How are small specialist stores existing in a market so widely dominated by large chain firms like Tesco and Asda?

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Abstract:

In this essay I will argue that the oligopoly that dominates the food retailing industry is not the same market as that of the convenience store. The two industries have the same market of people, but also have different requirements of them. Most people have shopped in a specialist store, yet most have also shopped in a chain supermarket. I will argue that these large supermarkets are attempting to penetrate the perfectly competitive market that is the specialist and convenience store area, and they have successfully done this. However, their brand identities, along with the quirky nature of these small businesses, are ensuring they keep their "heads above water" and can indeed expand and grow.

"The market for food is changing. We are seeing the beginnings of a shift away from the superstores and towards convenience stores and online retailing. That is not to say that superstores are in trouble, but gone are the days when they swept all before them over." [1]

If a customer has £5 to spend, in Asda they can buy two chicken breasts and one packet of seasoning; in the deli store across the road from them, they cannot afford the free range chicken breasts but can afford the free range chicken thighs and one packet of seasoning. The consumer receives the same amount of utility when consuming chicken breasts which are not free range from a store further away, as consuming free range chicken thighs from a convenience store closer to them. This is the marginal rate of substitution at which this consumer is willing to substitute one type of good for another, while yielding the same amount of utility from this purchase. However, most people would not use these small convenience stores in the same way as they would giant superstores- this is merely (to most) an issue of convenience.

The oligopolistic market that is dominated by supermarket chains can cater for the needs of everyone, to an extent. For example, Tesco has a range of products, from Tesco Value to Tesco Finest and in between the Tesco Everyday range. However, in a recent survey it was found that 27% of Tesco customers prefer to buy some fresh products from specialist shops such as butchers and green grocers, with 3/4 of single parents using higher priced convenience stores in the past month[2]. It appears that the supermarket chains hold the majority of the market share in this way; however, it would be acceptable to argue that the small specialist stores and convenience stores have an entirely different market.

[1] Richard Perks Director of Retail Research Mintel Reports March 2011

[2] Food Retailing - UK- November 2011. [Online] Figure 187 "where people shop for food" [Available at] Mintel Oxygen Food Retailing report.

The convenience store/specialty stores have a completely different market to that of the supermarket chains - Monopolistic Competition dominates the market for convenience stores and such like. The firms accommodate the high end professionals, elderly and convenient shopper which, it can be argued, to an extent encompasses the majority of people at one stage in their lives. The AB Socio Economic Group appears to be the largest consumer when it comes to the sector of buying fresh ingredients from local suppliers and small businesses. It is fair to argue that shoppers are not homogenous; they have different needs and large superstores cannot always satisfy these needs. Yet how do these small businesses manage to survive during times where massive firms can buy products at such low prices, and dominate the large majority of food purchasing?

Looking into the economics of the individual businesses, we see that for a small convenience store both the long and short run is vital in their position in the market, with profit maximization allowing them to expand. To maximize profits they must sell a quantity of goods at the point where total cost is minimized. This profit maximizing output is the difference between TR and TC. Moreover, due to the nature of the short run and the time frame, firms cannot alter capital and so this profit maximization is determined through the output of the firm. In Monopolistic Competition, as described in Appendix 2, it is a market which allows the firm to set its own prices (within reason) and so it is important that they compete with other local firms in order to keep prices at a reasonable level, which in turn keeps demand at a steady rate. This is done through the selection of input and output that lies on the highest isoprofit line (the point where the slope of the production function is tangent to the isoprofit line[3].)

In contrast, we have the larger chain supermarkets which appear to be attempting to penetrate the monopolistically competitive industry that is the small convenience store/specialist stores - for example Sainsbury's Local and Tesco Extra. The free entry/exit to/ from the market allows this to be an easy move for such a large firm, with the short run profit maximization issue being of little importance to a firm so large with capital which can sustain its place in the market, allowing the firm to exercise the idea of "predatory pricing." This undercuts the other local small businesses who (in order to survive in the industry) need to maximize profits in both the long and short run. It allows them to keep their position in the market while sustaining zero profits for an extended period of time. Undercutting their competitors in the short run means that they are likely to get more customers in the long run.

Yet in the long run, as more and more firms enter the market, it is clear that there would be an inwards shift of the demand curve, resulting in the fact that they would sell less at certain price levels due to the increased number of firms; the curve would become increasingly elastic. This would in turn mean the industry meets equilibrium and force profits down to zero, meaning no more firms would want to enter the market as profit would equal average cost. However, it appears as though these smaller firms are in the long run managing to make MR=MC and they are indeed producing normal profits, even with these larger supermarket chains entering their "pared

[3] Hal R. Varian 1987,Intermediate Economics, 8th Edition, New York, W.W. Norton & Company.

down versions" of mass production into smaller convenience stores. If this were not the case and these smaller firms were facing below normal profits, they would have to leave the industry.

The small convenience stores and specialty stores obviously have different ways of sustaining their profit maximization levels. Product differentiation means that each firm in the market can have better quality and more unique products focused on their own target market. For example, the higher quality of local produce and the more individual rustic or alternative packaging of goods can result in the increased demand for goods. The advantages of these small delis are also that people are now gearing away from large chain supermarkets and their brand image. Whilst it can represent value for money, it is also a constant reminder that small businesses are struggling in the current economic climate and many people do resent the oligopolistic market created by large firms. Moreover, these small businesses have a massive advantage over the large supermarkets, since it is a much faster process for a small business to see a new product and get it on its shelves than a large supermarket which has brands constantly competing for the space in its massive superstores. For example, in the retail industry, another small business which has managed to grow and expand is "Paper Tiger" in Edinburgh, at a time when large firms like Clinton cards are shutting down. Moreover, the small alternative card and stationary supplier managed to get the Lomography Camera brand on its shelves before superstore Urban Outfitters. This small card shop differentiates itself in a large way by selling a brand called "Cards from Africa"; these top price cards are best sellers because they are made from children in Africa who have lost their parents through disease or conflict, and each card has the name of the child who made it on the back. The quirky style of the shop, paired with the expert buying of novelty gifts with unusual packaging, presents the consumer with goods that are not mass produced but are of a higher quality - the consumer is willing to pay a higher price due to the alternative look of the product. Finally, it is important to note that in a recent report by the British Brands Group that consumers ranked freshness of products above price in terms of most important factor when purchasing food.

Thus to conclude, the small convenience and specialist stores are managing to maximize profits in the long run and the short run, as their differentiated product mix and easy location mean that they are holding on to customers. The larger stores are trying to penetrate this market, yet the mass produced nature of supermarkets mean that they cannot escape from the brand image and really create the personal shopping experience so many consumers crave these days, when it comes to buying high quality local sourced foods or quirky alternative birthday cards and gifts. Most things in the large supermarkets are “old news”; everyone has seen them and it is a predictable shopping experience. The small deli stores are maximizing their profits allowing expansion. To put this into perspective; the likes of Marigotta have expanded to six stores, while Tesco announced earlier this year it had no intentions of opening any more extra stores this year.