

The Administration's Response to the Consumer Council's Report on Competition in the Foodstuffs and Household Necessities Retailing Sector

Introduction

On 11 August 2003, the Consumer Council (“the Council”) released a Report on Competition in the Foodstuffs and Household Necessities Retailing Sector (“the Report”). The Report –

- (a) pointed out the gradual decline of wet markets vis-à-vis supermarkets and proposed that the Government revitalize the wet markets;
- (b) noted complaints about anti-competitive conducts by supermarkets and suggested a self-regulatory mechanism to deal with competition complaints in the foodstuffs and household necessities retailing sector; and
- (c) supported, as a long-term solution, the introduction of a competition law in Hong Kong.

2. The findings and recommendations of the Report [available at www.consumer.org.hk/mainmenu/english/eindex.htm] relate to the following three main areas –

- (a) competition in the foodstuffs and household necessities retailing sector, handling of complaints of anticompetitive practices and assistance to small retailers in this sector;
- (b) wet markets managed by the Food and Environmental Hygiene Department (FEHD); and
- (c) wet markets and retailing facilities managed by the Housing Authority (HA).

The Administration's response

3. Relevant bureaux and departments have examined the findings and recommendations of the Report. Their general response in respect of the three main areas, vide paragraph 2 is at paragraphs 4 to 16 below. Their responses to specific findings and recommendations are set out in **Annex I**.

Part I Competition in the foodstuffs and household necessities retailing sector, handling of complaints of anticompetitive practices and assistance to small retailers in this sector

Overall competition policy

4. The Government's competition policy is to enhance economic efficiency and free trade, thereby also benefiting consumers. Competition is best nurtured and sustained by allowing the free play of market forces and keeping intervention to the minimum. The Government should not interfere with market forces solely on the basis of the number of operators, scale of operations, share of the market per se, or normal commercial constraints faced by new entrants. The Government will take action only when market imperfections or distortions limit market accessibility or market contestability and impair economic efficiency or free trade, to the detriment of the overall interest of Hong Kong.

5. In line with this policy, the Government maintains a liberal and open regulatory framework in respect of the retail sector. Any person may open a retail outlet in Hong Kong provided that he has obtained a Business/Branch Registration Certificate and the relevant licences for the commodities that he intends to sell. The Government imposes no other administrative barriers.

Competition in the foodstuffs and household necessities retailing sector

6. The Council has adopted the concept of "one-stop shopping" for its competition analysis and identified two separate retail markets –

- (a) a market for fresh produce, with supermarkets and wet markets closely competing with each other; and
- (b) a market for packaged foodstuffs and household necessities, where supermarkets compete with other retail outlets, such as convenience stores, grocery stores, and specialty stores.

7. As far as the fresh produce market is concerned, the Report has stated that according to AC Nielsen, in 1999, the market share of wet markets vis-à-vis supermarkets in the fresh produce sector was 76%. In addition, according to the Council's surveys in 2001, 70% of the interviewees preferred buying fresh food in wet markets. This shows that wet markets still command a strong demand from consumers and remain the most important source of retail outlets providing foodstuff.

8. As for packaged foodstuffs and household necessities, the Council considered that there is a prima facie concern with the market share held by the two major supermarket chains and that the level of market concentration of the two chains would have reached the threshold level of the mergers or acquisitions guidelines in countries where there are competition authorities. However, in arriving at this conclusion, the Council has only had regard to the turnover shares and number of outlets of **supermarket chain stores** (including those in department stores) and **convenience stores**, and vertical integration into the convenience store sector. The analysis has not taken into account household product stores chains (which are getting increasingly popular), drug stores (which are popular places for the purchase of toiletries, shampoos and other cleansing products), hardware stores, groceries shops and many other small retail outlets. This raises doubts on the validity of the Council's claim that there is a prima facie concern with the market share held by the two supermarket chains in the packaged foodstuffs and household necessities sector. The Commerce, Industry and Technology Bureau (CITB) suggests that the Council should include household product stores chains, drug stores, hardware stores, groceries shops and other small retail outlets in its analysis of market share for the packaged foodstuffs and household necessities market in the future.

9. CITB notes that competition in the retail market is fierce and that there is no need for Government intervention in the operation of the retail market. There are a large number of players in the market, including supermarket chains, supermarkets in department stores, convenience shops, food stores and household product stores. Even if only the number of supermarkets, chain stores and convenience stores are taken into account, the number of outlets of the two large supermarket chains account for 17 % and 15% of the market share ^(Note 1) respectively. In addition, competition exists in the form of price and non-price competition. To cater for the preference of consumers, apart from

^(Note 1) Data extracted from page 46 of the Consumer Council's report on "Wet Markets vs. Supermarkets: Competition in the Retailing Sector".

reducing the selling price of products, many retail market operators try to gain a competitive edge by providing longer operating hours, cleaner environment and the convenience of one-stop shopping. Others strive to maintain their niche by providing personal and flexible services to cater for the specific needs of their customers. As a result, consumers benefit from having a wider choice of goods and service which are of better quality and offered at more competitive prices.

Part II: Wet markets managed by FEHD

10. The Health, Welfare and Food Bureau (HWFB) notes that the development of FEHD-run wet markets is inextricably linked to the history of relocating hawkers. The wet markets were built to free streets and public areas from hawking activities, thus eliminating a serious source of problems related to environmental hygiene, food safety and pedestrian obstruction. The FEHD's involvement in the provision of wet market facilities was therefore not primarily driven by economic considerations.

11. The HWFB observes that the Government's involvement in wet market operation is largely due to historical circumstances. There is indeed no economic reason why the private sector should not be allowed to build or operate wet markets/retail facilities. On the contrary, the private sector can more freely and efficiently respond to over- or under-supply of wet market/retail facilities in various localities around the territory.

12. Food safety and environmental hygiene in the wet markets, therefore, remain the Government's foremost concerns. The Government's policy is to ensure that the foodstuffs offered for sale in these markets are in compliance with food safety standards. The Government is also committed to reducing public health risks arising from unhygienic market environment or facilities. The various initiatives announced by Team Clean (i.e. monthly cleansing day & streamlining procedures for termination of tenancy) in early August are a case in point. Being the regulator for wet markets and fresh provision shops, the FEHD has a duty to ensure that the relevant regulations are enforced in an even-handed manner irrespective of the scale and ownership of retail outlets.

13. The HWFB has committed substantial resources to improve food safety and environmental hygiene of FEHD markets and to ensure that publicly funded facilities are put to the best use. For example, it has

earmarked over \$600 million in the next few years for carrying out improvement works to the FEHD markets. The scope of works includes upgrading of ventilation and/or drainage systems, replacement of floor and wall finishes, lighting improvements, upgrading of entrances, signages, escalators, etc. Such improvement works should also help enhance the competitiveness of the markets concerned and their appeal to members of the public.

14. Public markets completed in recent years have already been equipped with air-conditioning facilities. There are currently 106 FEHD markets/cooked food centres, over 20 of which are air-conditioned. New public markets coming on stream in the next three years, namely, Tai Po Market, Wanchai Market and Tai Kok Tsui Market will also be fully air-conditioned. In line with its previous undertakings to the Legislative Council (LegCo) and the stallholders concerned, the HWFB has concrete plans to retro-fit air-conditioning systems to three more markets where 85% ^(Note 2) or more of the tenants support such works and agree to pay the recurrent costs involved.

Part III Wet markets and retailing facilities managed by the Housing Authority (HA)

15. As far as wet markets and retailing facilities managed by the HA are concerned, the report recognizes that a level playing field for fair competition is one of the basic considerations of the HA's allocation policy for retail space, and that the HA has consistently made effort to improve the shopping environment of small retail shops and wet markets, through various initiatives including enhancement of the management model, upgrading the infrastructure of the retail facilities, and retrofitting air-conditioning for wet markets in older estates, etc.

16. The Council also sees the HA's divestment plan in respect of its retail and carparking facilities as a good opportunity to strengthen competition in the retail sector. The HA is actively pursuing the divestment plan. According to the preliminary divestment proposal, initially the management and ultimately the ownership of those HA's retail facilities suitable for divestment will be transferred to a private company and listed in Hong Kong's Stock Exchange sometime in 2004/05. The HA expects that the entrepreneurial skills of the private sector will have a positive impact on the operation of these retail

^(Note 2) The 85% threshold is required to ensure smooth implementation of the retro-fitting projects. This is also consistent with the 'user-pays' and 'cost-recovery' principles.

facilities.

Follow-up actions

17. The Government notes that :
- (a) There is ample competition in the foodstuffs and household necessities retailing sector. **The issue at stake is not one of competition but competitiveness, customer choice and preference.** The Government does not see the need for intervention or a competition law for this sector. The Government will nevertheless monitor the situation closely;
 - (b) In line with its approach to encouraging voluntary discipline, the Government welcomes the Council's suggestion of encouraging a self-regulating mechanism within the trade and is ready to render assistance as and when necessary. We will continue to monitor the situation closely;
 - (c) In keeping with Hong Kong's free market philosophy, the Government will continue to provide small and medium enterprises (SMEs), including those in the foodstuffs and household necessities retailing sector, with necessary support to enhance their competitiveness and efficiency. Regarding the proposal for the Government to develop specific programmes for SMEs in the foodstuffs and household necessities retailing sector, the Government is of the view that it will be more cost effective for the trade to come up with worthwhile initiatives and seek funding support from the SME Development Fund. This will ensure that the programmes being developed will meet the needs of SMEs in the sector and will therefore be well received by them;
 - (d) As regards the three options in revitalizing public wet market facilities outlined in paragraphs 35-38 of the Report, namely, (i) unencumbered sale of government-owned assets; (ii) establishment of wet market cooperatives; and (iii) creation of wet market development corporation, the HA is actively pursuing the divestment plan in respect of its retail and

carparking facilities. As regards FEHD-run markets, the Government has no plan to pursue options (i) and (ii) due to intractable practical difficulties identified, but is open-minded about option (iii). The policy orientation and resources commitments will continue to be driven by promotion of environmental hygiene and food safety predominantly;

- (e) While the Government is committed to improving public wet market facilities and encouraging private sector participation, it will pursue these objectives in line with the time-honoured principles of free enterprise and free trade. It will not, therefore, preclude or restrict any market players from tenders or prohibit their involvement in the management of the public markets as recommended in the Report;
- (f) The Government reckons improving the shopping environment is an important attribute in the foodstuffs and household necessities retailing sector. Other considerations such as customer service, sourcing of quality products, promotion and pricing strategy as pointed out in the Report are also important. The HA and FEHD will work in partnership with their wet market operators and smaller retailers to enhance the attractiveness of public wet markets in this direction.

Competition Policy Advisory Group Secretariat
November 2003

The Administration's response to specific findings and recommendations in the Council's report

Handling of complaints of anticompetitive practices through a self-regulatory mechanism or a competition law (paragraphs 41-51)

CITB recognizes that scale of operation or share of the market per se does not determine whether a business is anti-competitive or not. Besides, there is so far no evidence showing that supermarket chains have engaged in anti-competitive acts or have abused their market power to limit accessibility and contestability. Some of the complaints received by the Council may relate to commercial disputes on possible breach of contracts, while others may well be business acts prompted by fierce competition. In general, there is no evidence to prove that these practices are restrictive and detrimental to economic efficiency or free trade.

Self-regulation

2. CITB agrees with the Council's recommendation that there is a role for self-regulation to enhance competition and avoid anti-competitive behaviour within the trade. In this connection, the Competition Policy Advisory Group (COMPAG) has, in consultation with chambers of commerce, trade and industry organisations, as well as the Council, developed a set of guidelines to provide pointers with objective benchmarks and principles to assess Hong Kong's overall competitive environment; define and tackle anti-competitive practices; and ensure consistent application of Hong Kong's competition policy across sectors. The set of guidelines promulgated by COMPAG would be the appropriate basis for developing a self-regulatory mechanism for the retail sector.

3. In addition, the Government encourages retailers, including supermarket operators, to embrace competition through voluntary action. As good corporate citizens, supermarkets may wish to consider stepping up communication with all stakeholders so as to ensure a level playing field for all. The Government will continue to monitor the situation in conjunction with the Council and is prepared to render assistance as and when necessary.

4. With enhanced self-regulation, the Government does not see a need for a competition law or a competition authority in the retail sector for

the time being. In fact, there is no conclusion among the international communities that a general and all embracing competition law is the panacea to anti-competitive behaviour or to ensure fair competition.

Specific assistance could be given to small traders in foodstuffs and household necessities retailing sector by the Small and Medium Enterprise Office or relevant institutes (paragraphs 24 and 25)

5. Many of the wet market and retail service operators are small and medium enterprises (SMEs). CITB's policy is to provide SMEs, including those in the foodstuff and household necessities retailing sector, with necessary support to raise their competitiveness and efficiency while keeping in line with our free market economic philosophy of "maximum support, minimum intervention".

6. For example, the Trade and Industry Department (TID) has set up funding schemes to help SMEs secure loans from lending institutions to address their financing needs and enhance human resource development. Also, it administers the SME Development Fund (SDF) which provides funding support to trade and industrial associations, industry support organisations, professional bodies and research institutes for implementing projects which are conducive to enhancing the competitiveness of SMEs in general or in specific sectors. The department also provides SMEs with a comprehensive range of services through the Support and Consultation Centre for SMEs (SUCCESS), including information dissemination, seminars, mentorship programme, and advisory services.

7. TID will continue to work closely with SMEs and provide them with assistance where appropriate. On the other hand, in order to stay competitive, market operators may also wish to review their business strategy in the light of the changing business environment and consumer taste, upgrade their software and hardware, and improve on efficiency. Trade and industrial associations and industry support organisations which have come up with projects for helping SME market operators enhance themselves may consider seeking funding support from the SDF to implement the projects.

Wet market operators should be alerted to the need to make a paradigm shift in the way they operate (paragraph 26)

8. It is in fact HWFB's policy and strategy that sitting tenants have a pivotal role to play in enhancing the competitiveness of goods sold and services rendered in keeping with changing customer needs. With a view to

sharpening their awareness of the importance of food safety, environmental hygiene and a client-oriented approach in market settings, FEHD has provided customer service training for stall tenants of 10 public markets earlier this year. Similar training sessions will be run for tenants of another 10 markets later this year. FEHD will continue to alert sitting tenants to their responsibility in maintaining the viability of public markets concerned and the importance of adapting to customer needs in everyday business operations.

Government should employ the creativity and entrepreneurial skills found in the private sector to manage public markets (paragraph 32)

9. HWFB and FEHD have been pursuing initiatives in this direction. For example, FEHD has implemented a Market Manager Scheme in four public markets, namely, Fa Yuen Street Market, Hung Hom Market, North Kwai Chung Market and Smithfield Market, whereby well-qualified and experienced personnel from the private sector are engaged to enhance management of the markets. The Department is also looking into the feasibility of out-sourcing the management of several markets within a geographical cluster to private property management companies in a bid to improve cost-effectiveness in running the market premises.

It is incumbent on the Government to ensure that the decline of the wet market sector, if accepted to be inevitable, is managed in an orderly fashion (paragraph 29)

10. HWFB observes that of the 80-odd markets managed by FEHD, the majority are viable ones capable of survival in face of keen competition from supermarkets and other private retail facilities. There are admittedly a small number of FEHD-run markets with relatively high vacancy rates. FEHD is examining the viability of these markets with a view to identifying those that do not justify further resource commitments by the Government. In the interest of judicious use of public resources, the Government may need to close down a few markets with serious insurmountable viability problems.

Three options in revitalising public wet market facilities (paragraphs 35-38)

11. The Council suggests that the Government should consider three options in revitalising public wet market facilities, namely, (i) unencumbered sale of government-owned assets; (ii) establishment of wet market cooperatives and (iii) creation of wet market development corporation. HWFB has the following observations on these options:

Option (i) – “unencumbered sale of government owned assets”

HWFB is in principle agreeable to, and would facilitate, private sector participation. However, for historical reasons, the rentals currently paid by most market tenants are well below the ‘Open Market Rentals (OMR)’ assessed by the Rating and Valuation Department periodically. Over the years, the Administration has experienced substantial resistance from the LegCo, District Councils and stallholders concerned in seeking to bring the rentals back to the OMR level. HWFB’s assessment is that sitting tenants will strongly object to the takeover by the private sector for fear that the stall rentals will sharply escalate in consequence. Moreover, for a deal to be attractive to potential buyers, they would need much flexibility in the eventual selection of tenants, determination of stall rentals, trade mix and venue/stall layout, etc. This is tantamount to having to buy out or relocate all existing tenants before the market is sold, and this will inevitably require lengthy consultations and negotiations with stakeholders.

Option (ii) – “establish wet market co-operatives”

HWFB’s assessment is that most incumbent stallholders are unlikely to be willing to incur additional expenses to buy their own stalls unless the prices are set at unreasonably low levels. Moreover, given the diverse background of individual stallholders and the wide-ranging rentals they are paying, it would be a formidable task for them to reach a common goal to form a cooperative without additional government subsidy. Even if the incumbent traders could agree to form a coordinating body, this option could not resolve the fundamental problem of over-provision of stalls in many FEHD markets.

Option (iii) – “creation of wet market development corporation”

HWFB is open-minded about this option. HWFB considers that for the initiative to be realizable, the new statutory body must be provided with the requisite financial, institutional and professional capacities to grapple with the complicated implementation issues and vested interests involved. HWFB is

prepared to work with whatever agency/task force entrusted to take forward this initiative.

Balancing the allocation of market facilities for different distribution channels is crucial to the development of competition (Chapter 3, paragraphs 3.28 to 3.32 [extract at Annex II])

12. On the HA's policy which permits service-style provision of fresh food in superstores, the report expresses concern that the number of wet market stalls will likely drop with an expected rise in the superstores' market share in the fresh food sector, and remarks that a policy objective to balance the allocation of market facilities for different distribution channels is crucial to the development of competition.

13. The HA considers that the scale of retail provision and trade mix of HA's retail facilities have to be determined with regard to a number of factors including the catchment areas, availability of compatible facilities in the neighbourhood, and customer patronage, and that these factors have also to be balanced with competition considerations. Admittedly the traditional wet markets and small retail shops are facing a challenge from chain superstores. However, HA has to duly take into account consumers' preference as far as the allocation of HA's retail space is concerned if the operation is to remain commercially viable. It is not the policy of the HA to subsidize commercial operation in public housing estates.

14. Nevertheless, HA is committed to improving the shopping environment of the wet markets and retail shops. On a user-pays principle, the wet markets of a number of older estates have been renovated with new air-conditioning installation, and some 30 wet markets completed since 1997 are already equipped with central air-conditioning and improved design. Apart from upgrading the infrastructure, the HA has frequently launched promotion programmes that are particularly welcomed by small retailers. Unlike their chain superstore counterparts, small retailers would not otherwise easily stage sales campaign on their own.

15. Notwithstanding the upgrading of infrastructure and promotion programmes launched by the HA, the HA considers that customer service, sourcing of quality products, promotion and pricing strategy etc. of individual shops as remarked in the report are also important. They have to cater for the customers' needs and adapt to the changing business environment. After all, it is the market force that prevails.

Allowing existing supermarket chains to retain their retail outlets on renewal tenancy through negotiation and by paying current market value has the effect of perpetuating the incumbency of existing retail outlet by the same supermarket chain (Chapter 6, paragraph 6.35 [extract at Annex II])

16. The report expressed concern about the HA's practice on tenancy renewal through negotiation of market rent, which could hinder new entrants from bidding desirable retail space. The HA's policy on tenancy renewal involves consideration of disruption of services for the domestic tenants and a stable prospect for business operation, apart from providing opportunities for competition from new entrants. A stable prospect for business operation invariably attracts investment and interest from potential retail operators, and is very often relied upon in securing "anchor tenants" for newly completed commercial premises, especially those in relatively outlying areas. However, this discretionary arrangement is subject to the terms and conditions of the tenancy agreements, which, similar to the private sector, provide for the HA to conclude tenure upon expiry.

Retailers' ability to quickly respond to market changes being constrained by the rigid application of bureaucratic processes (Chapter 3, paragraph 3.48 [extract at Annex II])

17. The report remarks that some retail operators consider HA's management control rigid, hampering their ability to promptly respond to changing market circumstances.

18. The HA considers the present management control arrangements appropriate and they should not constitute unnecessary barriers to competition for the operators concerned. The management control at issue relates more or less to tenancy arrangement and enforcement, including compliance with the designated trade mix and prohibition of obstruction and encroachment on common areas. Over the years, the HA has actively responded to the changing needs of the retail business environment through various initiatives including the introduction of the Business Opportunity Centre, the single operator model, flexible letting, the trade-widening and "yellow-line" schemes, etc. While the HA sees the need to allow flexibility in managing the retail operation, it is committed to enforcing the tenancy provisions, especially if they concern public health and safety. Clearly tenants' cooperation is required if an orderly, clean and pleasant shopping environment is desired.

Ends