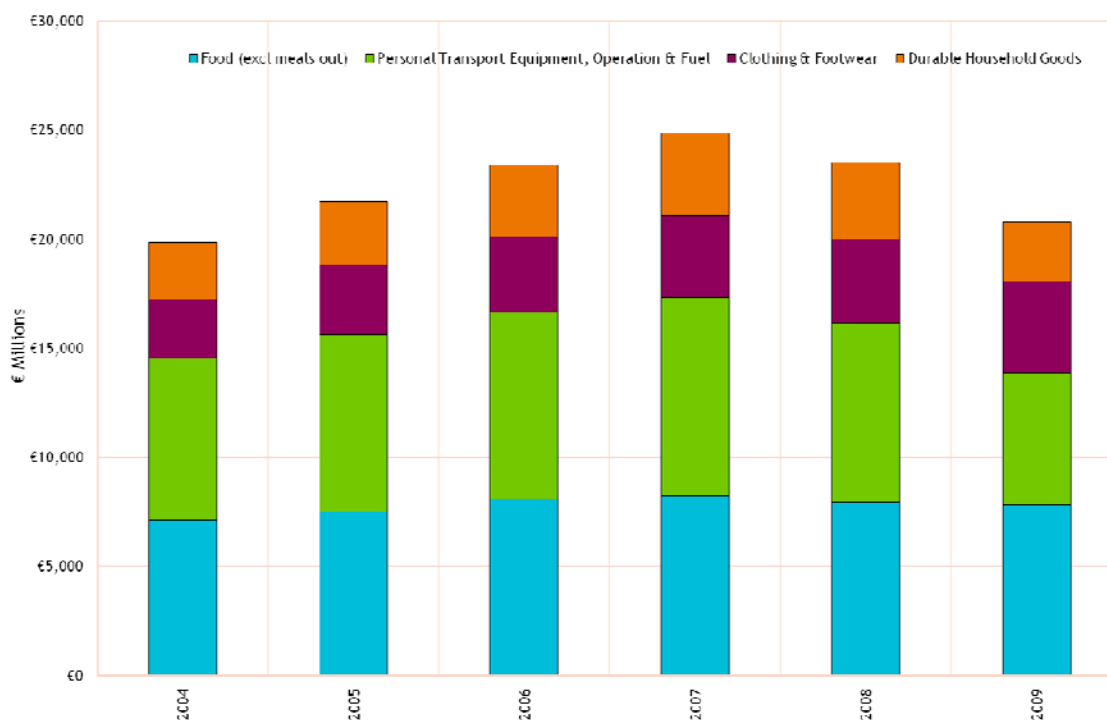
Strong growth in consumer spending was a key feature of the Irish economy from 2000 to 2008.

- Expenditure on personal goods and services peaked in 2007 at €22,170 per capita - an increase of 23.9 per cent since 2000.
- By the end of 2010, expenditure of personal goods and services fell to €19,478 per capita, a 12.1 per cent decline from the peak.

3.2 Retail developments

Changes in the economy and living standards during the last decade had a direct impact on the retail sector. This section sets out some of these changes.

Figure 3: Total Expenditure on Key Retail Goods at Constant Prices, 2004 - 2009¹⁸



Source: CSO, National Income and Expenditure

Figure 3 shows the expenditure on key retail goods for the period 2004 to 2009 in constant prices¹⁹.

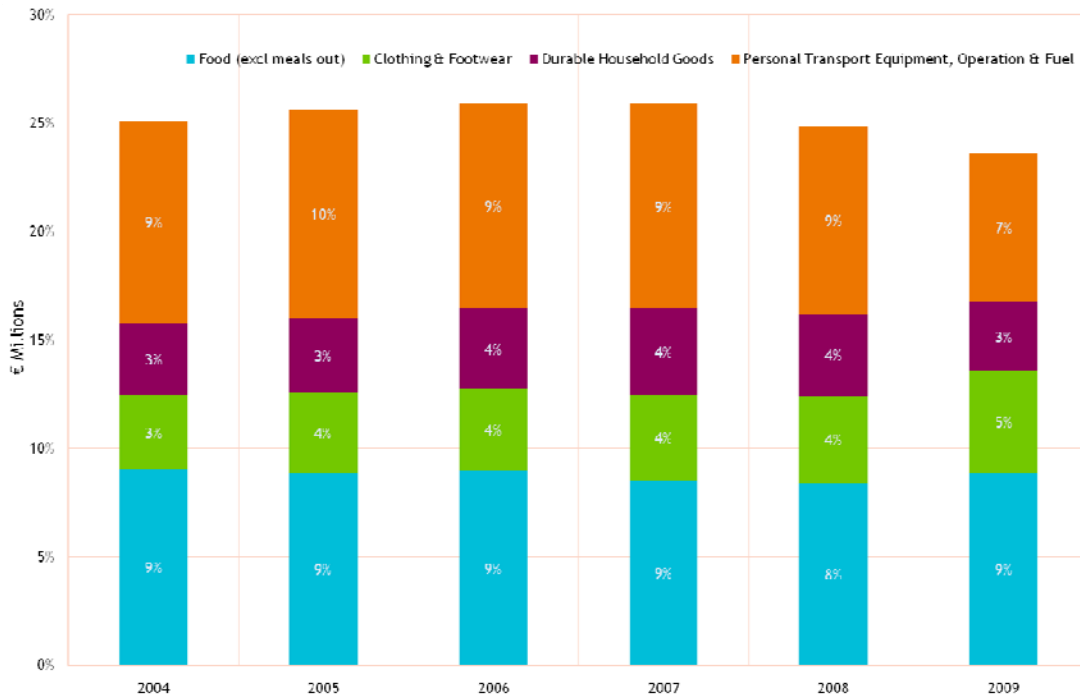
- Following strong growth between 2004 to 2007, spending has since fallen back sharply. The total increase in value of the food, personal transport and fuel, clothing and footwear and durable household goods consumed during this period was 4.7 per cent.
- The largest increase between 2004 and 2007 was on durable household goods (reflecting the domestic property boom) which increased by 44 per cent, followed by clothing and footwear which increased by 39.1 per cent. The smallest increase was in food which increased by 14.8 per cent between 2004 and 2007.
- From 2008 onwards, clothing and footwear is the only category to continue to increase, although at a much slower rate than previously. Meanwhile, personal transport and

¹⁸ In 2009, personal consumption of goods and services was equivalent to 53 per cent of Ireland's GDP. The key retail goods included in the chart are those that make up the main sales from retail outlets covered by the retail planning guidelines. In 2009, these key retail goods equated to 24 per cent of GDP. Goods and services not covered in the chart include alcoholic beverages (including pubs), tobacco, housing (rent, local government charges, repairs and decorations), non-durable household goods and services, public transport, communication, recreation, entertainment and education and miscellaneous goods and services.

¹⁹ To calculate expenditure at constant prices, the CSO uses two measures (output and expenditure). These measures are produced using annual chain linked indices. For further details see: <http://www.cso.ie/releasespublications/documents/economy/current/qna.pdf>

fuel witnessed the largest decline and actual expenditure fell below the 2004 level (-17.7 per cent). This is likely to be due in part to the significant decreases in international fuel prices between 2008 and 2010.

Figure 4: Total Expenditure on Key Retail Goods as a Percentage of GDP, 2004 - 2009

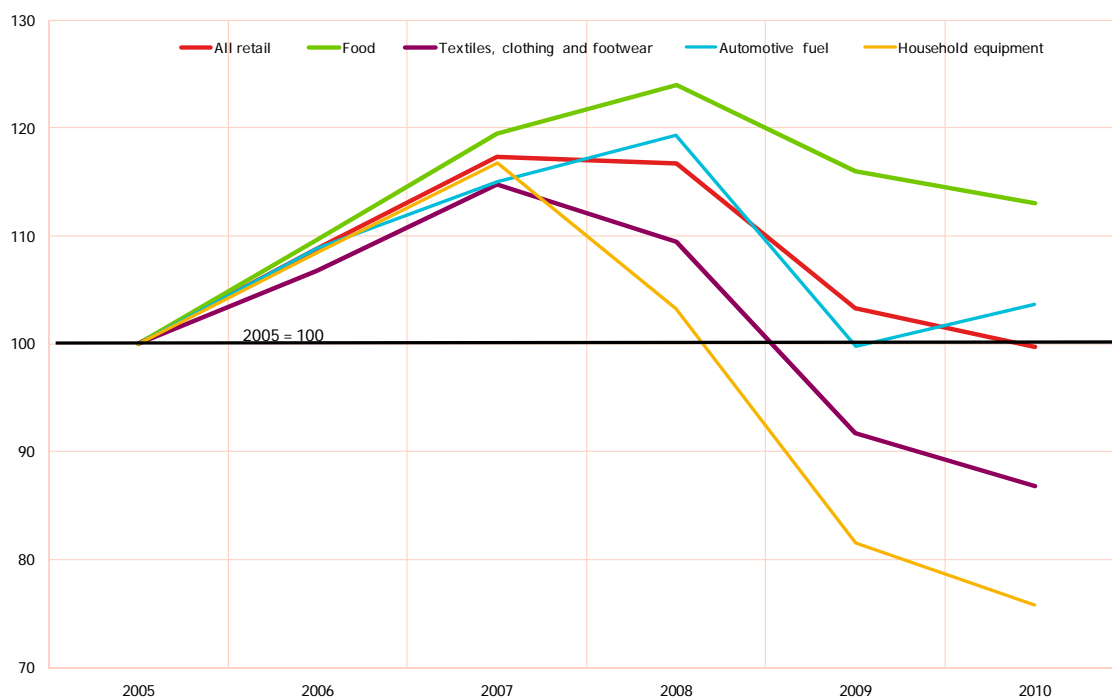


Source: CSO, National Income and Expenditure

Figure 4 shows expenditure on each of the key retail goods categories as a percentage of GDP between 2004 and 2009. The level of expenditure on food as a proportion of GDP remains relatively consistent throughout the period while there is greater variation in the other categories.

Figure 5 shows the change in the value of retail sales between 2005 and 2010. The value of total retail sales peaked in 2007, 17.3 per cent above the 2005 level. After a marginal decrease in 2008, the value of retail sales declined rapidly in 2009 and 2010. At the end of 2010, the value of retail sales was 0.3 per cent below 2005 levels.

Figure 5: Retail Sales Index by Product Category, 2005 - 2010²⁰



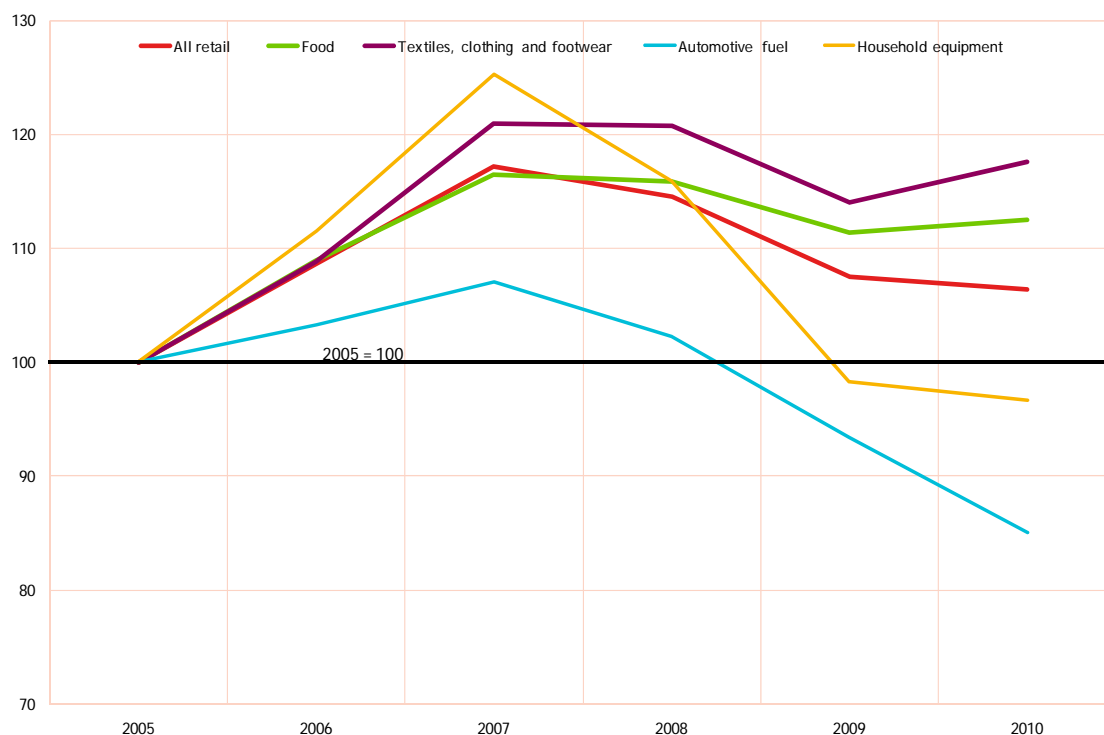
Source: CSO, Retail Sales Index

There is a notable divergence in trends between product categories during this period.

- Food sales peaked in 2008 when values rose 24 per cent above the 2005 level - the highest increase among the different categories benchmarked above. However, despite a two year decline, at the end of 2010 the value of food sales was still 13 per cent above 2005 levels.
- Unsurprisingly, given the collapse in the construction and property market, household equipment (which includes electrical goods, hardware, furniture and furnishings) has seen a significant decline in retail sales values, falling 24.2 per cent below 2005 levels by the end of 2010.
- The value of sales in the textiles, clothing and footwear sub-sector peaked in 2007, but has since fallen 13.2 per cent below the value of 2005 levels.

²⁰ If looking at this chart in conjunction with Figure 3, note the CSO uses different methodology to calculate constant prices in the National Accounts. See footnote 18.

Figure 6: Retail Sales Index by Product Category Type, Volume in 2005 = 100



Source: CSO, Retail Sales Index

Figure 6 shows changes in the volume of products sold between 2005 and 2010. It is important to note that changes in the values of retail sales (Figure 8) do not always translate into a corresponding change in the volume of goods sold. For example;

- The value of food sold in 2008 was 24 per cent above the 2005 level while the volume of goods sold increased by 15.9 per cent during this period. Since 2008 the value of food sales has fallen by nine index points but the volume of goods has fallen by just 3.4 index points;
- At the end of 2010, the value of automotive fuel sold was 3.7 per cent above the 2005 value (driven by world market and domestic taxation policy) but the volume sold was 14.9 per cent below the 2005 level (i.e. prices have increased while demand has fallen); and
- The value of clothing and textiles had fallen considerably by the end of 2010 (13.2 per cent below 2005 levels), however, the volume of goods sold was 17.6 per cent higher than the 2005 level.

The disparities in value and volume trends are a result of several factors such as changes in consumer behaviour. For example, the growth in the market share of discount grocery stores indicates that consumers are switching away from more expensive branded goods (see section 3.3 for a more detailed discussion on market structure). In developed economies, as consumers' disposable incomes change they may vary the quality or brand of food that they purchase but given its perishable nature they are unlikely to significantly change the quantity

they purchase. Retailer behaviour may also be an influencing factor (e.g. pursuing more aggressive price negotiations with suppliers/ offering lower value stock).

Consumer Behaviour Patterns

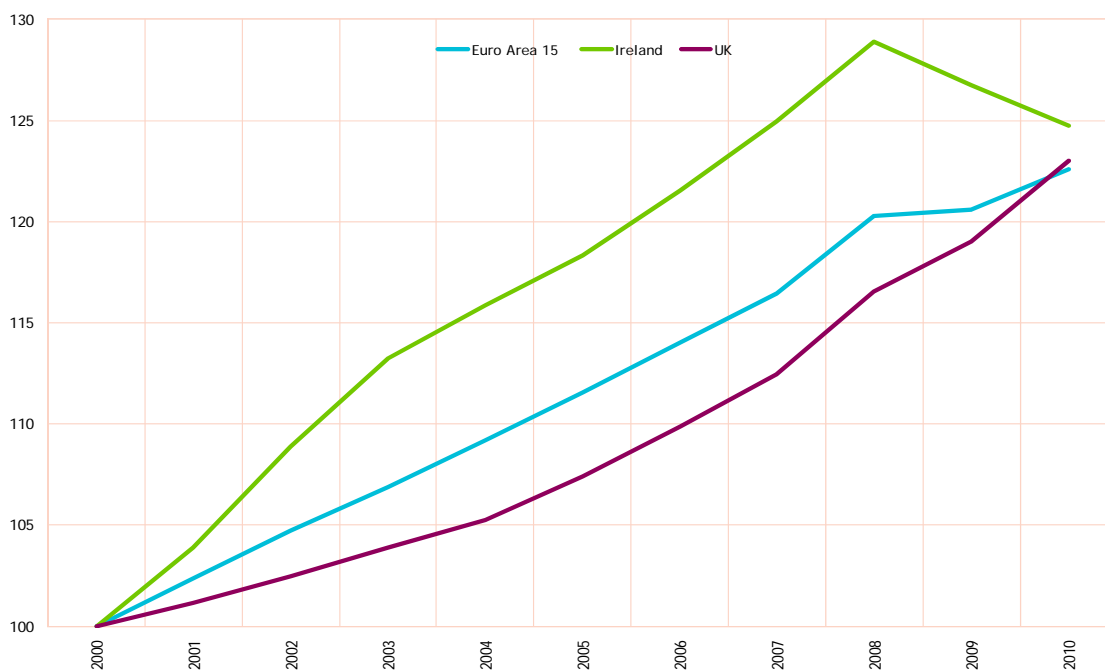
There are a wide range of factors which influence a consumer's decision on where to shop. According to National Consumer Agency (NCA) surveys of consumer behaviour patterns, price became the leading factor in determining where to shop in recent years but its importance declined significantly during 2010, from 72 per cent in June 2010 to 57 per cent in Nov/Dec 2010²¹. Convenience and experience (having shopped there previously) have become more important factors for consumers in deciding where to shop.

The most important factors in deciding where to shop vary. Price is the key deciding factor when shopping in supermarkets (29 per cent), clothing/footwear shops (26 per cent) and furniture/household appliances stores (25 per cent). Convenience (location/parking) is the second most important factor when deciding on supermarket shopping (19 per cent) but quality of products/services ranks second for clothing/footwear (23 per cent) and furniture/household appliances (21 per cent).

Prices

Irish consumer prices increased dramatically during the boom to the point that Ireland became the second most expensive country in the EU-15²².

Figure 7: Harmonised Index of Consumer Prices, Indexed to 2000, 2000 -2010



Source: Eurostat, Consumer Price Indices

21 National Consumer Agency, Market Research Findings: Shopping and Pricing, March 2011

22 Eurostat, Consumer Price Indices.

Figure 7 shows changes in consumer prices since 2000:

- Prices rose faster in Ireland than for the euro area-15 of the UK. By the end of 2008 prices in Ireland had risen by 28.9 per cent since 2000, compared to 20.3 percent increase for the euro area: 15 and 16.5 per cent for the UK.
- Prices in Ireland declined over the following two years but at the end of 2010 prices were still 24.7 per cent above the 2000 level.
- The euro area-15 sustained price increases throughout the period and at the end of 2010 prices were 22.6 per cent above 2000 level. In the UK, prices were 23 per cent above the 2000 level.

Of the euro area countries, Ireland experienced the smallest increase in the HICP (0.2%), during the twelve months to January 2011. The HICP for the euro area increased during that period by 2.3 percent. This indicates that Ireland’s cost competitiveness for consumers is improving relative to the euro area and other trading partners, such as the UK which increased by four per cent over the same period.

Figure 8: Comparative Price Level Index, 2001 -2009



Source: Eurostat, Comparative Price Level Index

Figure 8 shows the price level of consumer goods by category in Ireland and the UK indexed to the EU-15 average. This means that for each year shown, the average cost of each category of goods in the EU-15 is equal to 100. It is important to highlight some of the limitations that apply to this data. Firstly, these prices are influenced by taxation policies and secondly there are some differences in the basket of products which are used to create the index for each

category of goods²³. The data therefore provides a somewhat crude comparison of prices but a number of points are worth noting:

- The price level for consumer goods in Ireland in 2009 was 17.4 per cent above the EU-15 average while the UK is nine per cent below the EU-15 average. The cost of consumer goods in Ireland relative to the EU-15 average peaked in 2008 when Ireland was 18.5 per cent more expensive than the EU-15 and 28.4 per cent higher than the UK.
- The price level index for food and non-alcoholic beverages in 2009 in Ireland was 21.2 per cent above the EU-15 average (UK prices were nine per cent below the EU-15 average);
- The price level index for clothing and footwear in 2009 in Ireland was 3.4 per cent above the EU-15 average (UK: -21 per cent). The cost of clothing and footwear in Ireland relative to the EU-15 peaked in 2008 when prices were 13.6 higher than the EU-15;
- The price level index for furniture and furnishings, carpets and other floor coverings in 2009 in Ireland was 5.6 per cent above the EU-15 average (UK: two per cent below). The price peaked in 2007 when Ireland was 18.4 per cent more expensive than the EU-15 average; and
- The price level for household appliances was 0.6 per cent below the EU-15 average in 2009 (UK: -12.5 per cent). Between 2000 and 2009, the cost of household appliance in Ireland remained below the EU-15 average with the exception of 2003 when Irish prices rose 0.2 per cent above the average.

Notwithstanding the depth of the Irish recession and recent deflation, combining the analysis from Figures 7 and 8 suggests that Irish prices remain high relative to those in other competitor countries. However, it is likely that the gap between Ireland and its European partners has decreased since 2008.

The NCA conducts periodic surveys of the comparative price of a basket of 103 common branded grocery products in Dunnes Stores, Tesco, and Superquinn. In its most recent survey in July 2010, the NCA found that the price difference between the cheapest and the most expensive was €1.14, or 0.4 per cent²⁴. The NCA is of the view that the retailers are price matching in core branded products and that *this suggests competitive pricing is still not a feature of the Irish grocery market*²⁵. In June 2009, the difference between the cheapest and the most expensive basket was €8.54, or four per cent.

23 This is to reflect differences in tastes and cultural backgrounds, but all baskets will, in principle, provide equivalent satisfaction or utility. Eurostat, Purchasing Power Parity Metadata.

24 National Consumer Agency, Price Comparison Survey - Branded Grocery Products, August 2010.

25 http://www.nca.ie/eng/Media_Zone/Press%20Releases/grocery-price-survey-aug2010.html

3.3 Structure of the retail market

3.3.1 The international retail sector

Before looking in detail at the structure of the Irish retail sector, it is helpful to provide some international context and to provide an overview of the sector at a global level.

Although there has been considerable globalisation within the sector, the industry remains far more localised than others such as consumer products, hospitality, telecommunications and entertainment. Of the top 250 retailers in the world in 2009, 22.2 per cent of their sales in 2009 were derived from foreign operations. However, European retailers are significantly more globalised than retailers from elsewhere, with 36.5 per cent of their sales being made abroad in 2009²⁶.

In the past twenty years, Europe has witnessed a sharp increase in the number of mergers and acquisitions within the retail sector and the food retail sector in particular.

Between 1993 and 2002, the average share of the grocery market controlled by the top five leading retailers in EU member states increased from 48.5 per cent to 69.2 per cent²⁷.

Table 1: Categories of the Top 50 Global Retailers, 2009

Category	Retailers
Cash & Carry/ Warehouse	2
Clothes Store	2
Convenience / Forecourt	2
Department Stores	6
Discount	2
Electronics	2
Home Improvement	2
Hypermarkets	8
Internet-based	1
Others	2
Pharmacies	3
Supermarkets	18

Source: Deloitte, *Global Powers of Retail*

Leading International Retailers

This section is based on a review of publicly available information on the top global retailers²⁸. The Global Powers of Retailing report ranks the world's leading retailers according to retail sales values for 2009²⁹. While retailers often operate across several different formats, Table 1 shows the primary retail categories into which the top 50 retailers fall. Table 2 shows the country of origin of each of the top 50 retailers. There are no Irish owned firms among the top 50 retailers³⁰.

Of the top 50 global retailers, six have a presence in Ireland (Tesco, Lidl, Aldi, IKEA, Amazon and Inditex³¹). Fifteen of the 50 retailers have a presence in just one country.

²⁶ Deloitte, *Global Powers of Retail*, 2011.

²⁷ Defra, *Investigation of the determinants of farm retail price spreads*, 2003.

²⁸ Efforts to consult with stakeholders/potential new entrants who would be able to provide insights on the likely barriers to entry in the Irish retail market were unsuccessful.

²⁹ Deloitte, *The Global Powers of Retail - Leaving Home*, 2011.

³⁰ Of the top 500 global retailers, Dunnes Stores ranks as 224th. Deloitte, *Global Powers of Retail* 2010.

³¹ Inditex operates in Ireland under the brand names Zara, Massimo Dutti, Pull and Bear and Berksha.

Three of the top ten retailers have an Irish presence³². In order to examine the impact, if any, of the cap on retail units on potential entrants to the Irish market we reviewed the structure of the seven retailers that do not have a presence here.

It should be noted that while the cap on total convenience goods retail space is 3,000 square metres (3,500 square metres in the Greater Dublin Area), the limit does not apply to non-convenience (non-food) goods. For example the Tesco Extra units are upwards of 5,000 square metres but the space allotted to grocery is less than 3,000 (or 3,500 in Dublin) square metres.

Wal-Mart Stores, Inc: Wal-mart is a U.S. owned company and had the highest retail sales in the world in 2009 (\$405,046 million - more than three times that of its nearest rival Carrefour) and has stores in sixteen different countries - largely north, central and south America and east Asia.

The UK is the only country which it operates in within Europe. In 1999, the company bought the ASDA group of supermarkets and its stores continue to operate under the ASDA brand name in the UK. In 2005, the company opened ASDA stores in Northern Ireland³³ and Wal-mart now operates more than 370 stores throughout the UK.

ASDA stores are categorised into four formats³⁴:

- Supermarkets: These range in size from 900 square metres to 2,300 square metres. These are sited in smaller towns and suburban areas. The company currently operates 22 of these units in the UK.
- Superstores: Superstores are the core format for ASDA stores, with a model size of 4,000 square metres. These provide a wide range of food and non-food goods for sale. They are often used as an anchor for high street redevelopment and have tended to be developed on brownfield sites. There are 296 ASDA superstores in the UK.

Table 2: Country of Origin Top 50 Global Retailers, 2009

Country/ Region	Retailers
Europe	24
- France	7
- Germany	5
- Spain	3
- UK	3
- Switzerland	2
- Belgium	1
- Italy	1
- Netherlands	1
- Sweden	1
U.S.	19
Japan	3
Australia	2
Canada	2

Source: Deloitte, Global Powers of Retail

³² Tesco, Lidl and Aldi.

³³ ASDA now operates 15 supermarkets, one supercentre and one ASDA Living store in Northern Ireland. The supercentre was opened at Junction One Retail Park in 2010.

³⁴ <http://retail-development.asda.com/our-store-formats.html>

- Supercentre: These units are more closely aligned to the USA Wal-street format, with a model size 7,900 square metres. There are 29 supercentre units currently in operation in the UK³⁵.
- ASDA Living: The model size for these units is 1,858 square metres. These stores only stock non-food goods including clothing home wares, electrical, music and video, toys and baby products.

If Wal-mart was to enter the Irish market it may seek to expand its ASDA brand to enable it access to the economies of scale that would arise through its existing distribution network and own-brands in the UK. If it sought to roll out similar formats to those used in the UK, only the Supercentres would exceed the cap and these form a small proportion of their total stores in the UK (8.3 per cent of its food stores). Of its 16 grocery stores in Northern Ireland, ASDA has only one supercentre (and no superstore) - it opened in 2010.

It is not possible to ascertain the proportion of space within ASDA superstores which is allocated to grocery goods. According to UK Competition Commission research, stores with more floorspace will carry a more extensive non-grocery offering. In the case of ASDA, the number of grocery lines appears to remain stable or increases relatively slowly with store size³⁶. These stores are similar in format to Tesco Extra stores, several of which are already in operation in Ireland.

Carrefour: This French owned firm was the second biggest retailer in the world in 2009³⁷. The firm owns stores in 36 countries across continental Europe, South America, Asia and the Middle East. It does not have a presence in the UK.

Carrefour is largely known for its hypermarket format and the average size of stores in France is 9,700 square metres but the company varies store size by location. Its Belgian units have an average stores size of 6,700 square metres while its Greek stores have an average size of 5,300 square meters - significantly above the Irish cap.

More recently, the company has focused on developing smaller stores while retaining its existing large stores. The average size of a new hypermarket in 2008 equalled 5,400 square meters, which is 33 per cent smaller than the average size of store opened in 2004. According to Carrefour, this trend towards smaller stores is driven by consumer preferences³⁸. The company has developed units of 3,000 square meters in countries such as Spain, Poland and Romania to 'match as closely as possible the needs of each trading area'. Units of 2,600

³⁵ <http://retail-development.asda.com/food-stores.html>

³⁶ UK Competition Commission, The supply of groceries in the UK market investigation, 2008. Note details on the specific store size at which this applies have been blacked out in the Competition Commission's report as they are confidential.

³⁷ Deloitte, The Global Powers of Retail - Leaving Home, 2011.

³⁸ <http://www.carrefour.com/cdc/group/our-business/our-stores/our-stores-folder/hypermarket.html>

square meters have been developed in South America.

Given Carrefour's willingness to adapt store size to local market requirements and that their stores stock both convenience and non-convenience goods, it seems unlikely that that cap on units is preventing their entry to the Irish market. The company has recently entered a major restructuring phase, withdrawing from locations where it holds little market share and concentrating on building its business in its core locations France, Spain Italy and Belgium³⁹. Carrefour withdrew from the British market in the late 1980s. Many of these stores are now part of the ASDA group of stores operated by Wal-mart.

Metro: This German owned group operates a variety of retail store brands - a wholesaler (Metro), hypermarket (Real), electronics stores (Media Market and Saturn) and department warehouse stores (Galeria Kaufhof). The company has stores in 33 countries but in 12 of these countries, including the UK, it only operates wholesale cash and carry stores which are not of relevance to this study.

- Real, the firm's hypermarket arm, has stores in Germany, Poland, Romania, Russia, Turkey and the Ukraine. The average store sizes range from 5,000 square metres to 15,000 square metres and carry a mixture of convenience and bulky/non-food goods.
- Media Market and Saturn provide electronic consumer goods with locations in twelve EU countries and in Russia, Turkey and China. The stores vary in size from 2,500 to 10,000 square metres.
- Galeria Kaufhof stores are operated in Germany and Belgium and offer branded clothing, home-wares, beauty products, electronics and jewellery. The stores range in size up to 10,500 square metres⁴⁰.

The Kroger Co: The Kroger Co. operates under 24 different banners with store formats that include grocery, convenience, department and jewellery stores. It operates exclusively in the US.

Costco Wholesale Corp: The company's business model is based upon achieving high sales volumes and rapid inventory turnover by offering a limited assortment of merchandise in a wide variety of product categories at low prices⁴¹. Customers are required to purchase annual membership in order to shop in this cash and carry style warehouse store. The US-owned company operates in nine countries. Its only European operations are in the UK where it is designated as a wholesaler and individual membership is limited to certain employment groups including teachers, hospital staff and government workers⁴². Despite this constraint, 30 per cent of its UK sales come from individual customers rather than commercial businesses.

39 Economist Intelligence Unit, World retail: Key player - Careful Carrefour
http://viewswire.eiu.com/index.asp?layout=ib3Article&article_id=1215324106&country_id=&pubtypeid=1122462497&industry_id=&category_id=&fs=true&rf=0

40 http://www.stadtentwicklung.berlin.de/planen/staedtebau-projekte/alexanderplatz/en/heute/galeria_kaufhof/index.shtml

41 http://www.costco.co.uk/what_is_costco/what_is_costco.htm

42 <http://www.shelflife.ie/article.aspx?id=31>

- The average store size of Costco units worldwide is 13,500 square metres⁴³ with over half of the retailer's business arising from food.
- Unlike supermarkets which might carry 50,000 separate product lines, Costco averages just 4,000 product lines⁴⁴.
- Costco was denied planning permission for a retail unit near Clondalkin in Dublin 1997 (before the introduction of the cap) on the grounds that the 11,500 square metre store was deemed excessive in size and that it could have an adverse effect on local traders⁴⁵. According to media reports, in 2008 Costco expressed an interest in entering the Irish market and noted that "getting through the planning process" was "the primary issue".

The Home Depot: This US-owned retailer sells home improvement and construction products. It operates throughout the US, Canada, Mexico and China. It has no European operations. The store operates out of large warehouse style buildings averaging 9,800 square meters with larger megastore formats (20,900 square meters) operating in a number of locations⁴⁶.

Target Corp: This US-based discount retailer specialises in hardware and drapery and carries a limited line of non-perishable grocery items. The retailer currently only operates in the US but has recently announced plans to open stores in Canada. The average store size is 11,700 square meters with a number of superstores which have an average store size of 16,200 square meters⁴⁷.

Conclusions

In summary, the retail sector is less globalised than many other service sectors. However, a number of leading international retailers can be identified. Ireland has fewer international retailers than the UK - this may be in part due to the large differences in population size and densities, however retail planning regulations may also be an influencing factor.

A number of the top ten global retailers operate formats, which significantly exceed the Irish retail floorspace cap. However, many of these retailers also operate other formats that could operate within the current regulations. There is evidence also that many retailers are flexible and willing to adjust formats to meet the local market needs. The international trend in formats suggests retailers are moving towards smaller units in new developments in response to consumer preferences - while retaining existing large stores. It is difficult to assess to what extent the retail cap has acted as a barrier to entry for retailers. However, it is clear that at least one international retailer, Costco, attempted to enter the Irish market in

43 <http://phx.corporate-ir.net/phoenix.zhtml?c=83830&p=irol-homeprofile>

44 <http://www.shelflife.ie/article.aspx?id=31>

45 The retailer planned to provide over 4,000 square metres for grocery.

46 <http://www.allbusiness.com/retail/retailers-building-supply-hardware-stores/11898392-1.html>

47 <http://pressroom.target.com/pr/news/fastfacts.aspx>

1997 (before the retail caps were introduced) but failed to do so. Scale was one of the reasons for the planning refusal.

3.3.2 The Irish retail sector

The retail industry in Ireland has gone a long way towards eliminating the boundaries between wholesale and retail - with grocery and overseas-owned non-food retailers taking the lead. Major retailers have integrated distribution centres, which are mostly supplied directly by manufacturers. The major grocery wholesalers have developed symbol groups, controlling retail brands and supply chains, even though the retail outlets they supply are mostly owned independently. There is also some integration back to the supplier level⁴⁸.

Vertical integration gives larger retailers major advantages over fully independent retailers, which can have relatively weak supply chains, weak strategy and marketing, and poor access to training and management development. Vertical integration, and the scale that goes with it, allows enterprises (and in the case of symbol groups, groups of enterprises) to benefit from joint investment in a range of competitively important areas such as strong supply chain management and purchasing, centralised retail brand management, integrated technology; and common training and development. In this context, it is the size of the enterprise that matters with regard to market power, rather than the physical size of the retail outlets.

A recent Oireachtas report noted ongoing concerns over the level of competition in the market and the power of retailers over suppliers⁴⁹. While a number of retailers have entered the Irish market in recent years, as outlined above Ireland does not have as wide a range of grocery retailers as some larger European countries.

Much of the remainder of this section on the structure of retail in Ireland focuses on the grocery sector. This is partly because data available on the non-grocery sectors and the petrol forecourts sector is limited. However, as highlighted in Figure 8, the prices of food and non-alcoholic beverages were most out of line relative to the EU-15 average (based on 2009 data which is the most recent data available). Food and non-alcoholic beverages prices in Ireland were 21.2 per cent above the EU-15 average while clothing and footwear prices were 3.4 per cent higher and furniture and fittings prices were 5.6 per cent above the EU-15 average. Household appliances prices in Ireland were 0.6 per cent below the EU-15 average.

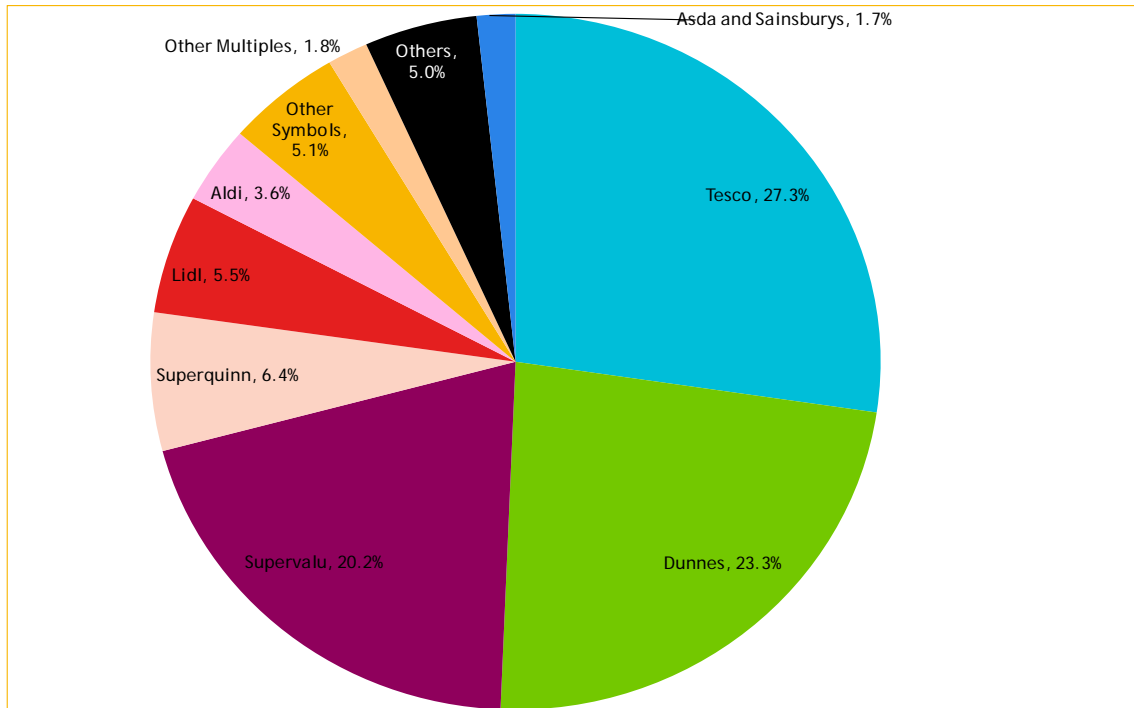
48 Expert Group on Future Skills Needs, Future Skills Needs of the Wholesale and Retail Sector, Forfás, 2010

49 Joint Committee on Enterprise, Trade and Innovation, matters Concerning the Retail Trade in Ireland, February 2011.

Market Share in the Irish Grocery Market

The following chart shows the market share of the leading grocery retailers in Ireland.

Figure 9: Market Share of Grocery Retailers in Ireland, 2011⁵⁰



Source: Kantar World Panel, 2011

- Tesco has the largest share of the Irish retail market followed by Dunnes Stores and Supervalu. These three retailers account for 70.8 per cent of the Irish retail market.
- Superquinn, Lidl and Aldi have a combined share of 15.5 per cent of the grocery market. This is 4.7 per cent less than Supervalu, the third largest retailer's share of the market.
- A number of new entrants have entered the Irish grocery retail market in recent years and continue to grown their market share (Lidl 5.5 per cent and Aldi 3.6 per cent).
- ASDA and Sainsbury's have a combined share of 1.7 per cent of the Irish market - although they do not have a physical presence in the State.

⁵⁰ Data for Ireland was collected in the 12 weeks to 21st February 2011.

Role of Cross Border Shopping

Figure 9 shows that ASDA and Sainsbury's have a combined share of 1.7 per cent of the Irish grocery market. Neither of these retailers have a physical presence in Ireland which indicates cross-border shopping. The CSO has collected data on cross border shopping since Q2 2009. In the 12 months to the end of June 2010, 14 per cent of Irish households made at least one shopping trip to Northern Ireland, down four per cent on the previous 12 month period. As is to be expected, households closest to Northern Ireland are the most likely to shop there. In the Border region 43 per cent of households shop in Northern Ireland. The greater the journey time to Northern Ireland the less likely households are to shop there (e.g. Dublin 15 per cent, Mid West three per cent, South-West two per cent).

Households who shopped in Northern Ireland increased their average number of shopping trips from 6.7 trips in the 12 months to the end of June 2009 to 8.6 in the following 12 months. However, this increase was almost entirely attributable to households in the Border region who increased their average number of trips from 14.4 in the 12 months to Q2 2009 to 20.2 in the 12 months to Q2 2010. Households in the other regions made an average of between 1.7 and three shopping trips to Northern Ireland in the 12 months before Q2 2010.

There appears to be a relationship between the average amount spent on shopping trips to Northern Ireland and the time taken to travel there. Given the frequency of cross border shopping by households in the Border region, it is unsurprising that their average spend on cross border shopping trips is the lowest across the regions (€155). Consumers that live further away make less frequent cross-border shopping trips and therefore their average expenditure is higher (Dublin €284, Mid East €391, Mid-West, South-East and South-West €523).

The above are the latest statistics on cross border shopping patterns. Among the factors that influence the level of cross border shopping are currency fluctuations, VAT rates and petrol prices.

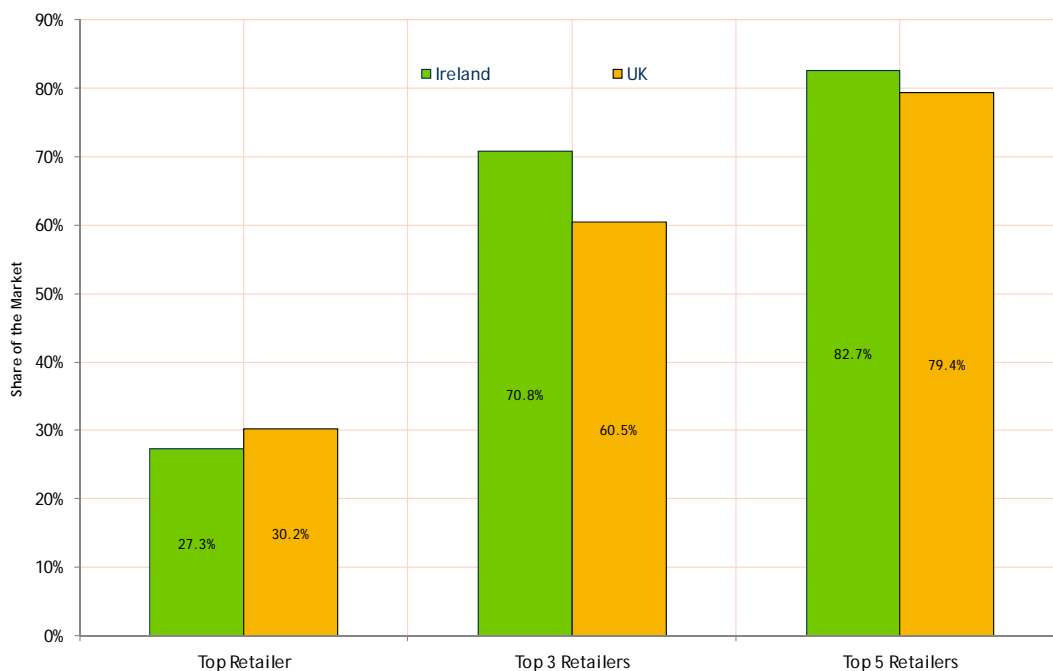
Data Source: CSO, Cross Border Shopping, QNHS - Q2 2010, November 2010.

Role of Internet Shopping

Online shopping has become a feature of the Irish retail market with 28 per cent of individuals surveyed in 2010 making an online purchase within the previous three months compared to 14 per cent in 2005. However, Ireland lags the EU-15 average (36 per cent) and is considerably behind the UK (60 per cent). The low levels of shopping online in Ireland for grocery (two per cent) and household goods (six per cent) highlight the importance of traditional retail models in the Irish market.

Concerns have been expressed that the grocery retail market in Irish is less competitive than in other countries which have a larger number of retailers in operation. One way to examine the level of competition within a market is to compare market concentration levels.

Figure 10: Concentration in the Irish and UK Grocery Markets, 2011⁵¹



Source: Kantar World Panel, 2011

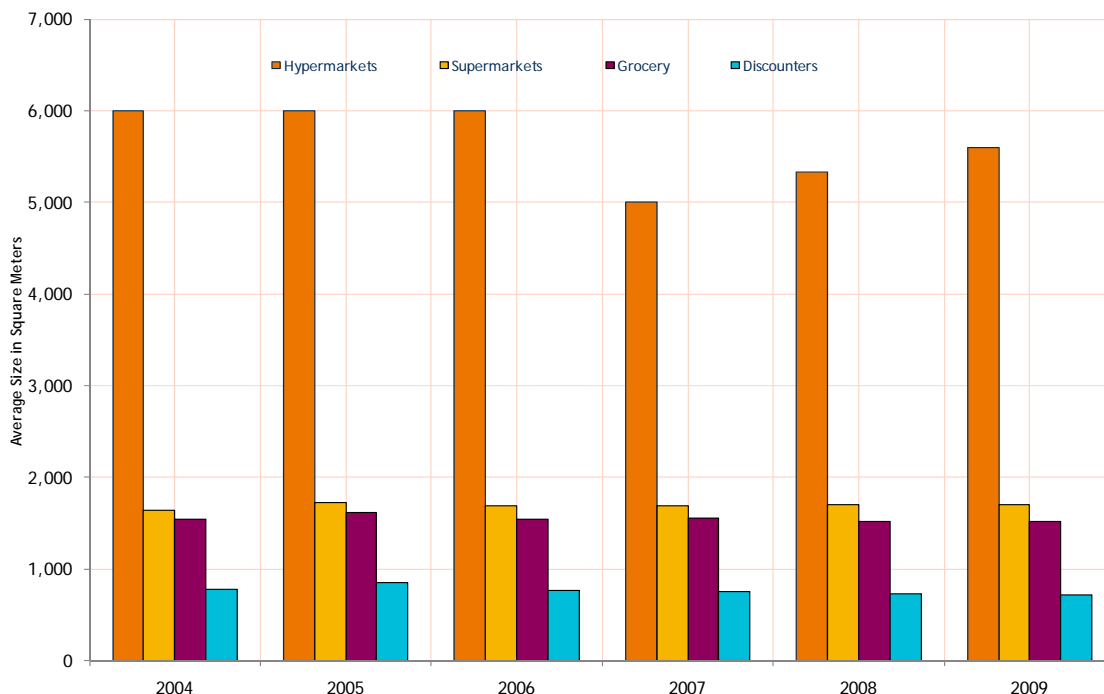
The above chart compares the level of concentration in the Irish grocery retail market with the UK where a larger number of global retailers operate. It assesses the market share of the top retailer and the combined market share of the top three and top five retailers.

- In both markets Tesco is the leading retailer; however, its market share in the UK is 2.9 per cent higher than in Ireland.
- The top three retailers in Ireland (Tesco, Dunnes Stores and Supervalu) supply 70.8 per cent of the market compared to 60.5 per cent in the UK. Dunnes Stores (23.3 per cent) and Supervalu (20.2 per cent) supply a larger proportion of the market than their UK counterparts ASDA (17 per cent) and Sainsbury's (13.3 per cent).
- The difference in concentration of market power among the top five retailers in Ireland (82.7 per cent) and the UK (79.4 per cent) is small.

⁵¹ Data for Ireland was collected in the 12 weeks to 21st February 2011. Data for the UK was collected in the 12 weeks to March 21st 2011.

Average Grocery Unit Store Size

Figure 11: Average Grocery Store Size in Ireland by Format, 2009



Source: Euromonitor, 2010

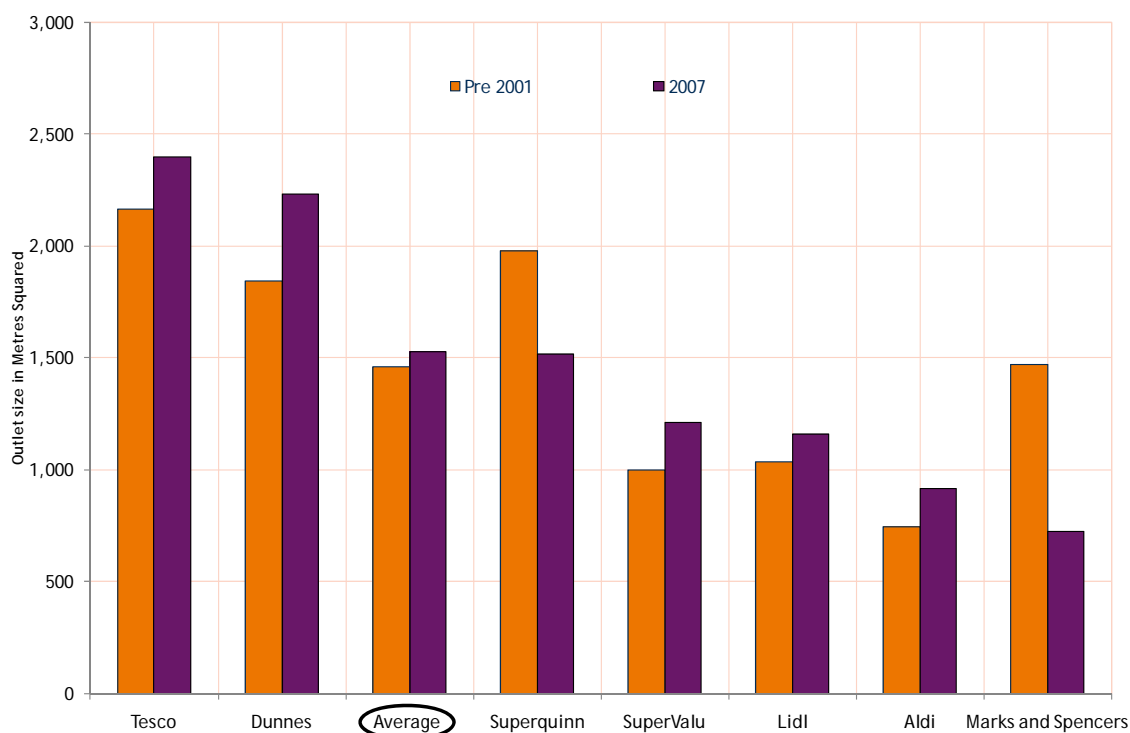
The above chart shows the average size of grocery units by format in Ireland.

- The average size of grocery units (including hypermarkets, supermarkets and discount stores) in Ireland was 1,515 square metres in 2009, a decrease of 2.2 per cent since 2004⁵².
- The average size of supermarkets in 2009 was 1,701 square metres; this is an increase of 3.7 per cent since 2004. The average size of discount stores in 2009 was 718 square metres, a decrease of 8.4 per cent since 2004.
- According to Euromonitor, between 2004 and 2009, the number of hypermarkets (units in excess of 5,000 square metres) increased from one to 10⁵³. The average size of hypermarkets in 2009 was 5,600 square metres (a decrease of 6.7 per cent since 2004).

As the type of outlet format differs by retailer it is also useful to examine the average store size by retailer.

⁵² Euromonitor, Retailing in Ireland 2009, 2010.

⁵³ The retail planning guidelines define hypermarkets as stores in excess of 5,000 square metres. The space allocated to grocery is capped at 3,500 square metres in the Greater Dublin Area and 3,000 square metres in the rest of the country.

Figure 12: Average Grocery Retail Outlet Size in Ireland (m²), 2001 and 2007

Source: The Competition Authority, 2008⁵⁴

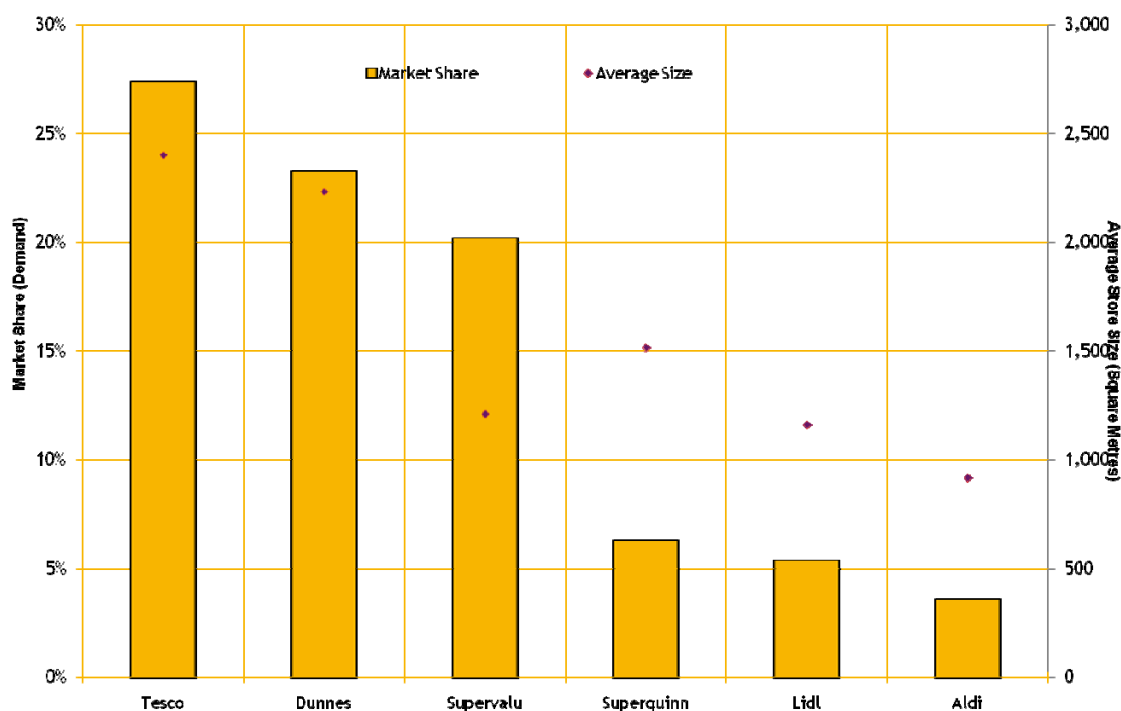
- The most recent published data for average store size by grocery retailer is from the Competition Authority⁵⁵. Over the period 2001 to 2007, floorspace devoted to the retailing of groceries increased from 471,508 square metres to 835,647 square metres. Lidl and Aldi were the most active in opening new outlets while Tesco and Dunnes Stores were the most active in adding floorspace.
- The average floor area of grocery outlets opened between 2001 to 2007 increased marginally - from 1,461 square metres to 1,529 square metres. A range of factors affected the average store size during this period. A small number of stores were built close to the retail cap, many small independent stores closed, and the relatively small size of new entrants (e.g. Aldi / Lidl) limited the increase in average store size.
- According to publicly available information, 18 out of the 130 stores Tesco operates are superstores (Tesco Extra)⁵⁶. The Tesco Extra stores are in excess of 5,000 square metres. In line with the cap on retail floorspace, the space provided for convenience goods is limited to 3,000 square metres (3,500 square metres in Dublin). The remainder of the space is allocated to comparison goods such as clothing, home-ware, electronics and books. There is no cap on the amount of space provided for comparison goods. Tesco also opened a number of new stores at the smaller end of the market. It has 22 Tesco Express stores - these range in size from 150 square metres - 500 square metres

⁵⁴ The Competition Authority, The Retail Planning System as Applied to the Grocery Sector: 2001 to 2007, 2008.

⁵⁵ Ibid.

⁵⁶ Tesco website: <http://www.tesco.ie/press2.html>

Figure 13: Grocery Market Share (2011) and Average Store Size (2007) in Ireland



Source: Kantar World Panel 2011⁵⁷, Competition Authority 2008⁵⁸

The above chart shows the market share of each of the leading grocery retailers and their average store sizes.

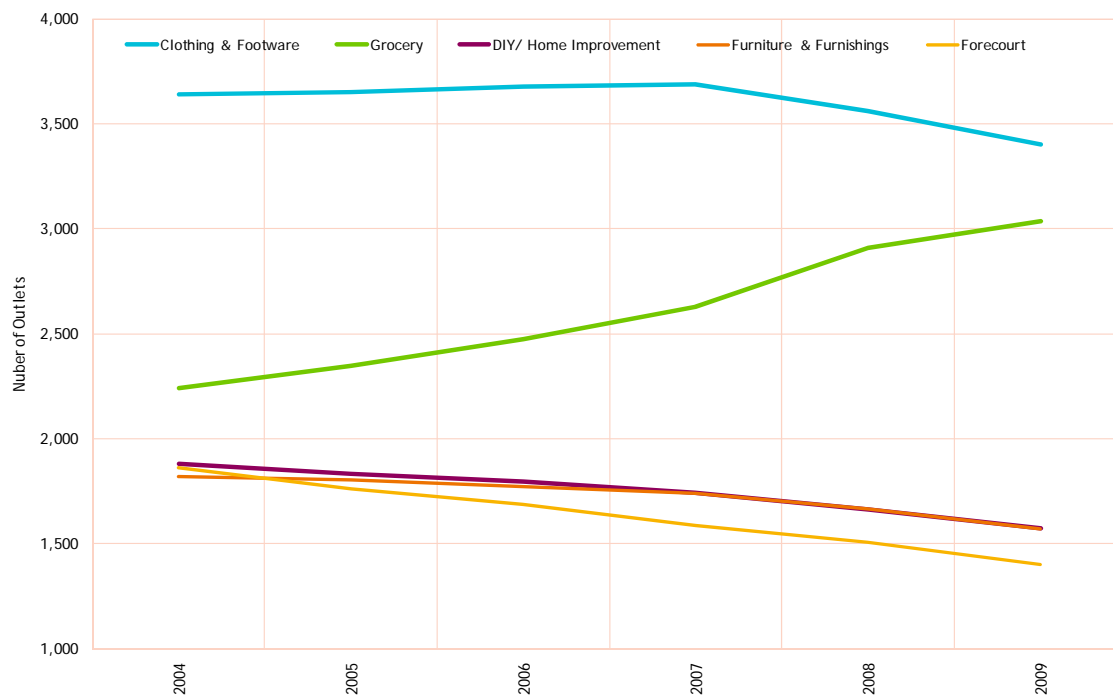
- Tesco has the largest share of the grocery market (27.3 per cent) and the largest average store size (2,400 square metres). Dunnes Stores has the second largest share of the market (23.3 per cent) and the second largest average store size (2,232 square meters).
- Superquinn has a larger average store size (1,516 square meters) than Supervalu (1,210 square meters) but a much smaller share of the grocery market (6.3 per cent as opposed to 20.2 per cent). Superquinn has a significantly smaller number of outlets than Supervalu.

57 Market share data is from the Kantar World Panel and refers to the twelve weeks to 20th February 2011.

58 The Competition Authority, The Retail Planning System as Applied to the Grocery Sector: 2001 to 2007, 2008.

Retail Outlets

Figure 14: Number of Retail Outlets by Category, 2004 -2009



Source: Euromonitor, 2010

- The number of grocery units increased by 798 stores between 2004 and 2011. All categories of grocery units including hypermarkets, supermarkets, discounters and local convenience stores increased during this period.
- The number of non-grocery stores in the key retail categories (clothing and footwear, furniture and furnishings, DIY, Forecourts and electronics⁵⁹) declined by 13.6 per cent between 2004 and 2009 to 8,236 stores⁶⁰.

Research from The Competition Authority indicates that there was a substantial increase in the number of grocery outlets controlled by the vertically integrated (+65 per cent) and affiliated retailers⁶¹ (+66 per cent) between 2001 and 2007. However, there was a significant decrease in the number of independent retail outlets (-50 per cent). The decrease in the number of independent retail outlets reflects a long term trend in the sector. This is driven by a combination of closures and a movement by independent retailers to affiliation with a wholesaler-franchisor⁶².

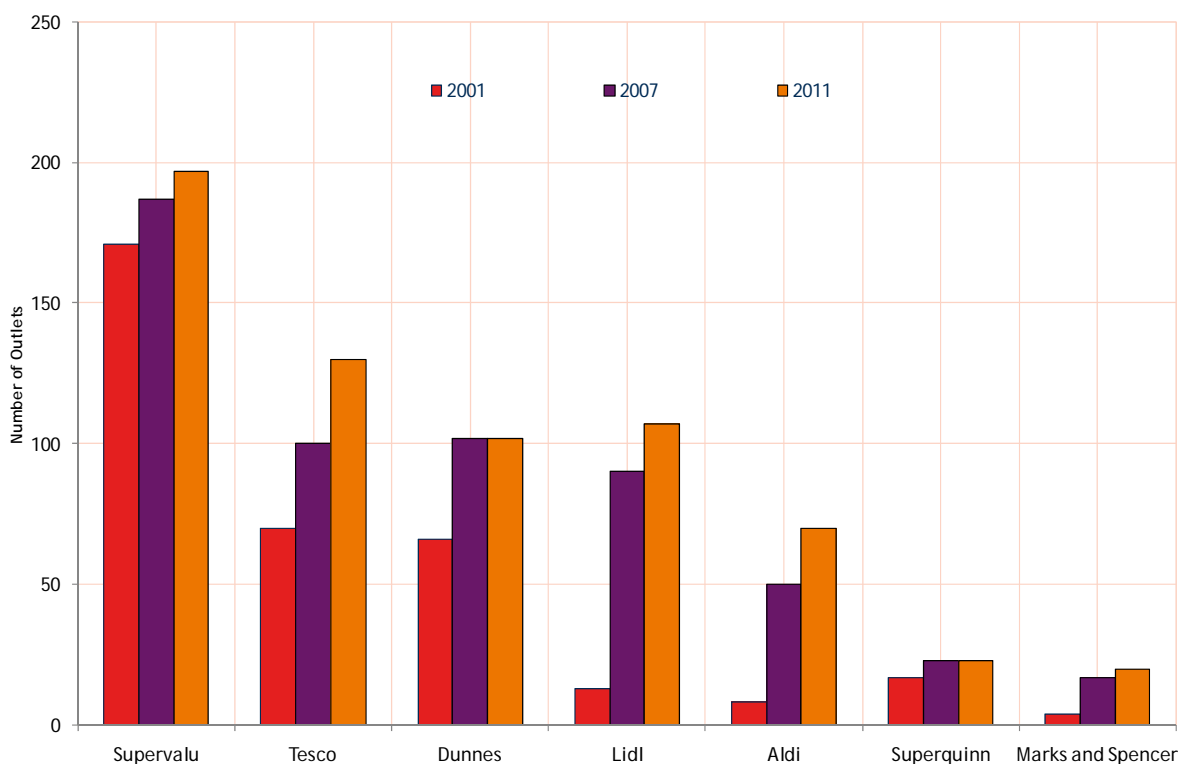
⁵⁹ Electronic stores are not included in the chart given the small number of stores in this category relative to the others. Between 2004 and 2009, the number of electronic stores fell from 324 to 288.

⁶⁰ Euromonitor, Retailing in Ireland 2009, 2010.

⁶¹ Retailers who have aligned themselves with a wholesaler-franchisor by contract (e.g., Supervalu retailers to the Musgrave Group etc.)

⁶² The Competition Authority, The Retail Planning System as Applied to the Grocery Sector: 2001 to 2007, 2008.

Figure 15: Number of Grocery Retail Outlets, 2001 -2011



Sources: The Competition Authority, 2008 (2001 and 2007 data); Forfás Research (2011 data).

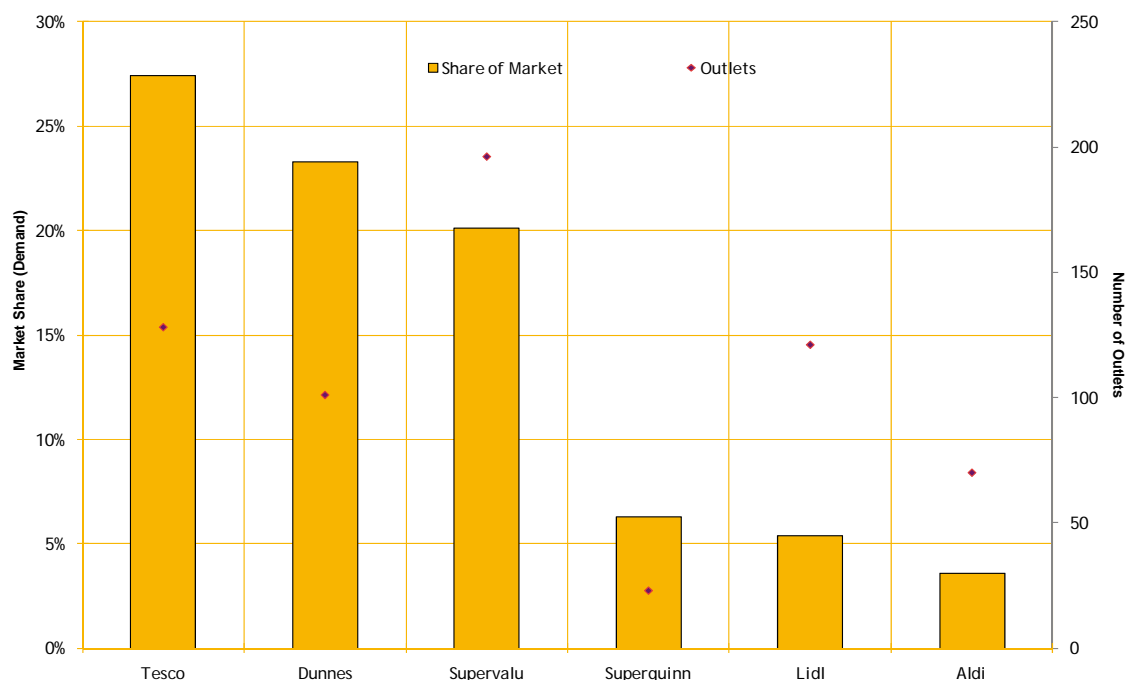
Figure 15 shows the growth in the number of outlets operated by the largest grocery firms.

- Between 2001 and 2011, there was a total increase of 86 per cent in the number of outlets operated by these firms in Ireland. This amounted to an increase of 300 outlets since 2001 to 649 outlets in 2011.
- Aldi (+775 per cent/ 62 outlets), Lidl (+723 per cent /94 stores) and Marks and Spencer (+400 per cent /16 stores) showed the greatest growth rates in terms of the number of new retail outlets, albeit from a very low base.

Figure 16 shows the market share of each of the leading retailers and also the number of outlets operated by each retailer.

- Supervalu has the highest number of outlets (196) but the third largest share of the grocery market (20.2 per cent). Lidl has the third highest number of outlets (121) but a market share of 5.5 per cent.

Figure 16: Market Share and Number of Outlets in Irish Grocery Sector, 2011



Source: Kantar World Panel, Forfás Research

Table 3 indicates how many of the seven main grocery retailers operate in urban centres with a population above 10,000 (based on the 2006 Census) and the number of outlets they have in each centre.

There are a number of caveats that need to be considered when drawing inferences from the data:

- The data does not take account of the size of the various outlets in each location as this data is not publicly available. Given the different formats operated by retailers, there can be considerable differences in outlet size. This means that equal weighting cannot be assigned to each outlet as the level of in-store choice and the degree of competition provided by an outlet in a given location will vary;
- It does include large local retailers which operate in certain parts of the country (e.g. Pettitts in Wexford); and
- It is not possible to do a full spatial analysis to take account of the proximity of these large urban centres listed to one another and to other centres. For example, Celbridge, Maynooth and Leixlip are all within twelve minutes drive of each other and are also within easy reach of large Dublin based stores.

Table 3: Grocery Retailers in Urban Centres with Population of Greater than 10,000

	Population	Tesco	Dunnes	SuperValu	Lidl	Aldi	Marks & Spencer	SuperQuinn	Total	Choice
Dublin City and County	1045769	42	25	24	22	12	10	16	151	7
Cork City	119418	5	7	8	3	7	2	0	32	6
Galway City	72414	3	6	3	3	2	1	0	18	6
Limerick City	52539	5	4	2	3	2	0	1	17	6
Waterford City	45748	3	1	1	2	1	0	1	9	6
Dundalk	29037	2	3	0	2	2	0	1	10	5
Drogheda	28973	2	3	1	2	2	1	0	11	6
Bray	27041	2	1	0	0	0	0	0	3	2
Kilkenny	22179	0	2	0	1	0	0	1	4	4
Tralee	20288	2	2	1	0	1	1	0	7	5
Ennis	20142	1	1	0	1	1	0	0	4	4
Naas,	20044	2	0	0	1	1	1	0	5	4
Sligo	17892	1	1	0	1	0	0	0	3	3
Celbridge,	17262	1	0	0	0	1	0	0	2	2
Clonmel	15482	1	1	1	1	1	1	1	7	7
Leixlip	14676	0	0	1	1	0	0	0	2	2
Athlone	14347	2	2	0	1	1	1	0	7	5
Carlow	13623	1	1	1	1	2	0	1	7	6
Killarney	13497	2	1	1	1	1	0	1	7	6
Carrigaline	12835	0	1	1	1	0	0	0	3	3
Arklow	11712	1	1	1	1	1	0	0	5	5
Tullamore	10900	1	2	0	1	1	0	0	5	4
Maynooth	10715	1	1	1	1	1	0	0	5	5
Castlebar	10655	1	1	1	1	1	0	0	5	5
Greystones	10112	1	0	1	1	0	0	0	3	4
Ballina	10056	1	1	1	1	0	0	0	4	4

Source: CSO Census 2006, Retailer Websites, Forfás Research.

The key findings are:

- Dublin is the primary retail location in the country with all seven grocery retailers operating multiple outlets across the city and county;
- The number of retailers operating in large towns is likely to be influenced by the distance between each town and other towns with populations in excess of 10,000. For example, Clonmel has a choice of seven retailers which may be due to its large catchment area. The nearest urban centres with a population greater than 10,000 are Waterford and Kilkenny which are almost an hour's drive away;
- Similarly, towns near the Dublin county line (e.g. Bray, Greystones, Celbridge, Leixlip) have a lower number of retailers than other centres further from Dublin with comparable population sizes. This is likely to be due to the large proliferation of

outlets located in nearby Dublin as well as the relative proximity of these large towns to other large towns which provide alternative retail options; and

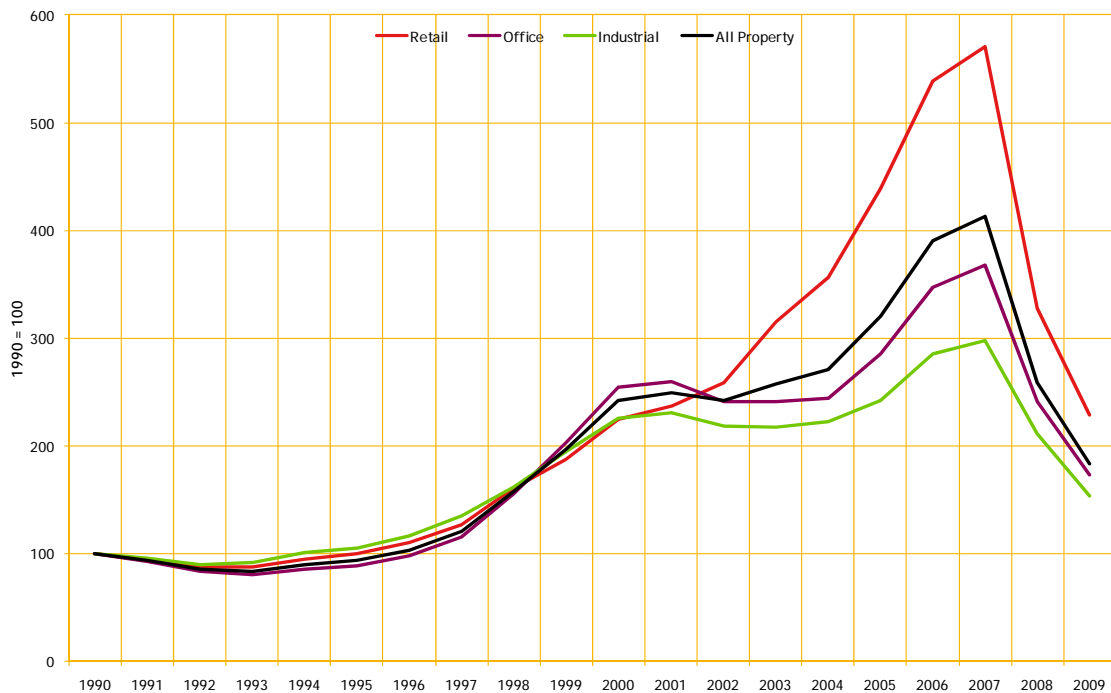
- Superquinn and Marks and Spencer have a significantly smaller network of outlets than the other retailers. While they have multiple stores in Dublin, they have just seven outlets each across the remainder of the large towns.

It is notable that the number of retail units per population centre declines sharply outside Dublin.

Retail Property Market

The analysis in this section tracks changes in the retail property market in Ireland and provides a price comparison with a range of international locations.

Figure 17: Rate of Change for Commercial Property Values in Ireland, 1990 - 2009



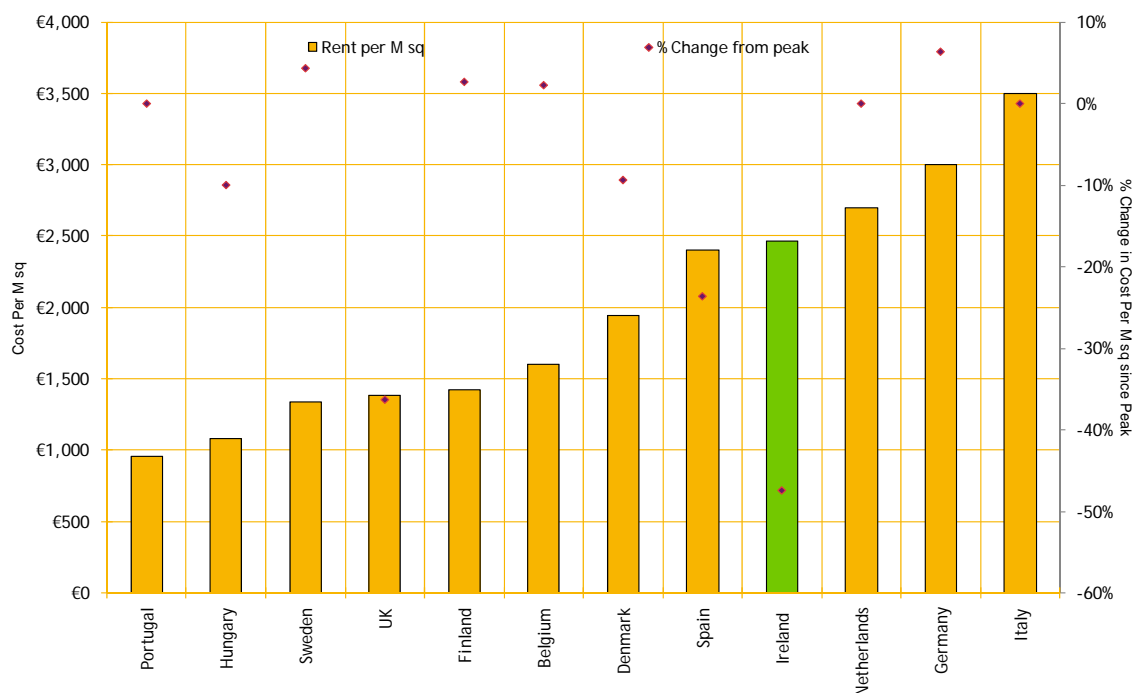
Source: IPD, Irish Property Index

- Despite floor space increasing during the boom, retail property costs grew rapidly. DTZ data highlights that retail property prices grew by almost 500 per cent between 1990 and 2007 - significantly higher than that experienced by commercial office (260 per cent) and industrial space (200 per cent). The sharpest increase occurred between 2001 and 2007. As of December 2009, retail property prices had fallen back to 2001 levels while offices and industrial property are at 1999 and 1998 levels respectively⁶³.

⁶³ NCC, Costs of Doing Business in Ireland, 2011, Forfás (not yet published)

The ban on upward only rent review clauses in business leases is a positive development. However, many retailers are tied into long leases with no opportunity to renegotiate the terms so it will mainly benefit new and expanding or relocating retailers.

Figure 18: High Street Retail Rental Cost per Metre Squared in Capital Cities and Percentage Change since Peak, Q4 2010⁶⁴



Source: CBRE, Market View EMEA Retail, Q4 2010

Retail property costs grew rapidly during the boom. Ireland is the fourth most expensive location among the benchmarked group for the rental of high street retail space. According to CBRE, in Q4 2010 the average cost to rent a metre squared of high street retail space in Dublin was €2,467. Despite being among the most expensive locations, retail property in Dublin has declined by 47.5 per cent since the peak, more than any other of the benchmarked countries. Although the pace of decline has slowed considerably in recent months, downward pressures remain.

- According to research from Experian, there are low levels of take-up and rates of retail vacant space vary considerably across the country. In 2010, the vacancy rate in Ireland was forecasted at 15.5 per cent while the rate in Northern Ireland was 14.1 per cent,

⁶⁴ Figures indicate the degree of change from the highest rent or lowest yield recorded in the previous three years to the current level.

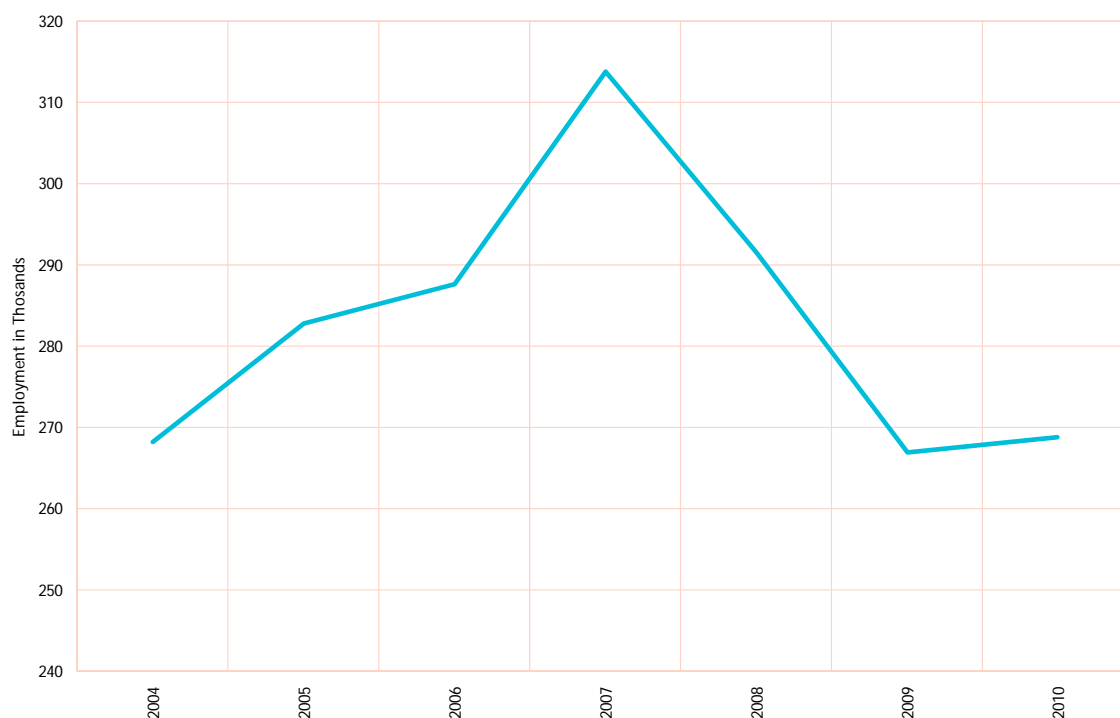
one percentage point higher than the UK average⁶⁵. While there may be retail space available, it may not be suitable (e.g. the space available is too big/small; location)⁶⁶.

- According to research by UK retail analysts, more than one shop in seven on England’s high streets is vacant. However, CBRE research indicates that, despite retailer difficulties, there are low levels of vacant space on Dublin’s high streets as of Q2 2010 at between 3.2 per cent and 5.8 per cent. CBRE concluded that ‘with funding for new projects still difficult to obtain and vacancy a threat in many shopping centres in the Dublin suburbs and provincial schemes, it is unsurprising that there is virtually no new retail development coming on stream in the current climate⁶⁷.

Employment in the Retail Sector

This section looks at employment trends in the retail sector.

Figure 19: Employment in Retail and Wholesale Sector, 2004 - 2010



Source: CSO, Quarterly National Household Survey, 2010

The CSO provides employment data for the combined retail and wholesale sector.

- Employment in the combined retail and wholesale sector peaked in 2007 at 313,700, representing 14.6 per cent of the total employees in the State. Despite a significant decrease in employment in this sector, by the end of 2010 retail and wholesale

65 Experian, Goad Database (http://www.finfacts.ie/irishfinancenews/article_1018353.shtml)

66 Planning magazine, article on empty shops, February 2011.

67 CBRE, Dublin Retail Market View, Q2 2010.

employees accounted for 14.7 per cent of people employed. This is slightly higher than the EU-27 and EU-15 averages (14.1 per cent and 14 per cent respectively).

- Employment levels dropped significantly in 2008 and 2009, falling by 7.1 percent to 291,500 in 2008 and then by 8.5 per cent to 266,900 in 2009. At the end of 2010, employment in the sector was at 268,300, an annual increase of 0.7 per cent.

Based on ESRI forecasts in 2009, employment in the broad wholesale and retail is expected to undergo a gradual recovery with employment reaching 289,000 in the sector by the end of 2016.

It is outside of the remit of this study to review the extensive literature on the impact of larger stores on employment. The literature is extensive and diverse in its views. In this context, we note the views of the OECD that *'the precise impacts of such entry [new large format stores] are still hotly debated, but increasingly evidence suggests that preventing the development of large stores actually reduces employment and raises prices to a higher level. In the UK, for example, Sadun (2007) finds that regulations that prevent construction of new large stores outside town centres have led grocery chains to instead develop smaller, local stores. These local stores have had a negative impact on pre-existing small grocery stores. In fact, employment in small, non-affiliated grocery stores appears to have fallen as a result of the switched entry patterns of large chains from greenfield sites to within-town sites. Basker (2005) finds that, overall, Wal-Mart entry appears to be associated with slight increases in employment, rather than decreases. In France, Bertrand and Kramartz (2002) examined the impact of stringency of entry regulations for large stores and find that restricting entry lowers employment'*⁶⁸.

Others have expressed conflicting views on the impact of larger stores on employment. As stated in the recent Oireachtas report, *according to the Musgrave Group, proponents for changing the planning regulations argue that larger stores reduce prices and create jobs. However, it maintains that the facts prove otherwise. Their representatives referenced the British National Retail Planning Forum which carried out an examination of the impact on local employment of the opening of 96 superstores throughout England and Wales. The Forum concluded that each superstore opening resulted in an average net loss of employment of 276 full-time equivalents. This research was, the Musgrave Group stated, replicated by IGD which found that new superstores meant fewer employment opportunities. IGD found that during a two-year period following the opening of 93 superstores there was a net job loss in food retailing alone of 270 jobs.* The Oireachtas report also noted research commissioned by the Northern Ireland Independent Retail Trade Association (NIIRTA) which found that *while jobs may be created in the short-term, consideration is not given to the resulting displacement of existing jobs or a potential net reduction in overall employment*⁶⁹.

⁶⁸ OECD, Land Use Restrictions As A Barrier To Entry, Working Party No. 2 on Competition and Regulation, Background Note by the Secretariat, 18 February 2008.

⁶⁹ Joint Committee on Enterprise, Trade and Innovation, Matters Concerning the Retail Trade in Ireland, February 2011.

4. Factors driving costs and competition in retail

The relationship between the retail cap, prices and competition is complex. Theoretically, the elimination of the retail cap could through economies of scale create greater cost savings for retailers which could, subject to the presence of vigorous competition, be passed on to retail customers. If successful, this would drive a downward adjustment in Irish consumer prices, thereby protecting real incomes and improving competitiveness.

However, the risk exists that retailers could extend scale advantages to create local monopolies for customers and potentially suppliers. This is a particular challenge in the grocery market where most consumers are generally do not travel long distances to do their weekly grocery shop⁷⁰. The challenge is to enable retailers to leverage the benefits of scaling while avoiding the risks of weakening competitive forces.

4.1 Impact of the retail caps on costs

Before we can assess the impact of the retail cap on costs, it is important to understand the composition of retail costs in Ireland. Previous Forfás work concluded that retail costs fall into two broad categories: the cost of buying goods for resale (which accounts for 75-80 per cent of total costs) and operating costs (20-25 per cent)⁷¹. Operating costs include:

- Labour;
- Property;
- Transport and distribution;
- Utilities (incl. electricity, gas, telecoms, waste and water); and
- Other costs (e.g. security, cleaning, advertising, legal, accounting, IT).

The Forfás study found that operating costs are dominated by labour costs (particularly for smaller more labour intensive grocery stores), property costs (particularly for department stores which are centrally located, and retail park stores which have significant store sizes), transport and distribution costs, and utilities (especially energy and waste).

Role of store size in driving economies of scale

It is essential that we assess the relationship between store size and potential economies of scale. If there are economies of scale at store level, restrictions on store sizes may increase retailer costs and these increased costs are likely to have an impact on consumer costs. Of course, this will also be influenced by the degree of competition which is dealt with in the next section.

⁷⁰ The average journey time of Irish consumers to do their main grocery shop is 22 minutes. Source: The Competition Authority, *The Retail Planning System as Applied to the Grocery Sector: 2001 to 2007, 2008.*

⁷¹ Forfás, *The Cost of Running Retail Operations in Ireland, December 2008.*

Given the lack of data and studies on the Irish retail market, we must rely on international studies. However, given the increasingly internationalised nature of the retail sector, it is reasonable to assume that the key findings should also apply to the Irish market.

Most of the international studies that examine the relationship between store size and economies of scale relate to the grocery sector. The main findings are summarised below:

- Savitt (1975) examined the effects of scale (measured by sales area and store utilisation) on store expenses (measured as a percentage of sales) for a sample of 333 Canadian supermarkets⁷². The supermarkets ranged in size from 700 to 3,700 square metres. This study concluded that store size had little effect on store operating expenses but store sales density had a very significant effect;
- Shaw et al (1989), in a comprehensive study of the costs of operation of grocery stores of different sizes in the UK, concluded that a U-shaped cost function provided the best fit for the effects of sales area on costs⁷³. However, the relationship is relatively weak. In terms of sales area, the cost function turns upwards at approximately 2,200 square metres, indicating that any economies of scale in grocery retailing are exhausted beyond this store size;
- Based on the above evidence and other studies, Goodbody (2000) concluded that the available evidence suggested that economies of scale for food stores are exhausted at a store size of approximately 2,000 square metres. However, they noted that where retail planning framework acts to restrict store size below this level, significant increases in retailing costs and consumer prices could result;
- UK Competition Commission (2000) analysis concluded that there are economies of scale, which are driven by savings in staff costs but that these are most relevant for small grocery stores⁷⁴. They found that above 3,000 square metres, the impact of economies of scale on total store costs is modest⁷⁵. The Competition Commission noted that for some retailers the staff cost benefits of scale might be hidden, for example, by larger stores having increased services and facilities. However, the Competition Commission found that, while there were substantial economies of scale in stores up to 3,000 square metres, the average store size in the UK is less than 500 square metres, with the planning system being partly responsible for this; and
- In a conflicting study, McKinsey Global Institute claimed that, based on a combination of interviews and regression analysis, store size appeared to have a significant impact on labour productivity⁷⁶. It identified three reasons why store size should have such an

72 Savitt, R, Economies of Scale in Canadian Supermarkets. Canadian Association of Administrative Science, Conference Proceedings, University of Alberta, 1975.

73 Shaw, S et al, Economies of Scale in UK Supermarkets: Some Preliminary Findings. International Journal of Retailing, Vol. 4. No.5, 1989.

74 The Commission also reviewed potential economies of scale from other costs (power, heat, light, water and telecommunications), bought-in and outsourced services, wastage and other costs (excluding loyalty cards and price discounts). The results indicated that economies of scale derived from other operating costs are less significant than those from staff costs. No clear relationship was found between capital costs and store size. Competition Commission, Supermarkets: A report on the supply of groceries from multiple stores in the United Kingdom, 2000.

75 According to the UK Competition Commission, comparing a store of 3,000 sq metres net sales area and a store with a 50 per cent larger sales area (i.e. 4,500 sq metres) at the same sales density, its analysis indicated that the latter would have staff costs which were only 44 per cent higher (other things being equal) than the former. This would reduce the total cost of running the store as a percentage of sales by about 0.4 per cent.

76 McKinsey Global Institute, Driving Productivity and Growth in the UK Economy, 1998.

impact: (1) management costs as a proportion of total labour costs fall; (2) labour costs of additional services as a proportion of total labour costs fall as store size increases; and (3) improvements in goods flow mean that workers make proportionally fewer trips in order to stock shelves.

There are limited studies on the economics of scale that exist outside of the grocery sector. The studies that do exist indicate that the presence/ absence of economies of scale is sector/ product dependent. For example, one significant study of economies of scale in the non-food sector carried out by Ingene (1984) found that, in the US, the existence of economies of scale in retailing was highly dependent on the sector under observation⁷⁷. Using sales as a measure of output and the number of employees and gross square footage as inputs, constant returns to scale were found for department furniture stores and general merchandise stores. Some evidence of increasing returns to scale was found for hardware and variety stores. Based on this research Goodbody (2000) concluded that there is no evidence that economies of scale persist up to the retail warehouse cap of 6,000 square metres.

Store size is also likely to be influenced by broader economic and societal trends. Increasing population densities and improvements in transport infrastructure (public transport, increases in car ownership, new motorways/by-passes, etc.) are likely to affect consumer demand for large stores as their potential catchment area grows. Competition Authority research indicates that most new grocery stores opened in Ireland between 2001 and 2007 had an average size of 1,529 square metres. The cap is unlikely to be the only factor restricting size - Ireland's small population, low population density (even in cities), and dispersed settlement patterns may also influence optimal store sizes. Other factors that may influence store size are the scale of suitable locations and the retailers' business model (e.g., discount stores like Aldi/Lidl tend to be in the 1,000-1,500 square metres range).

Role of other factors in driving economies of scale

In addition to store size, a wide range of other factors can influence the nature of economies of scale in the retail sector. A range of studies (e.g. Shaw, UK Competition Commission) indicates that economies of scale are more important at the level of the enterprise than at the store level. As highlighted by Irish and international data, the cost of goods sold is the dominant cost facing retailers - up to 80 per cent in the Irish case. Large retail enterprises have greater potential to drive economies of scale in terms of centralised procurement and distribution, management of technology, staff training and dealing with red tape. In addition, large retailers can drive significant efficiencies in store development (e.g. construction, planning) and operations management (IT, marketing, fixtures and fittings, etc). Large enterprises also tend to negotiate other costs like utilities and insurance centrally too.

However, in order to ensure that such advantages benefit the consumers through lower prices and development of new products, it is essential to have a competitive environment. For example, a study of competition in the Nordic food markets concluded that increased

⁷⁷ Ingene, C, Labour Productivity in Retailing. *Journal of Marketing*, Vol. 46, No 4, 1982.

concentration in the retail sector has significantly strengthened the bargaining position of retailers when negotiating with suppliers⁷⁸. However, the extent to which savings are passed on to customers is limited by the level of competition between retail chains. The average number of retailer groups operating in the Nordic grocery markets is between four and six⁷⁹.

4.2 Impact of the retail caps on competition

Strong competition is essential to drive down retail costs and ensure that costs savings are passed on to retail customers in the form of lower prices. Competition also promotes innovation and productivity. US research indicates that productivity growth in retail is driven by new entrants rather than competition between the existing players.

As highlighted earlier, Irish price levels are significantly higher than the EU-15 average. Previous Forfás research indicates that only part of this is explained by the higher costs of doing business in Ireland⁸⁰. The study, which was undertaken in 2008 when there was a significant differential between prices in the Republic of Ireland and Northern Ireland, found that operating costs (e.g. property, labour, utilities, local services) in Dublin are on average 25 per cent higher than those in Belfast. These operating costs account for approximately 20-25 per cent of the total cost of running retail operations - the remaining costs are dominated by the costs of goods. Forfás concluded that the higher operating costs add approximately five to six per cent to the total cost base of retailers in Dublin versus those operating in Belfast. Other Irish cities were found to be relatively more cost competitive.

The Forfás study also contended that given Ireland's reliance on the UK and the US in terms of imports, a strong euro should result in cost savings on imported goods and services for consumers and businesses. The fact that the strong euro did not appear to be translating into lower import costs may be indicative of a lack of competition in the import, distribution and retail sectors.

Restrictions on competition allow existing providers (large and small) to produce goods and services inefficiently and/or to inflate prices artificially. The remainder of this section will look at the impact of the retail caps on competition in Ireland. Retailers compete at both an enterprise and store level.

Impact of store size on competition

Competition for customers occurs primarily at a local level as customer's willingness to travel, especially for grocery goods, is relatively limited. Competition Authority research indicates that on average Irish consumers' journey time to grocery shop is 22 minutes^{81, 82}.

78 Working Group of Nordic Competition Authorities, Nordic Food Markets - A Taste for Competition, 2005. The study covers Denmark, Finland, Iceland, Norway and Sweden.

79 Ownership of supermarkets has become more concentrated partly due to mergers - a number of supermarkets are now owned by the same company or group.

80 Forfás, The Cost of Running Retail Operations in Ireland, December 2008.

81 As highlighted in the text box in Section 3.3.2, this may vary depending on factors such as currency fluctuations, VAT rates and petrol prices which influence the level of cross-border shopping.

82 The Competition Authority, The Retail Planning System as Applied to the Grocery Sector: 2001 to 2007, 2008.

This is supported by the UK Competition Commission who noted that that one-stop shopping patterns are primarily local, with consumers rarely travelling more than 10 minutes in urban areas, and rarely more than 15 minutes elsewhere to do their main weekly shopping⁸³. For larger bulky goods (e.g. furniture, washing machines, carpets, etc.) that are purchased less frequently, markets can be significantly larger.

In assessing the impact of the caps on competition, we need to establish the ease of entry and exit in the Irish retail sector. There has been a significant increase in the number of grocery stores since 2001 (Figure 15) largely driven by an increase in the number of Lidl and Aldi stores. However, the number of national grocery retailers has not increased during this period. In Dublin and the other main cities (Cork, Galway, Limerick and Waterford), customers have a choice of at least six key grocery retailers and access to a wide range of outlets (see table 3). The choice of grocery retailers and the number of outlets in other towns tends to be lower. There is a strong risk that increases in store size in small population centres could, by reducing the number of stores, limit consumer choice further.

The OECD notes that 'for many businesses, their strongest rivalry comes from their geographically closest competitors. One interesting piece of evidence on this comes from the recent Competition Commission "Supply of Groceries in the UK Market Investigation" which examines the impact of entry on the sales of nearby stores. It estimates the effect of entry of a new store on the revenue of incumbent stores. The impacts vary depending on the distance of the entrant from the existing stores and on the relative size of the stores. When an entrant is located in close proximity to an incumbent, the effect on the incumbent is much more pronounced than when the entrant is far away. This is not surprising, as for retail goods like groceries, we would expect consumer drive times to play an important factor in determining where they shop'.

As retailers do not submit planning applications that they know are likely to be rejected given the time and costs involved, we need to be cautious about drawing inferences about the impact of the caps on market entry from planning rejections. It is possible that caps may discourage new entrants into the Irish market. It is not known whether potential international new entrants have declined to enter the Irish market because of the existence of the cap - the Costco planning refusal in 1997 predated the introduction of the cap⁸⁴. The relatively small market size and dispersed settlement patterns may also affect Ireland's attractiveness to new entrants. Of the 10 most globalised retailers in the world, only three have operations in Ireland (Tesco, Aldi and Lidl).

83 UK Competition Commission, Supermarkets: A report on the supply of groceries from multiple stores in the United Kingdom, 2000.

84 The grounds for refusal included the scale of the proposed development as well as location and traffic related factors.

At a store level, larger stores can create more space to display competing products, including own brand products⁸⁵. The evidence suggests that larger stores do display more products but that this relationship is not linear. As grocery store sizes increase, retailers will stock a wider range of grocery goods but they will also seek to branch out into other product lines (e.g. clothes, books, electrical goods).

Research from the UK Competition Commission found that generally stores with more floorspace will carry more non-grocery (e.g. clothing and electrical equipment) but that the relationship between store size and the range of products sold varied by retailer. They found that the number of lines of both grocery and other products increased steadily with store size for Safeway, Sainsbury and Tesco in the UK. In ASDA, the number of grocery lines remains stable or increases relatively slowly with store size, while Morrison claimed that all its stores stocked the same number of lines⁸⁶.

Retail productivity

There is no recent, reliable data available on productivity trends in the retail sector in Ireland. Therefore, we rely on international studies to understand how competition affects productivity performance in the retail sector. The international literature indicates that a wide range of factors influence retail productivity including the strength of competition, the threat of new entrants, planning regulations, the use of ICT and human capital.

Changes in productivity may be due either to changes in the productivity of the incumbent firms or to a composition effect, with low productivity firms exiting the market and being replaced by new, higher-productivity competitors. High entry rates may impact positively on productivity on the grounds of intensified competition, driving out poorly performing shops, and of the greater technological sophistication of new entrants.

Planning regulations can negatively affect retail productivity in two ways:

- If planning regulations (including caps on store size) result in retail stores operating below the minimum efficient scale, leading to lower productivity levels; and
- If planning regulations hinder the opening of new stores or, most frequently, the closure of old ones, thereby impeding sectoral productivity gains from the substitution effect of old by newer, more productive stores.

The main findings from country research on retail productivity are:

- Empirical studies (Foster et al. 2002) show that almost all retail productivity growth in the US in the 1990s can be accounted for by the composition effect (i.e. it is driven by new entrants rather than by existing players);

⁸⁵ There is a strong positive relation between store size and number of product lines. For example, a store of 1,000 square metres would typically carry between 12,000 and 15,000 lines, while a store of 3,000 square metres could carry up to 30,000 lines.

⁸⁶ UK Competition Commission, The supply of groceries in the UK market investigation, 2008.

- Empirical research by Griffith and Harmgart (2005) on UK data suggests that planning regulations have acted as an entry barrier, although the authors also considered that the economic effects of this may have been overestimated;
- McKinsey research (2010) argues that weak productivity performances in the retail sector are driven by a lack of scale. In the case of Denmark, McKinsey concluded that a lack of scale in the retail sector results in higher administration and distribution costs and less use of productivity enhancing IT⁸⁷. While McKinsey research suggests that there are increasing economies to scale, they do accept that costs are primarily driven by input prices, typically making up 80-90 per cent of grocery retailers costs. McKinsey argues strongly that competition can play a key role in driving productivity. With respect to new entrants, they note that the hypermarket and discount store chains segments offer the greatest potential for new competition as the supermarket segment is mature with stores located within cities where it is difficult to find space for new stores.

4.3 Other factors that impact competition/prices

While the primary purpose of this study has been to assess the impact of retail caps on prices and competition, it is clear that the broader retail planning guidelines also impact on prices and competition. Studies in other jurisdictions (e.g. Australia) have found that zoning and planning regimes can act as an artificial barrier to new entry (e.g. centres policy which seeks to ensure the vibrancy of town centres), thereby restricting competition⁸⁸.

Research undertaken by Bradley et al (2004) on behalf of the Consumer Strategy Group concluded that other factors (e.g. floorspace projections, the sequential approach to development) had a greater impact on competition and consumer choice than the retail cap. The availability of suitable sites is a key factor in determining entry to the retail sector. Unlike other enterprise activity, a store's location is critical to attract and retain customers.

Incumbent retailers can also use the planning processes to lodge objections as part of the third party submission facility to oppose or delay new retail development in circumstances where there may be no legitimate planning related concerns. UK Competition Commission research indicated that the speed of the planning system has a significant impact on retail investment and costs⁸⁹. It should be noted that the current retail planning guidelines expressly state that it is not the purpose of the planning system to inhibit competition, preserve existing commercial interests or prevent innovation⁹⁰. Furthermore, An Bord Pleanála has powers to dismiss planning appeals which are vexatious or without substance.

87 McKinsey, Creating economic growth in Denmark through competition, November 2010.

88 Australian Competition and Consumer Commission (ACCC), Report of the ACCC inquiry into the competitiveness of retail prices for standard groceries, July 2008.

89 The average time to secure planning permission in the UK is likely to be higher than in Ireland, due to procedural differences between the two planning systems

90 The Department of the Environment's 2007 Development Management Guidelines also advise that planning authorities should eliminate all avoidable delays in processing planning applications.

In addition to the formal floorspace caps, a range of other factors are likely to inhibit store size and the potential for greater competition and lower prices. These include:

- The quantitative method for assessing future retail capacity needs (as part of retail planning strategies) depends on data which is not readily available in Ireland, and the estimates are highly dependent on various assumptions made. Moreover, if the results are interpreted too rigidly, they can act as a barrier to new entrants to the retail sector. Forfás supports the Competition Authority recommendation that the retail planning guidelines be amended to ensure that planning authorities and An Bord Pleanála place minimal weight on projections of floorspace requirements when assessing planning applications and clarify that individual applications should instead be assessed on their merits;
- There may have been over-emphasis placed by some planning authorities on the impact of proposed new or expanded shopping centres on existing outlets, which may not offer consumers competitive prices and / or a wide range of products. Forfás supports the Competition Authority recommendation that the retail planning guidelines should be amended so as to effectively reduce the level of importance that planning authorities apparently place on trade diversion when considering the retail impact assessment process. Where this provision is used, the planning authority should be required to clearly state the rationale for doing so;
- One of the objectives of the planning framework is that out-of-centre development should be contemplated only where there are no sites, or potential sites, within a town centre or on its edge, or where satisfactory transport accessibility (including park-and-ride) cannot be ensured within a reasonable period of time⁹¹. Given that the availability of suitable location plays a significant role in determining entry, the application of this approach needs to be consistent across all planning authorities to ensure that it is not acting as a barrier to entry across the retail sector
- As evidenced by this study and others, there is very limited data available on the Irish retail sector. Timely national and local data on key indicators such as retail floorspace, number of stores, turnover rates, vacancy, newly constructed floorspace by retailer type is essential to inform retail strategies and ensure effective application of the guidelines; and
- To ensure consistency in the application of the retail planning guidelines across planning authorities and to minimise uncertainty for investors/retailers, definitions of the different types of retail stores and goods should be reviewed and any potential overlap and/or ambiguity removed.

We understand that these specific issues are being considered in the Department of the Environment's ongoing wider review of the retail planning guidelines.

4.4 Impact of the retail cap on suppliers

Ireland is a major food and drink producing nation, which serves both the domestic and overseas market. The power of retailers is a major issue for food companies and there is a concern that larger sized stores will have implications for suppliers, particularly smaller

⁹¹ This is referred to as the sequential approach.

producers. However, the data highlights that store size is not the main determinant of retailers' buying power (see Section 4.1). Most of the retailers' purchasing power vis-a-vis suppliers is driven by enterprise size as scale allows retailers greater bargaining power, primarily through central procurement and distribution. Limiting store sizes does not automatically limit enterprise size and is unlikely to limit the perceived power of retailers over suppliers. Other more effective policy tools exist under competition law to limit potential abuses of market power.

As indicated earlier, at store level, larger stores can create more space to display competing products, including own brand goods. The evidence suggests that as grocery store sizes increase, retailers will stock a wider range of grocery goods but they will also seek to branch out into other product lines (e.g. clothes, books, electrical goods), including own brand products. The converse is that smaller stores stock fewer lines, which could limit the opportunities for suppliers' products to be stocked by retailers.

If new international retailers enter the Irish market, a challenge will exist to encourage them to stock Irish products but it also has the potential to provide an opportunity for Irish suppliers to sub-supply into any new retailer's overseas branches.

5. Conclusions and recommendations

The main objective of this study is to assess the economic impact of eliminating the cap on the size of retail premises with a view to enhancing competition and lowering prices for consumers. In assessing the economic impact of eliminating the retail caps on prices and competition, we need to acknowledge the wider context - the cap is but one element of the planning framework. Other elements of the planning framework also affect competition and prices. In addition, the objectives of the cap and the planning framework are not just economic - there are also important societal (e.g. ensuring the vibrancy of town centres) and sustainability (e.g. minimising congestion and journey times, better use of existing development land rather than greenfield sites) objectives.

The relationship between the retail cap, prices and competition is complex. As indicated earlier, theoretically, the elimination of the retail cap could through economies of scale create greater cost savings for retailers which could, if strong competition exists, be passed on to customers. However, there is a risk that retailers could, particularly in areas with low populations/ low population densities, extend their scale advantages to create local monopolies. This is a particular issue in the grocery market where most consumers are generally unwilling to frequently travel long distances to do their weekly shop.

Forfás believes that a sweeping removal of the caps would produce mixed results in terms of enhancing competition and reducing consumer prices:

- In large population centres which can support a range of large stores, facilitating greater economies of scale at the store level could result in new entry, more vigorous competition and price savings for consumers;
- In smaller population centres, it could lead to a greater concentration of retailers' power and potentially higher prices for consumers; and
- The cap is not the only element of the planning framework that has an impact on competition and consumer prices.

Forfás believes that the challenge is to enable retailers to leverage the benefits of scaling while avoiding the risks of embedding local monopolies. This requires changes to the retail caps and some aspects of the broader retail planning guidelines. Our recommendations are set out below.

Large convenience store floorspace cap

The cap on large grocery stores is set at 3,500 square metres within the Greater Dublin Area and at 3,000 square metres in the remainder of the State. There is no cap on the floorspace allocated to non-grocery products (e.g. books, clothes, home-ware) within a hypermarket (store over 5,000 square metres).

As highlighted in Section 4, restrictions on store size may lead to higher costs. There are economies of scale but they decrease as store size increases. Research indicates that

economies of scale recede close to the current Irish limit for convenience stores (i.e. above 3,000 square metres). As the presence of economies of scale will vary by retailer, potential exists to increase the convenience limit to ensure that potential economies of scale are not constrained. It is outside the scope of this exercise to suggest what the level of the revised cap should be to take advantage of potential economies of scale. In 2007 Denmark, which has a similar population profile to Ireland, increased the cap on retail store size from 3,000 square metres to 3,500 square metres⁹². It also made changes to other elements of the planning framework.

Our analysis also found that removing the convenience cap is likely to produce mixed results for competition. In Dublin and the other main cities, customers have a choice of at least six key grocery retailers and access to a wide range of outlets (see table 3) indicating that the market can accommodate a diverse range of stores sizes. In other towns, the choice of retailers tends to be more limited and the number of outlets is substantially lower. There is a strong risk that increases in store size in small population centres could over time, by reducing the number of stores, limit consumer choice further and lead to higher prices. While, national pricing policies by the large retailers may limit the risk of higher prices in local markets, consumer choice would be constrained.

Currently the higher cap applies to the Greater Dublin Area which covers counties Kildare, Meath and Wicklow as well as Dublin city and county. This means that the higher cap also applies in smaller regional towns (e.g. Ardee, Athy and Trim) which may not have the population size and density to justify larger stores. This could restrict competition in those centres and result in local monopolies. Any changes to the cap in Dublin should apply to the Dublin Region only⁹³.

Recommendations:

- Forfás recommends expanding the regional differentiation in the convenience cap. There are good reasons to differentiate the floorspace cap between Dublin and the other main cities and the remainder of the State:
 - The lower cap (currently 3,000 square metres) should be marginally increased in those areas outside of the five main cities to ensure potential economies of scale can be realised without limiting competition. Competition in the grocery sector is local in nature. Our research indicates that competition is already relatively limited in smaller centres;
 - A larger increase in the level of the cap(s) in the main cities (Dublin - currently 3,500 square metres - and Cork, Galway, Limerick and Waterford - currently 3,000 square metres) is justified, given their greater size and density. Consideration should also be given to mirroring the approach adopted under the retail warehouse cap where no cap applies in some urban centres under specific conditions. This could through greater economies of scale and more vigorous competition lead to price savings for consumers; and

⁹² Denmark removed the cap on retail stores within city centre districts of large urban centres with a population greater than 40,000.

⁹³ The Dublin Region is made up of the four local authority areas in Dublin city and county.

- The current retail planning guidelines describe discount food stores as being of a size normally between 1,000 square metres and 1,500 square metres which has sometimes been interpreted as a cap. To avoid any future uncertainty, the revised retail planning guidelines should explicitly state that the same caps apply to discount stores as apply to large convenience stores.

Petrol filling station cap

A forecourt operator can build a shop of up to 100 square metres of retail space when associated with a petrol station. However, where the proposed shop attached to the petrol station is above the cap, the forecourt operator can apply for planning permission for a bigger store in the same way as any other retailer applying for planning permission to build a grocery store only in that location. A cap of 200 square metres has been proposed in Northern Ireland.

Recommendation:

Given that forecourt operators can make a planning application for shops above 100 square metres on the same basis as any other retailer, the merits of retaining a separate cap for petrol filling stations should be considered further within the review of the wider planning framework currently underway.

Retail warehouse cap

Retail warehouses are defined in the guidelines as large single-level stores specialising in the sale of bulky household goods such as carpets, furniture, electrical goods, and bulky DIY items, which cater mainly for car-borne customers in out-of-centre locations⁹⁴.

The cap on the size of retail warehouses is currently set at 6,000 square metres - excluding certain areas of the NSS gateways⁹⁵. Following the revision of the guidelines in 2005, this cap does not apply in those areas of the NSS gateways which are covered by the Integrated Area Plans under the Urban Renewal Act, 1998.

Recommendations:

- Forfás recommends maintaining the current regime as it allows for significantly larger stores in the NSS gateways; and
- As Integrated Area Plans no longer exist, the way in which the exemptions to the cap are operationalised in the NSS gateways will need to change. Forfás recommends that the revised planning guidelines develop an alternative classification with certain criteria attached to replace the Integrated Area Plans. Criteria should be informed by market needs and spatial planning considerations such as the availability of space of

⁹⁴ There is some overlap with the definition of comparison goods in the current guidelines (e.g. furniture appears on both).

⁹⁵ The NSS gateways are Dublin, Cork, Galway, Limerick-Shannon, Waterford, Dundalk, Sligo, Letterkenny-Derry and Athlone-Tullamore-Mullingar.

the required size that is zoned and adequately serviced and the implications for traffic management/congestion.

Proposed amendments to the wider planning guidelines

In addition to the formal floorspace caps, a range of other factors can inhibit store size and the potential for greater competition and lower prices. It is likely that any changes to or the elimination of the cap will have limited impact in the absence of other measures. Building on the points raised in section 4.3, these include reviewing the planning guidelines to:

- ensure that planning authorities and An Bord Pleanála place minimal weight on projections of floorspace requirements when assessing planning applications;
- effectively reduce the level of importance that planning authorities place on trade diversion when considering the retail impact assessment process. Where this provision is used, the planning authority should be required to clearly state the rationale for doing so;
- ensure a consistent application of the sequential approach to development across all planning authorities to ensure that it is not acting as a barrier to entry in the retail sector⁹⁶. The availability of suitable locations plays a significant role in determining entry;
- establish a central database to provide timely national and local data on key indicators to inform retail strategies and to ensure effective application of the guidelines; and
- review definitions of the different types of retail stores and goods and any potential overlap and/or ambiguity to ensure consistency in the application of the retail planning guidelines across planning authorities and to minimise uncertainty for investors/retailers.

We understand that these amendments to the wider planning framework are being considered as part of the Department of the Environment's ongoing review of the guidelines.

⁹⁶ Under the sequential approach to development, town centres are the preferred location for new retail developments that attract many trips, followed by edge of town sites and finally out of town sites. See Section 2.1 for more details

APPENDIX: Terms of Reference

These are the Terms of Reference for the study as agreed with the Departments of Enterprise and Environment in February 2011.

1. BACKGROUND / CONTEXT

The EU/IMF Programme of Financial Support for Ireland contains the following compliance requirement:

To encourage growth in the retail sector

The Government will conduct a study on the economic impact of eliminating the cap on the size of retail premises with a view to enhancing competition and lowering prices for consumers and discuss implementation of its policy implications with the Commission services.

2. OBJECTIVES OF THIS STUDY

The purpose of this study is to deliver on the EU/IMF compliance requirement by undertaking an evidence-based study which:

- sets out the economic impact of eliminating the cap on the size of retail premises;
- identifies whether eliminating the cap on the size of retail premises would enhance competition; and
- identifies whether eliminating the cap on the size of retail premises would result in lower prices for consumers.

The study can also consider the economic, competition and price impacts of relaxing the floorspace caps.

The study will help inform the shaping of relevant policies in the review of the Retail Planning Guidelines which is currently underway and which is also considering other policy objectives including location and accessibility, the role of town centres, etc.

3. OUTCOME AND TIMEFRAME

A focussed report should be prepared within 8 weeks, and be structured as follows:

- Brief overview of developments in the retail sector;
- Review of developments in consumer prices;
- Identification of any role played by the retail floorspace cap as a barrier to competition in the retail sector; and
- Conclusions and recommendations.

It is envisaged that the proposed study would, as one its key inputs, review the evidence base and policy recommendations in the report prepared in 2000 by Goodbody Economic Consultants on retail caps which was jointly commissioned by the Departments of Enterprise and Environment to inform the development of the original 2001 Retail Planning Guidelines. Other key economic analyses of the retail sector (especially the three Competition Authority "Grocery Monitor" reports) since the 2001 guidelines were published should also be reviewed.

Following consideration by the Steering Group, the draft report will be communicated informally to the EU/IMF Team for their views. The finalised report will then form the basis of formal engagement with the Team on the policy implications of the economic analysis and recommendations, during the second quarter of 2011.

4. OVERSIGHT

The Steering Group overseeing the delivery of the study will comprise:

- Department of the Environment, Heritage and Local Government;
- Department of Enterprise, Trade and Innovation; and
- Forfás (who will undertake the study, with appropriate input as required from economic experts).

The publications of Forfás and the advisory groups to which it provides research support are available at www.forfas.ie

To sign up for our email alerts contact us at info@forfas.ie or through the website.

April 2011

Forfás

Wilton Park House
Wilton Place
Dublin 2

Tel: +353 1 607 3000

Fax: +353 1 607 3030

www.forfas.ie