

## GROCERIES MARKET INVESTIGATION

### Summary of the round-table discussion with supermarket suppliers on the Supermarkets Code of Practice held on 5 December 2007

#### Background

1. The purpose of the event was to allow the Competition Commission (CC) to gather views on a confidential basis from a range of suppliers and others in the supply chain on the operation of the Supermarkets Code of Practice (SCOP) and how it might be amended in the light of the CC's provisional findings on supply chain issues.

#### Focus on transfer of risk and unexpected costs

2. There was overall agreement that the CC had been right to focus on the transfer of risk and unexpected costs by the supermarkets to suppliers as the practices most likely to give rise to concern and which needed to be addressed in the remedies phase of the inquiry. Un-negotiated extensions in credit terms, including a settlement discount, supermarkets seeking payments to compensate for what they argued were under-performing products and the transfer of risk to suppliers in the provision of shelf-ready packaging were all quoted as examples of such practices. An additional concern for brand manufacturers arose from the supermarkets interfering with their communications with their customers.
3. There was, however, no consensus that the market position held by the large supermarkets was necessarily harmful to the supply industry. The suppliers entered into business relationships with the supermarkets willingly on the basis of the clear benefits they enjoyed—for instance, long-term stability on sales to the supermarkets facilitated investment and innovation. To an extent, the behaviour of the supermarkets was predictable—and had not changed significantly over the previous ten or 20 years—and some suppliers were able to deal with it. It was argued by some that the more successful supermarkets took a long-term view of their businesses and saw the need for, and value in, having a strong and profitable supply base. It was also possible, at least for some suppliers, to reconfigure their businesses so as not to deal with the large supermarkets if they so wished; in such circumstances a smaller business might also be a more profitable one. However, it was suggested that this strategy might not be applicable to products for which a significant proportion of volume was sold via supermarkets—for example, soft drinks and some alcoholic drinks with high capital investment requiring economies of scale—or to suppliers that wished to reach a mass market.

#### Extending the range of the Supermarkets Code of Practice

4. There were mixed views on the merits of extending the range of the SCOP, either to include second-tier and even smaller retailers or to encompass processors' relationships with the primary producers. It was indicated that there was likely to be merit in extending the SCOP to other retailers. Points made during the course of discussion were:
  - Remedies should be focused on areas where the problems identified were most acute, ie where the retailers' buyer power and the impact on suppliers were greatest.

- The SCOP was of little practical benefit to suppliers. As an example of this, a supplier stated that if suppliers provided good service to the retailers they found that they were well-treated. But when let down, the retailers were 'unforgiving'.
- The SCOP was, in particular, considered to be of little benefit to larger suppliers who generally maintained good relationships with the supermarkets (though the view was also expressed that even the largest suppliers were vulnerable in respect of smaller brands that were not 'must-stock' items).
- Smaller suppliers were keener to see the SCOP extended so that they enjoyed its protection in all of their dealings with retailers. There was evidence of smaller retailers, particularly those with more aggressive shareholders or higher levels of borrowing, behaving more aggressively with their suppliers than the larger supermarkets.
- There was also evidence that the second-tier retailers, although not within the ambit of the SCOP, acted no differently from those that were covered by it.
- The development of tripartite arrangements in the supply chain embracing producer, processor and retailer (eg the milk sector) reduced the case for the extension of the SCOP down the supply chain.
- There needed to be some thresholds, particularly in relation to extending the SCOP down the supply chain, otherwise it risked becoming over-bureaucratic.
- To be a fair process, all parties should be either included or excluded.

### **Improving the effectiveness of the Supermarkets Code of Practice**

5. There were also mixed views as to the present effectiveness of the SCOP. While the CC had received a good deal of evidence that it was not acting as a credible restraint on the behaviour of the large supermarkets, some suppliers thought that it had had a deterrent effect, though possibly not in the way intended, given that there had been few actual complaints. The suppliers suspected that the large supermarkets tended to behave in ways that went to the limits allowed by the SCOP but not beyond them.
6. It was, however, agreed that there were strong disincentives to the suppliers making a formal complaint under the terms of the SCOP—the benefits to be gained from any individual complaint might be limited, while making it could lead to some kind of 'retribution' and might well jeopardize the entirety of the commercial relationship with the supplier. In practice, a supplier was only likely to consider a formal complaint when his business as a whole was at risk. There was also no certainty that a complaint would be dealt with in a robust and thorough way.
7. The suggestion that complaints under the SCOP be dealt with on an anonymous basis met with little support; retailers would be able to determine the complainant's identity relatively easily from the facts of the case, while a properly anonymous process would not allow for a full investigation. The suggestion that in the event of a complaint the retailer would not be able to alter the terms of its relationship with a supplier for a period of 12 months was also not seen as a practical way of addressing the problem; an aggrieved retailer had a number of other ways of making life uncomfortable for a supplier. In addition, the suggestion was open to abuse by suppliers who might make a complaint solely to protect a vulnerable commercial position.

8. There was similarly little support for the suggestion that the effectiveness of the SCOP might be improved by replacing the current 'reasonableness' test with an approach that focused on a range of specified types of behaviour; the suppliers noted that in some circumstances, for example, a product launch or relaunch, they might be willing to participate in the sort of arrangements, such as waste support, that had been identified by the CC as a cause of concern.

### **Monitoring and enforcement of the Supermarkets Code of Practice**

9. The supply industry did not see the Office of Fair Trading (OFT) as the ideal body to monitor and enforce the SCOP in the future. There was, however, a need for an authority with the power to take enforcement action for clear breaches of the code should this ever be necessary. It was suggested that the approach adopted following the Carlton/Granada merger, with the creation of a tailored ombudsman, seemed to offer a better alternative. That particular model had a light-touch approach, was independent and effective, and its costs were met by the industry concerned. In the case of grocery retailing, the costs could be met by the retailers on the basis of their turnover. The overall financial effect would be slight; while the costs would necessarily be passed on to consumers they would also benefit from the positive effects of the change.
10. It was suggested by some of the participants that, given the disincentives on suppliers to make a complaint under the SCOP, a new monitoring body would need to take a proactive approach, receiving regular flows of information from the industry, holding regular monitoring meetings with the large retailers and conducting both 'spot audits' on typical supplier-purchaser relationships and surveys, possibly anonymously, of particular sectors. One additional possible element of an independent monitoring authority could be to recognize instances of retailers actively encouraging open dialogue and building positive long-term relationships with suppliers as a way of encouraging others to improve their performance. There was a mixed response to this proposition as some suppliers considered that a proactive ombudsman required an auditable trail of agreements and negotiations that was likely to be a burden. This additional level of administration was not generally supported.
11. The suppliers had mixed views on the extent to which trade associations could play a more prominent role in the enforcement process, for example, by aggregating complaints across a sector or presenting issues to a monitoring authority. There were concerns that individual member companies would not wish the detail of their commercial relationships to be revealed even to a trade association, while the associations themselves were reluctant—and even in some cases constitutionally unable—to play any role in commercial disputes between members. Trade associations could, however, be useful in seeking the views of members on generic issues, identifying common practices among retailers and feeding information back to the monitoring authority.
12. On possible sanctions for non-compliance under a revised SCOP, the suppliers thought that the key issue was speed—a quick reaction time was essential—and that a 'naming and shaming' approach offered a possible way forward.