



Sectorial Observatory

November 2008

Retail distribution: a balancing act

In the wake of the debate unleashed regarding the optimal retail distribution model, the current situation in Spain is analysed by region:

- In Spain the retail sector employs 41 of every 1,000 inhabitants compared to an EU-27 average of 35.
- The Spanish retail sector is highly fragmented, with the self-employed accounting for 34% of the total.
- Retail models vary significantly across the various autonomous regions.

Applicable regulation has a significant impact on the retail model:

- The winds of deregulation prevailing in national legislation from the mid-1980s gave way to greater intervention by the regional authorities during the 1990s.
- The transposition of the EU directive on services in the internal market (the Bolkestein Directive) will warrant, in addition to standardisation of the criteria for building new shopping centres, a more objective set of planning criteria. The criteria of economic viability will cease to be a requirement while the general interest criteria will remain in force. The directive will not set rules on opening hours, Sunday/public holiday openings or sales below cost, all of which will remain under the exclusive jurisdiction of the member states.
- BBVA has created an indicator of the severity of regional regulations governing retailing in Spain, with Madrid ranking as the least regulated.

According to the economic literature, more restrictive regulation may erode retail sector productivity

- Tighter regulation may have a negative impact on job creation and inflation.
- Restrictions on large-scale outlet openings translates into a smaller average business size, which slows productivity growth in the sector, although this is not confirmed in the regional analysis performed in the case of Spain
- Prevailing regulations have benefited neither consumers nor traditional retailers, but rather the large supermarket chains, while hurting small retailers and hypermarkets, leading to higher prices and margins.

The search for a more productive retail model would increase the wealth and well-being of all system operators.

Introduction

In recent years, an intense debate has sparked in several European countries regarding the optimal retail model. On the one hand, some economic observers blame small retailers as the cause of reduced services sector productivity, limited job creation and higher inflation in Spain relative to the rest of the European Union. However, the small retailers claim halting the increase of monopolistic power of the large-scale retailers, underpinning a socially balanced retail model, eliminating car trips, benefiting the environment and facilitating store access by certain groups such as the elderly. For these reasons they demand protection from the large scale retailers.

This report describes the Spanish retail landscape by region, reviewing sector regulation in passing. Within this framework we analyze the economic literature dealing with the effects regulatory constraints on the retail sector have on the overall economy.

A fragmented and diverse sector

The retail industry makes a significant contribution to the Spanish economy. Specifically the sector accounts for 9.5% of the employed workforce in Spain and generates 4.7% of gross added value.

Small retailers play a very prominent role within the Spanish retail sector, in line with the pattern observed in other Southern European nations. If measured in terms of the average number of workers per business, at 3.3 Spain trails the UK's 15.4 by a long margin. Mapping this analysis on the Spanish autonomous regions, we observe a certain level of diversity in terms of the retail models prevalent in each. Madrid stands out for its low density of retail outlets and high average outlet size. In contrast, the Balearic Islands have a high number of large sized premises.

Meanwhile, the percentage of self-employed storekeepers also appears to be the highest in southern Europe. There is evidence to suggest that the higher the percentage of self-employed shopkeepers, the lower the percentage of the working population employed by the sector. This by extension reduces the number of jobs created in the retail sector. This correlation holds true when comparing the pattern across the Spanish regions where the percentage of self-employed retailers varies widely. Finally, there is a degree of positive correlation between the average business size and job creation both at the pan-European level and when comparing the Spanish regions against each other.

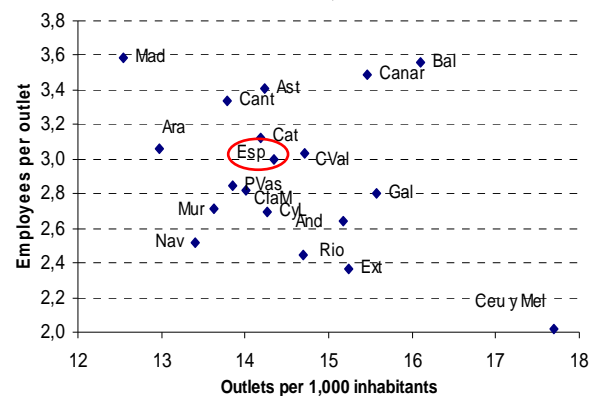
Recent urban planning developments have driven the expansion of large-scale retailers¹, with the pace of openings and average surface area size increasing in recent years. Despite following the Mediterranean retail model, the density of shopping centres in Spain is far higher than the European average, with a gross lettable area (GLA) of 263.4m² per 1,000 inhabitants, compared to 172m² in the EU-27. In addition, the bulk of this growth has

Retail sector in Spain
(Spanish Classification of Economic Activities no. 52)

	2006	Average annual growth 2000-2006 (%)
Number of outlets	636.451	1,16
Turnover (€ 000)	206.833.747	9,98
Wages and salaries (€ 000)	18.590.688	13,28
Gross capital investment (€ 000)	6.743.625	9,14
Turnover/sector employee (€ 000)	113	3,28
Wages/sector employee (€ 000)	10	7,93

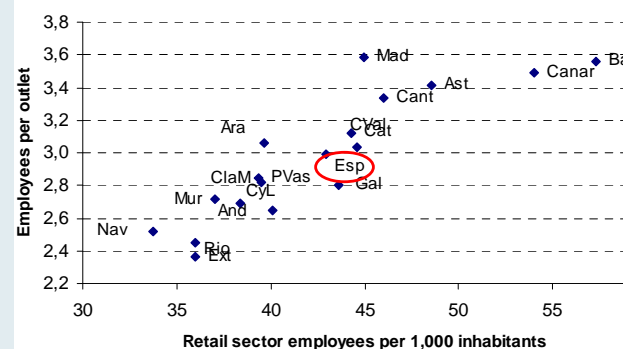
Source: Annual retail survey by the Spanish National Statistics Institute (INE)

Retail sector, 2007



Source: INE, DIRCE (company directory) and

Retail sector, 2007



Source: INE, DIRCE (company directory) and municipal census bureaus

¹ On this point it is worth pointing out that shopping centres tend to house a large number of small retailers and are not obliged to set space aside for hypermarkets/large outlets.

been recent, with 47.7% of existing GLA in Spain opened between 2000 and 2007.

By region, the analysis pinpoints a wide range of shopping centre densities across the nation, ranging from a GLA of 112m² per 1,000 inhabitants in Extremadura compared to 441m² in Madrid. Although the appropriate level of concentration per region also depends on the distribution of the population and the density of built-up areas, it is also noteworthy that restrictions on shopping centre permits have also shaped this pattern. We observe how the regions with lowest densities of shopping centres (such as Extremadura) are those with the most fragmented retail sectors and lowest employee numbers per outlet.

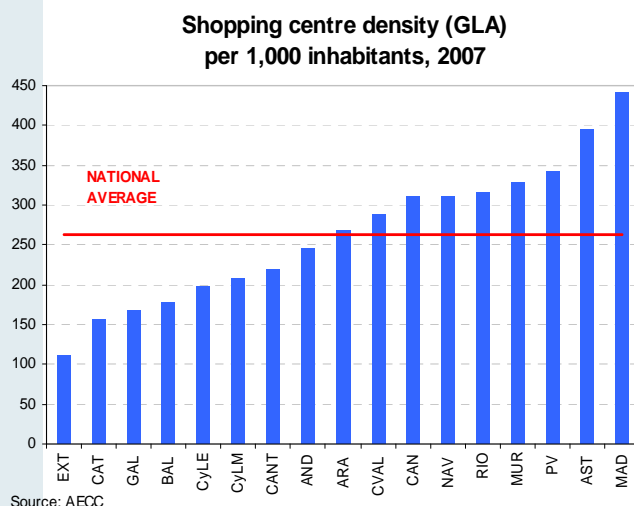
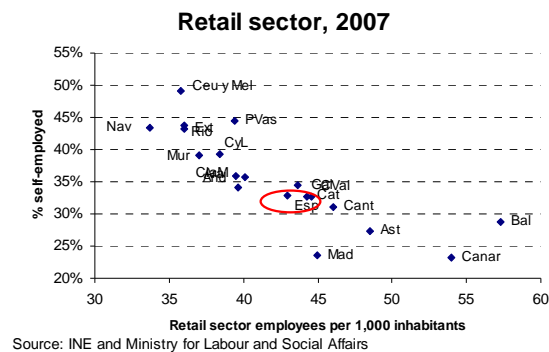
Public aid is another factor that explains the diverse regional development of retail models. In 2005 the state implemented a the [Plan for the Improvement of Quality in the Retail Sector](#). The objective of this plan was support modernisation and raise the competitive position of small and medium sized businesses in the retail and wholesale sectors. The structure of this aid entails co-financing by, and is channelled through, the regional authorities. In addition, all regional authorities have different aid programs that support the retail sector. Commerce is most highly subsidised in the Balearic Islands and Aragon while the Canary Islands and Castilla-La Mancha lie at the opposite extreme.

In short, the small retailer plays a prominent role in the Spanish economy, although the retail landscape varies by region.

Regulation: a heterogeneous picture

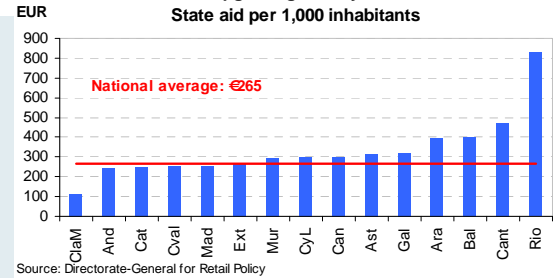
Having described the general state-of-affairs of the retail sector, in this section we provide a more in-depth analysis of the various sets of regulation governing it. The retail sector is regulated at three levels: by EU, national and regional legislation.

Until recently, the EU had not closely regulated the retail sector, leaving national legislators with a significant role. The fact that retail legislation was not harmonised across the various member states made it harder for cross-border operators to develop efficient economies of scale. The development of such economies would have boosted investment in technology, therefore making the sector more competitive overall. At the end of 2006 the EU Directive on Services in the Internal Market (the Bolkestein Directive) was passed, which is currently being transcribed into the member states' laws. The goal of the directive is to eliminate obstacles to free commercial activity among service providers and the free movement of services among the various member states. While the directive establishes a member states' ability to intervene in retail regulation, it also limits the criteria that can be used to regulate the opening of retail outlets to those related to the environment, urban planning and free competition. This implies that although the regional authorities may continue to issue required second opening permits², they may no longer fall back on economic grounds such



² The Spanish Ministry for Industry appears to be leaning towards a single set of standards applicable either at the regional or at the local level, i.e., eliminating thesecond permit.

2007 Plan for Upgrading Quality in Retail Sector
State aid per 1,000 inhabitants



Retail Sector Regulation, 2007.

Region	M ² for qualification as large outlet in towns with 30,000 inhab.	Moratorium on new outlets	Govt. permit required to open a discount store	No. of authorised Sunday/holiday openings	Barriers to entry (from 0 to 10)	Tax of large retailers
Andalusia	2,500	At one time	Yes	8	5 ⁽³⁾	No
Aragon	1,000	At one time	No	8	7 ⁽⁴⁾	Yes
Asturias	2,500	At one time	Yes	8	8	Yes
Balearics	(1)	In place	No	8 [4]	10	No
Canaries	1,000 or 1,500 ⁽²⁾	No	Yes	9	9	No
Cantabria	2,500	At one time	Yes	8	6	No
C. y Leon	1,500	At one time	Yes	8	7	No
C.-La Mancha	2,000	No	No	8 [4]	3	No
Catalonia	2,000	At one time	No	8 [1]	8	Yes
Valencia	600	No	No	8	6	No
Extremadura	1,500	No	No	8	3	No
Galicia	2,500	No	No	8	6 ⁽⁵⁾	No
Madrid	2,500	No	Yes	20 ⁽⁶⁾	3	No
Murcia	1,500	No	Yes	10	3	No
Navarra	2,500	At one time	No	8	6	Yes ⁽⁵⁾
Basque countr	2,000	No	No	0	9 ⁽⁴⁾	No
Rioja	2,500	No	No	8	7 ⁽⁵⁾	No

(1)- 250 workers, revenue of €40mn or 25%-owned by such a company
 (2)- Depending on the island
 (3)- Not applied
 (4)- Permitted in regions of scant interest in commercial terms
 (5)- More restrictive regulations are being drafted
 (6) 22 from 2008
 [] No. of holiday openings that are not attractive commercially speaking

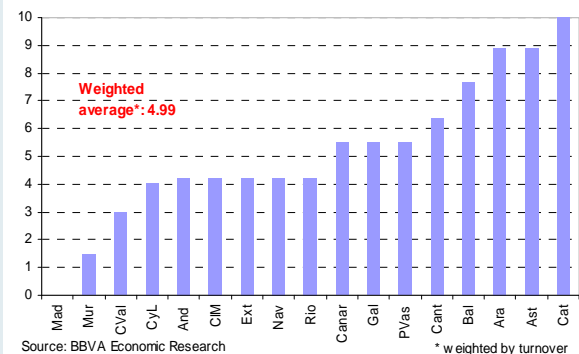
Source: Anged, Ministerio de Industria, Turismo y Comercio

as regional wealth or lack of demand, although they may rely on other criteria set up on an ad hoc basis if they fall within the remit of European legislation. Nonetheless, this regulation is not likely to unleash a dramatic shift in the current legal framework due to the heavily watered down legislation finally passed by the European Parliament. Accordingly, the national regulators will continue to play a prominent role in this sector.

According to indicators of regulatory conditions in the retail distribution sector published by the OECD, Spain's retail sector is more closely regulated than the EU-15 average. In fact, Spanish sector regulation has tightened in recent years in terms of both opening hours and Sunday/holiday openings and in terms of store opening requirements. Considering the Spanish state model, an analysis of sector regulation must take into consideration both national and, more particularly, regional legislation. The historic evolution of this regulation demonstrates that the liberalising trends prevalent in national legislation from the mid-1980s did not deliver expected results. The Constitutional Court upheld the competence of the regional authorities in this matter in 1993, at which point the autonomous governments began to issue stricter regulations on trading hours, trading on authorised Sundays and holidays and the requirements for qualifying as a large outlet, and therefore requiring a second opening permit from the regional government, with some authorities even going so far as to introduce an injunction or moratorium with a view to temporarily suspending permit processing for new store openings. In addition, the regional authorities typically charge a fee for processing opening permits for large-scale retailers and a regional tax on their business volumes. The latter charges have been appealed in court by the state claiming that the regional governments have no jurisdiction in this matter. In any event, the application of the new autonomous statutes could alter this regime.

To measure how restrictive commercial regulations are by region, BBVA has created an indicator which rates from 0 (least restrictive) to 10 (most restrictive) 3. To do so, available information on the existence of moratoriums on new store openings, the number of authorised Sunday/holiday openings, barriers to entry and taxes on large-scale retailers were combined, as these variables proved to be those that best explained the disparity by region in statistical terms. The outcome shows that Catalonia, Asturias, Aragon and the Balearic Islands are the most restrictive, while Madrid and Murcia are the most permissive.

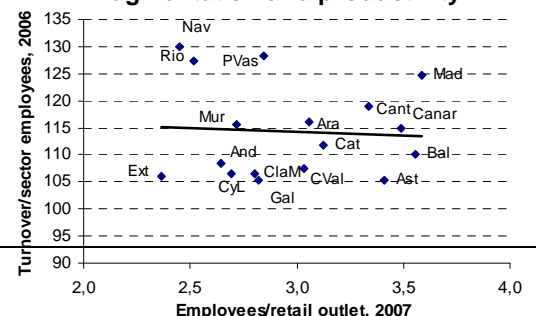
Indicator of regulatory conditions in the retail sector 2007



Impact of the retail distribution model on the economy

Considering the current structure of the retail sector and the prevailing sector regulation, it is worth analysing the extent to which the regulatory bias has an impact on Spain's economic performance. Firstly, the analysis looks at whether the restrictions on sector activity have an impact on productivity. Productivity comparisons in the retail distribution sector by region must be approached with caution given the different market structures. Nonetheless, some of the differences between economic regions are very pronounced,

Retail sector: correlation between fragmentation and productivity



(http://www.elpais.com/articulo/economia/Industria/eliminar/doble/licencia/centros/comerciales/elpepueco/20081014elpepieco_15/Tes).

³ Based on principal components analysis which generates a linear combination of the variables and explains a large portion of the discrepancy across regions in the original series.

Such is the fact, that apparent workplace productivity in the retail sector in the US, where regulation is very relaxed, went from growing 1.62% in 1990-95 to 5.34% in 1996-2004, compared to 1.53% and 1.03% over the same periods in the EMU and -0.39% and -0.38%⁴ in Spain.

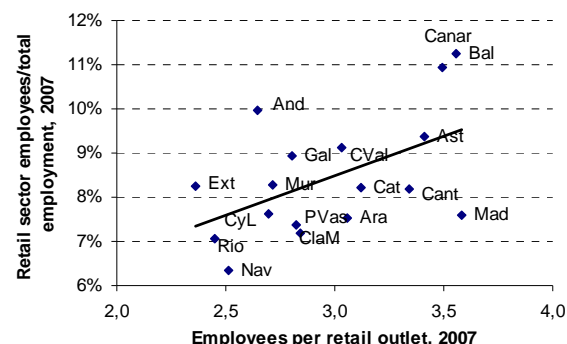
According to a European Central Bank study⁵, growth in workplace productivity in the Spanish services sector between 1981 and 2003 ranked among the lowest in Europe, especially in the retail subsector. This study indicates a positive correlation between the average business size and productivity growth. However, mapping the analysis onto Spain by region, we cannot conclude, using current data, that a less fragmented structure results in higher productivity. It is likely that the existence of common legislation on many matters (e.g. employment law) evens out productivity gains across the various regions.

On the other hand, several studies demonstrate that restrictive retail regulations do have a negative impact on investment, job creation, consequently pushing inflation higher. Since Spain ranks as one of the most strictly regulated nations, it is logical to assume that it could be relatively more exposed to these adverse factors, particularly the more regulated regions. In fact, employment in the sector rose 24% in 2000-2007; this figure been as low as 13% in the closely regulated Catalonia⁶, while in the, according to the BBVA indicator, relaxed Madrid this fire reached 34%. Average inflation in the Spanish food and beverage sector between July 2002 and July 2008 stood at 4.2%, well above the EU-25 average of 2.3%; average inflation in 2002-07 was lower in the regions with a less fragmented retail distribution structure such as the Canaries. Specifically, the correlation with sector fragmentation is weaker for food prices than for other non-food products which are typically cheaper at large-scale supermarkets.

According to the International Monetary Fund⁷, each barrier to the concession of a second permit in the various regions identified by the Anti-Trust Court reduces long-term employment by 10% and increases inflation by 0.1 percentage points, discouraging investment. A subsequent BBVA study⁸ confirms the pernicious impact of these measures, although the magnitude of the fallout was lower. The aforementioned ECB report claims that regulatory changes introduced to protect traditional storekeepers from competition from the hypermarkets have increased sales margins and end prices. A recent IMF report⁹ finds empirical evidence that the barriers to entry on large-scale retailers imposed at the regional level in Spain have led to higher prices in these regions, protecting traditional retailers and possibly driving large-scale retailers out of the market.

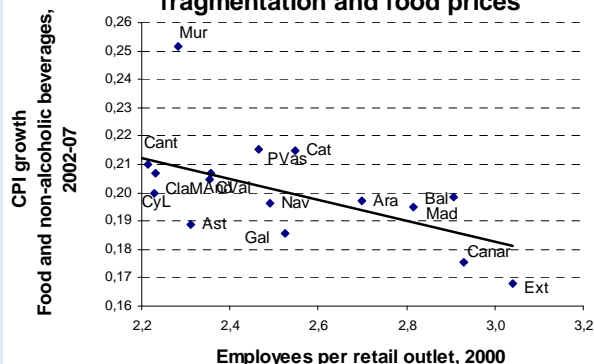
Nor does it seem that the regulatory changes introduced in Spain since 1996 have fully achieved their original objectives. The reduced competition induced in the retail sector drove margins and prices higher at a faster pace than in other sectors, this being detrimental for consumers. Meanwhile it is

Retail sector: correlation between fragmentation and job creation



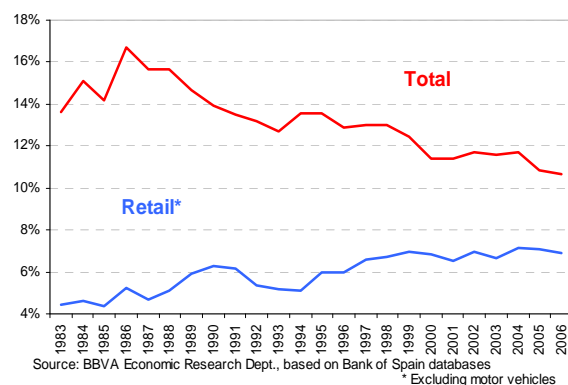
Source: DIRCE, INE and regional gov. accounts

Retail sector: correlation between fragmentation and food prices



Source: DIRCE and INE

GROSS OPERATING PROFIT/REVENUE



Source: BBVA Economic Research Dept., based on Bank of Spain databases
* Excluding motor vehicles

⁴ Bank of Spain: Annual Report, 2005.

⁵ ECB. Competition, Productivity and Prices in the Euro Area Services Sector, April 2006.

⁶ BBVA: Catalan Situation Report, July 2006.

⁷ IMF: Country Report 04/89. Spain, Article IV Consultation, March 2004.

⁸ BBVA: Spain Situation report, May 2004.

⁹ IMF: Working Paper 06/231. Barriers to Retail Competition and Prices: Evidence from Spain, October 2006.

unclear whether traditional retailers benefited as large outlets, prevented from making their desired investments, in many instances adopted the supermarket format for continued growth. As a result, small retailers and hypermarkets alike have lost market share to the small and medium sized supermarkets which are not required to get a second permit and are for the most part owned by large retail chains. This highlights the implicit challenges in implementing restrictive regulations.

Conclusions

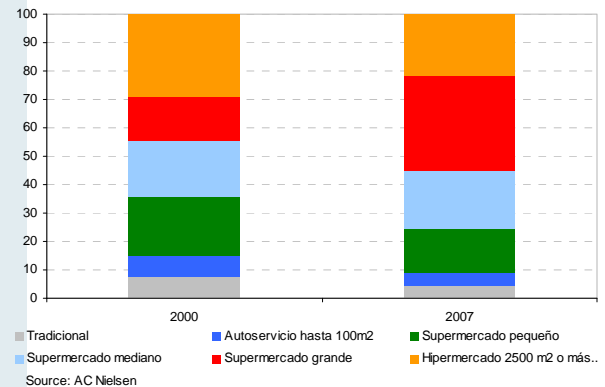
The retail sector in Spain can be characterised as being relatively more fragmented than that of northern Europe, where penetration of shopping centres is also higher. The recent trend in sector indicators such as workplace productivity and inflation indicates underperformance relative to other EU member states. Analysis of national and regional sector regulation, and recent modifications, highlights that the regional authorities have introduced stricter regulations on matters falling under their jurisdiction. According to the economic literature as well as empirical evidence, these measures may have contributed negatively to sector productivity.

In this, as with many other instances, lawmakers find themselves in a dilemma as they attempt to strike an optimal balance between conflicting interests. On the one hand, large retail chains, in their attempt to maximise profits, need to achieve the economies of scale afforded by greater business size. On the other hand of this balancing act lie smaller traditional retailers which cannot afford to innovate and offer significant price discounts, but whose services are still in high demand.

However, the consumer, whose well-being would increase if able to buy the same goods for less, must not be left out of this equation, especially in the lower income segments of the population. In addition, the incorporation of growing numbers of women in the workplace and suburban living trends are prompting less frequent shopping with higher spending per trip .

The consequences of deregulating the sector need not be dire: there is no evidence that a more relaxed regulatory environment leads to an imbalance in which large outlets totally dominate. We can find such an example in Murcia, which, despite being subject to a less strict regulation than the Spanish average, registers intermediate productivity levels and fewer workers per business. Accordingly, it would appear that markets adjust to foster the optimal business size for each economy and as a function of social demographics, an adjustment which results in higher productivity. In any event, while there is no one-size-fits-all solution for the sector, a search for a more productive retail model would increase the wealth and well-being of all system operators.

Spain: market share, food retailing



Retail sector: correlation between regulation and rise of supermarket

