



24th August 2007

Tim Oyler Esq
Inquiry Secretary (Groceries market inquiry)
Competition Commission
Victoria House
Southampton Row
London
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Dear Mr Oyler

Groceries market investigation – Working paper on supply chain practices and the Supermarkets Code of Practice

- 1 Following the publication of the Working paper on supply chain practices and the Supermarkets Code of Practice, we are writing to comment on those aspects of the document that relate to our members – brand manufacturers in the UK – and consumers.
- 2 We strongly support the Competition Commission (CC)'s intention to assess the supply chain practices of grocery retailers.

3 The CC's approach

The starting point that "*given that the various practices covered by the SCOP are regulated rather than prohibited, we see no reason to consider that the grocery retailers have ceased to practise them*" (Para 63) is in our view sensible and reasonable for the CC's review. It accords with the feedback we have received that the SCOP has changed little in respect of relationships between suppliers and retailers with buyer power since its inception.

- 4 We are encouraged that the original practices identified in 2000 are being re-assessed.
- 5 The CC considers many of the practices explored to be potentially anti-competitive because "*these practices have the potential to be a source of considerable uncertainty for suppliers and, as noted previously, act as a disincentive to investment and innovation as well as potential barriers to entry for small suppliers*" (para 68. See also para 59). While we

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agree with this basis for analysis, it understates the likelihood of the negative effects of the practices, as the working paper does not comment on retailers' ability to **impose** conditions and requirements on suppliers. With the imbalance in bargaining power between suppliers and major retailers, suppliers may have no choice but to comply with unreasonable requirements to which they do not agree. Without a requirement on retailers with buyer power to deal fairly, supply chain practices may distort this market to the detriment of suppliers and consumers.

- 6 While we note that the CC's analysis of the practices in Annex E is still underway, we were surprised to see that ID39 (*Over-ordered goods at a promotional price from a supplier, which you subsequently sold into retail at a higher price without compensating the supplier*) is not considered a problem, although it was considered a problem in 2000. We strongly question the CC's reasoning. The practice of suppliers providing goods to retailers at promotional prices is not about extracting better terms. It is about retailers and suppliers reaching an agreement, with suppliers investing behind that agreement, for suppliers to supply x amount of product at y promotional price for temporary onward selling at a special retail promotional price. This agreement is then breached by the retailer who sells promotional-priced stock at higher non-promotional prices to shoppers. This does not benefit the shopper. We strongly suggest that the competitive impact of this practice is reconsidered.
- 7 We assume that any successor to, or development of, the SCOP will have the potential to address competition concerns beyond those identified in 2000 and this will be taken into account as the investigation proceeds.
- 8 We remain deeply concerned that the basis for considering whether or not any or all of the practices identified may cause serious problems will be flawed. The CC states that "*The extent to which these practices are causing substantial problems could be expected to be reflected in aggregate data on innovation activity and the extent to which small firms supply the grocery retailers*" (para 69). We do not believe that innovation activity is in any way a safe measure, (i) because investment decisions on innovation are removed from the immediate effect of the practices under consideration and (ii) because so many factors influence innovation investment decisions, many of which may mask the impact of supply chain practices. Such a broad analysis does not identify what the investment activity would have been had the market been working well. Also it does not identify whether suppliers are having to "run to stand still" ie. suppliers spending considerable amounts of money to counteract the effect of practices without necessarily benefiting consumers in terms of improved products.
- 9 It would be more appropriate for the CC to question suppliers on the concrete operational consequences of these practices (for example, in terms of time and resource needed to deal – and comply – with retailers' practices), assessing whether there is a balance of benefit between suppliers and retailers and whether there may be a detrimental impact on other retailers and consumers. Such evidence could offer a solid insight into how the business of suppliers is affected by these practices and how suppliers would better be able to operate and compete in their absence.

10 The way forward

We note that the CC is considering alternatives to the SCOP, citing the Australian Code of Conduct as a case where suppliers have come forward and sought mediation for disputes with retailers. While others with first hand experience of this code will hopefully comment, there are some observations that we would make.

- 11 Importantly, there are some significant differences between the UK and Australian grocery markets that suggest that a code that works in Australia (if indeed it does work) might not work in the UK. We firmly believe that supply chain practices reflect the differing structures of national grocery markets and the differing nature of relationships between retailers and suppliers that result. Supply chain practices therefore, and remedies where relevant, need to be considered in their national context.
- 12 For example, the vast distances and low population densities (apart from the major cities) in Australia mean that the supply chain is significantly longer and less responsive to short term movements in retail sales, resulting in higher inventories. In contrast, the UK retail structure is highly integrated, with short lines of both communication and physical distribution between retailers and their suppliers. Concepts of efficient replenishment (rapid response), with production closely mirroring retail sales and minimal supply chain inventories (buffers), are a strong feature of the UK market. This, combined with sophisticated IT systems, leads to activities such as self billing by retailers who decide what they should pay, which in turn leads to much of the friction with suppliers identified in the 2000 report. One indicator of the different levels of integration of the supply chains in the two countries is the differing levels of penetration of own label.
- 13 A further difference between these markets is average store size and location. Australia does not have large out of town superstores to the same extent as the UK. As a result store switching is easier, with the result that each Australian supermarket is continually competing for the consumer. This diminishes the power of the retailer over both consumers and suppliers.
- 14 To summarise, there may be greater concentration of retail ownership in Australia but less integration, lower private label penetration and a greater threat of consumer switching. As a result retail power may be greater in the UK and manifests itself in a different *modus operandii*. This needs to be taken into account when considering supply chain practices and the effectiveness of any potential remedy.
- 15 Finally, it is worth noting that the legislative framework in Australia is very different to that in the UK. The Australian Trade Practices Act governs behaviour in markets and includes strong provisions against “unconscionable conduct”, provisions that create an environment for trading relationships that is absent in the UK.
- 16 Were it helpful, we would be willing to undertake a study comparing more thoroughly the structural differences of the UK and Australian markets and the implications of these to the effectiveness of any remedy regulating relationships between retailers and suppliers.
- 17 Turning to specific comments on the Australian code, we are struck that, like the SCOP, there is an emphasis in the first instance on resolving disputes internally (Annex A, para 4, bullet 4, 2nd point). This is a significant flaw of the UK approach, as it fails to take account of

the “climate of apprehension” that pervades the UK market. We do not believe this same climate exist in Australia for the reasons we have just given, despite the greater retail concentration. While we would agree that any successor to the SCOP should encourage resolution of disputes between the parties concerned, there must also be provision to resolve disputes in other ways as well, for example through a confidential approach to a third party such as an adjudicator as discussed below (para 20).

- 18 The Australian approach of focusing its code on a number of core principles is however positive. Part of the problem with the SCOP in regulating rather than prohibiting specific named practices is that it risks institutionalising the practices it seeks to deter.
- 19 Given the limitations of the SCOP, as currently formulated, to prevent the various practices identified in 2000, we believe there is already a powerful case for it to be strengthened. We also suggest that, should supply chain practices that are not currently covered by the current SCOP (eg. misleading “copycat” packaging) be identified as also causing concern, these are brought within the remit of the SCOP’s successor.
- 20 We support the principle put forward by Andrew George MP for a grocery adjudicator as a potential means to address key features that currently prevent the SCOP from working, namely (i) operating an effective, confidential complaint dispute procedure, (ii) proactive monitoring of the market to ensure that supply chain practices are not harming competition, and (iii) remedying any breaches of a future SCOP or harmful conduct. All necessary information gathering and enforcement powers would need to be given to enable the adjudicator to carry out his responsibilities effectively. We support such an approach on the basis that it would be achievable, effective, proportional and low cost.

21 **Conclusion**

We strongly support the CC’s efforts to investigate supply chain practices. A survey of the operational consequences for suppliers of such practices would provide a far more realistic and useful indicator of their potential effects than an examination of innovation spend. In terms of a remedy to any negative effects, we suggest that the SCOP be revised to include core principles, and that an adjudicator with effective powers of investigation and enforcement be appointed to oversee relationships between retailers and suppliers.

- 22 We continue to be willing to assist the CC in its ongoing investigation in this area in any way that we can, including providing an analysis of the structural differences between the UK and Australian grocery markets if required. Additionally, we expect to address in more detail the question of potential remedies as the CC’s investigation progresses.

Yours sincerely



John Noble