



Groceries market investigation

Notice of possible remedies

A response from the British Brands Group

INTRODUCTION

We welcome the opportunity to provide views on the questions posed by the Competition Commission (CC) in its Notice of possible remedies in relation to its groceries market investigation. In this document we are responding specifically to the questions posed in paragraphs 26, 27 and 28 of the Notice as these are of particular relevance to brand manufacturers.

We will be responding separately with comments on the provisional findings.

MEASURES TO ADDRESS THE TRANSFER OF EXCESSIVE RISKS AND UNEXPECTED COSTS TO SUPPLIERS

27(a) whether the SCOP should be retained in its present form with no changes.

Retaining the SCOP in its current form would not be an effective remedy to retailers' transfer of risks and excessive costs to suppliers. The uncertainty over whether or not a specific practice is proscribed would continue, while the reasons behind suppliers' reluctance to complain would remain.

Our conviction that "no change" is not a viable option is supported by the Provisional Findings. The CC has noted that the practices covered by the SCOP are regulated, not prohibited, with the result that supermarkets have not ceased these practices (Appendix 8.10, para 45). It also observed that practices identified by suppliers as causing harm were, in general, described by supermarkets as either not covered by the SCOP or in compliance with it (PFR para 8.55), illustrating current uncertainty. Further evidence that the current SCOP is not effective is provided by the finding that many of the practices covered by it have been carried out with increased frequency over the past twelve months (PFR para 8.54). If the SCOP had been adequate and if there had been an effective enforcement mechanism then the CC's Provisional Findings on retailer/supplier practices would not have been necessary

The reliance of the enforcement regime on suppliers bringing complaints is a significant flaw in the current SCOP. Suppliers have raised "serious and credible concerns" as to the significant commercial harm that would result were the CC to disclose details of complaints to supermarkets (Appendix 8.10 para 11) and these same concerns have caused difficulties in investigating the supply chain (PFR para 8.3). It is exactly these concerns that prevent suppliers from bringing complaints, undermining the effectiveness of any remedy that relies on such complaints. An unchanged SCOP would do nothing to address this.

27 (b) and (c) whether all grocery retailers and symbol groups should be included in the SCOP? If not which retailers should be included and why? How could any threshold for inclusion best be designed in order to ensure that the SCOP remained relevant over time?

In the sense that all grocery retailers and wholesalers in certain circumstances have been found to have buyer power in relation to at least some suppliers, it would not seem reasonable to exclude some of them from the remit of the SCOP. However we question whether smaller retailers, symbol groups and wholesalers have sufficient buyer power to justify inclusion within the SCOP.

Buyer power is greatest when a retailer has the ability (or power) to delist a supplier or some of its products. When delisting can reduce the available market for that supplier substantially, as is the case with larger retailers, the impact of lost sales upon the supplier's profit is disproportionately large while the cost to the retailer in lost sales is relatively small. The cost to the retailer is minimized with the presence of apparently close substitutes, such as own label products. Thus the power to negotiate non-cost related discounts is greater when:

- (1) a retailer's market share is large;
- (2) there is a direct and significant loss of sales to the supplier (the loss in retail sales via a symbol group is not direct where the affiliation between buyer, wholesaler and retail store is loose¹).
- (3) the presence of apparently close substitutes.

The key determinant for inclusion in the SCOP therefore should arguably be the presence of significant buyer power, a threshold which was set at 8% of the national procurement market in 2000. Perhaps applying this threshold on both a national and local level would ensure that all retailers capable of exercising buyer power at these levels would be covered by the SCOP's provisions. Such an approach would remain relevant over time, accommodating automatically those retailers or symbol groups that increase or decrease their market share (and therefore buyer power) at either national or local level. An alternative approach would be to include any retailer with sales over a set sales threshold nationally or regionally, with the sales threshold subject to annual indexation. This may be easier to apply than a market share threshold.

26 (c) changing the SCOP such that only certain suppliers are included within it, and if so which those suppliers should be.

In paragraph 26 of the Notice, the CC raises the issue of whether the SCOP should relate only to certain suppliers, although a specific question is not raised in paragraph 27. While this issue is crucial to all suppliers, it is not clear what specifically the CC has in mind.

As a point of principle, any practice that has an adverse effect on competition (and thus on consumer welfare) ought to be addressed irrespective of the nature of the supplier, and on this basis all suppliers should be free to raise disputes under the SCOP should they wish to do so. Furthermore, to exclude certain suppliers would amount to discrimination, unless valid and objectively verifiable reasons exist for such a difference in treatment.

¹ Where there are competing wholesalers the independent retailer, albeit part of a symbol group, can obtain 'delisted' products from alternative wholesalers or Cash & Carries. This in turn diminishes the buyer power of the Symbol Group.

We note that the CC has found that retailers' buyer power may be offset by the market power of suppliers, in particular suppliers of prominent branded goods. We also note that the CC has focused to a large extent on the impact of retailer practices on smaller suppliers and primary producers. However we do not see how it would be possible in practice reasonably to draw a line between suppliers who would require the protection of the SCOP and those who would not. A split on the basis of branded and unbranded suppliers (with only the latter being covered) would create uncertainty for those companies that make both types of product. Furthermore few if any manufacturers of prominent branded goods do not also sell secondary and tertiary brands which are always more likely to be targeted by retailers for retaliatory action, including those practices covered by the SCOP. A split on the basis of scale of the supplier, rather than the nature of its products, would also be inappropriate. For example, where would the line be drawn and how would this address the fact that suppliers' market power is not simply a question of scale? Measuring negotiating and market power is very hard to do and is not dependent solely on the presence of brands or of scale. For these reasons, we propose that all suppliers should remain included within the SCOP.

Some suppliers may prefer not to be covered by the SCOP. If they wish to accept retailer practices covered by the SCOP, they should be free to do so and to not make use of the protection afforded by the SCOP and its monitoring body, as is currently the case.

27 (d) do the current restrictions in the SCOP adequately cover those problematic behaviours in which grocery retailers, wholesalers and buying groups engage? If no, what restrictions should be added?

We are deeply concerned that, in the Provisional Findings Report, the CC seems to be allowing the effective exchanging of information between suppliers. Specifically we refer to the provision by brand manufacturers to retailers of detailed information on new products and marketing plans many months prior to launch in order to secure shelf space and support, which is both a business necessity and potentially beneficial to consumers. However that same advance information can then be passed directly by that retailer to its suppliers of own label competitive products, for which it is acting as client and specifier.

We are equally concerned that product packaging that misleads consumers and distorts competition between suppliers and between retailers (and which is not addressed by intellectual property laws and the CAP Code²) is not of competition concern to the CC. In particular our concerns relate to the packaging of products that mimics that of familiar brands and misleading on-pack claims.

We will address these issues more fully in our response to the Provisional Findings Report but we raise it here as we believe the SCOP could represent an effective and proportional remedy to our concerns.

However, aside from the question of potentially new behaviours to be covered by the SCOP, the CC's evaluation in Appendix 8.10, Annex 3 suggests that some practices may be dropped from any future SCOP. In particular, ID39 (the retailer practice of over-ordering goods at a promotional price and then selling those goods at the full price to consumers without compensating the supplier) is not currently considered a problem. This is a practice that a

² The British Code of Advertising, Sales Promotion and Direct Marketing, endorsed and administered by the Advertising Standards Authority (ASA)

retailer could only feasibly adopt if it had market power. Furthermore, it amounts to a breach of the principle of good faith that should apply to a retailer's dealings with consumers when the products concerned are manufactured by, and promoted to, consumers by a manufacturer whose only access to those consumers is via the retailer.

27 (e) are there restrictions currently in the SCOP which are no longer necessary? If so, should they be removed or changed? If they should be changed, how should they be changed?

All the practices currently included in the SCOP are there as a result of a rigorous analysis by the CC in 2000 when they were found to have an adverse effect on competition. The CC has found that many of the practices in the SCOP continue. This is a constantly changing and evolving market, and any practice which may reduce in prevalence at any given time has the potential to re-surface. Thus, even if the Provisional Findings Report does not find an adverse effect resulting from some practices at present, that does not mean that they are not capable of and likely to cause such an effect if left unchecked. We urge that all the restrictions in the current SCOP remain in any successor to the SCOP.

27 (f) does the way in which the current restrictions in the SCOP are phrased militate against complaints, monitoring or enforcement? If so, how could the phrasing be changed?

The answer to the first question is "yes". The introduction of the concept of "reasonableness" shrouds the SCOP in uncertainty, making it unclear to suppliers whether or not a specific practice is or is not covered. Furthermore, the addition of "unless" clauses in a number of provisions permits practices in certain circumstances which the CC in 2000 considered should be prohibited. The consequent lack of clarity creates uncertainty amongst suppliers, makes it impractical for the OFT to produce clarifying guidelines on what might or might not be permitted (something we have requested) and makes the SCOP significantly harder to monitor.

The weakness in the current wording is further evidenced by the poor level of self-enforcement of the SCOP. Retailers interpret the provisions to allow a number of the practices to be permitted, weakening the effect of the provisions (Appendix 8.10 para 45).

The wording of a future SCOP needs to be clear, unequivocal and less open to broad interpretation. The ambiguity of the current SCOP has had the perverse effect of encouraging some of the conduct it seeks to prevent.

27 (g) is the monitoring of compliance with the SCOP effective? Do suppliers need encouragement to raise complaints about the behaviour of grocery retailers, wholesalers or buying groups? If so, how could this be achieved? Are there practicable ways in which suppliers could be offered anonymity? Would a requirement on those within the SCOP to submit regular reports to the monitoring body increase the visibility of compliance or non-compliance? In order to be meaningful, what should such reports contain? Would a requirement on those within the SCOP to conduct business with suppliers in writing (eg. written contracts, discussions by email) usefully increase the visibility of compliance or non-compliance?

Each of these questions is taken in turn:

- the monitoring of compliance has not been effective to date. The reluctance of suppliers to come forward has long been recognised as a significant obstacle to effective monitoring

but this has never been successfully addressed. While we as a trade association have given input and feedback to the OFT to address this weakness, it is unclear what consideration this has received. Guidelines from the OFT on the nature of evidence and level of detail it sought would have been helpful, and were requested, but proved not possible (except for the requirement for written evidence, a problem in this fast-moving market where agreements and discussions are often not written).

We particularly note that, aside from monitoring, enforcement by the OFT is dependent on substantial criteria being met, including clear evidence, sufficient scale for there to be a detrimental effect on competition and a significant impact on consumers, and the availability of remedies (Supermarkets: The code of practice and other competition issues 2005, para 3.23). Such criteria militate against the enforcement of the sort of practices covered by the SCOP unless discovered on a significant scale. Thus, individual suppliers are deterred from making complaints in relation to their specific situations even though the practices that they face may well be in operation on a wider scale and cumulatively have the requisite impact to meet the OFT's criteria.

- It is difficult to encourage suppliers to come forward where the risks of them doing so (eg. the potential delisting of their products and product ranges for varying lengths of time) are so high and so costly. The commercial retail relationships at stake are crucial to the future competitiveness of suppliers and they cannot afford to jeopardise them. The range of punishments that can be levied by major retailers against a supplier over both the short and long term are potentially devastating and there is no mechanism for a supplier to obtain redress against retribution that would follow if its identity became known.

Trade associations can have an important role in informing the regulator how the SCOP is working in practice. To encourage such monitoring, it would help were the CC to recognise this role formally and for a non-exhaustive list of trade associations to be made available so that suppliers of all sizes can identify those best able to represent their interests.

- We believe an important way to encourage suppliers to raise complaints is to have in place an intermediary between the supplier and the retailer with the powers to investigate and resolve problems while safeguarding the anonymity of the supplier. We refer to such an intermediary as a "monitor / enforcer" in our responses below, envisioning that such a role may represent lighter touch regulation than an ombudsman.
- It is also extremely difficult to reconcile retailers' right to know of what they are being accused with suppliers' requirement for anonymity. This will always make it difficult to enforce the SCOP against a practice that affects only one or a small group of suppliers.

It may be helpful to recognise the role of trade associations as potential complainants on behalf of their members, but we acknowledge that even these may well be reluctant to raise formal complaints with regulators for fear of damaging the trust between themselves and their members and the risk of reprisals by retailers against their members, given the ease with which delisting can and does take place with direct adverse financial consequences for the supplier.

The most practical approach we see is to put in place a monitor / enforcer who would investigate alleged breaches of the SCOP on his own behalf without having to disclose the identity of the supplier.

- We do not believe that it would be effective to attempt to determine at this stage what amount of regular reporting by retailers would be necessary. It is clear that whatever information is gathered to assist in the monitoring and enforcement of the SCOP must be relevant, sufficient and proportionate. This would best be assessed by the monitor / enforcer in the course of his duties. Were such a monitor / enforcer to be appointed, we suggest it would be most practical therefore for that person to decide what information is required, in what form and when, and for retailers to be obliged to supply it. We recognise that in making this decision, he would have reference to the resources and costs that would be involved on the part of all those submitting the information and/or any corroborative information.
- We recognise that requiring retailers and suppliers always to conduct business in writing would improve the effectiveness of monitoring the SCOP but it may well be found to place a high burden on all parties in the supply chain, potentially undermining the significant efficiencies and speed that typify this fast moving market. If so, this would be clearly to the detriment of consumers. We are aware of requests from suppliers for retailers to put particular discussions in writing, but for these requests either to be refused or the written record not to reflect the verbal discussion. A requirement for retailers to put discussions in writing if requested might be helpful, though recognising that a retailer may always consider such requests incompatible with a positive business relationship.

27 (h) is the OFT best placed on its own to monitor compliance with the SCOP, bearing in mind the changes that the CC's remedies may bring? Could the OFT usefully receive expert assistance in its compliance monitoring and enforcement role? If so, from whom? Would a 'supermarkets ombudsman' be appropriate? Would it be appropriate to introduce some dispute resolution or mediation mechanism within the SCOP? How would any such expert assistance be paid for?

We do not believe that monitoring and enforcement of the SCOP should be left to the OFT alone. The OFT has many different obligations and calls on its resources which means that it may be more difficult for it to investigate practices proactively and to engage in complaints except in the most significant of instances. We believe that this has been the case to date. We recognise nonetheless that it has been constrained by the wording of the SCOP, which it could only interpret rigidly rather than on the basis of the underlying principles.

Some assistance with monitoring could well be provided by trade associations. However we believe that effective monitoring and enforcement is dependent on the appointment of a dedicated monitor / enforcer. This is crucial. Such a person would need the powers and resources to require evidence from retailers, to investigate, to reach conclusions and to impose remedies. Proper resources in terms of budget, manpower and skills will be required. It will be essential for suppliers and their representatives (including ourselves) and retailers to be consulted on the appointee. We recognise that such a person will need the firm support of a main regulator behind them to ensure that they can act effectively if they are faced with delay and/or obfuscation by any retailer unwilling to co-operate. We find the ITV Adjudicator, introduced by the CC to regulate the sale of advertising time by ITV following the merger of Granada and Carlton, a useful model generally. In this instance, Ofcom plays an important role in supporting the Adjudicator and ensuring compliance. Maybe the CC itself could play this role in the grocery retailing sector, applying similar procedures to Ofcom and acquiring the appropriate resources.

As a point of principle, we believe that dispute resolution or mediation mechanisms should be provided for within the SCOP but that this should be in conjunction with robust monitoring and enforcement where complaints from suppliers or their representatives arise. Should this market return to a climate of fairer dealing, it could be expected that a more self-regulatory approach would become more viable and effective.

A strong case can be made that those retailers subject to the SCOP should be the ones to pay for it (as happens in the case of the ITV Adjudicator). An alternative would be for a mechanism similar to the ASBOF³ levy on advertisements that pays for the ASA but we consider this unnecessarily unwieldy were it to be levied on grocery sales.

BEST PRACTICE

In paragraph 28 of the Notice of possible remedies, the issue is raised of identifying best practice in relation to grocery retailers' dealings with their suppliers and how such best practice might be best disseminated. We consider such an approach to be potentially valuable as long as the status of the best practice is as a guideline only and that the process of developing it involves both retailer and supplier interests equally.

We do not see this is a role for the CC. It is potentially a significant task and one best undertaken by those directly involved in the industry. It would also be important to ensure that best practice guidelines evolve with the marketplace. Certainly for brand manufacturers there are strong mechanisms already in place through which to develop and disseminate best practice, most notably through the Institute of Grocery Distribution and ECR⁴.

The development and adoption of best practice would be helpful in establishing a positive framework for supply chain practices, going beyond the proscribing of specific conduct through the SCOP. This would set out a basic framework for retailer / supplier relations without attempting to prescribe specific conduct for specific situations, thereby providing some degree of flexibility.

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³ The Advertising Standards Board of Finance

⁴ Efficient Consumer Response : this forum was established in 1996 for suppliers and retailers to work together to deliver greater value to consumers, particularly through the efficient working of the supply chain. See www.ecrnet.org.