

## Summary of hearing with Traidcraft, September 2006

### Background

1. Traidcraft told us that it consisted of two organizations: a plc and a registered charity. The purpose of both parts of the operation was to fight poverty in developing countries through trade. The trading activity was carried out through Traidcraft plc, which was established in 1979. It bought a range of goods from more than 100 producers in 31 developing countries and sold them through a range of outlets, including supermarkets, in the UK. The fair trade model it had pioneered was geared up to equitably share the risk of the supply chain and to advance the efforts of producers in developing countries to achieve a sustainable access to markets. The registered charity, Traidcraft Exchange, helped producers who wanted to trade to build a viable business model and develop business planning, marketing, financial modelling etc. It also helped with trade facilitation where producers want to make market linkages, either with Traidcraft or separately. Traidcraft Exchange was part of the Responsible Purchasing Initiative and as such had been meeting with developing country suppliers and workers, as well as UK importers and suppliers to UK food market.
2. The fair trade market in the UK had grown very considerably over the past ten years. Traidcraft plc was one of the largest fair trade companies in the UK, with turnover for the year ended March 2006 of about £16.5 million. It now sold coffee, tea, cocoa-based products, a range of cereal products, handcrafts, and clothes. It tried to shorten the supply chain or undertake direct trading where possible, but there was no single formula. It aimed to get the product to market at the best value for the producer.
3. The fair trade model involved payment of a social premium, an additional payment to producers for the goods they sold, which they invested in community development or business development. Many of the supply chains had a consolidating function in the middle which, among other things, would provide training to the producer groups on basic aspects such as pricing and understanding markets. The consolidator might also facilitate visits to trade fairs and undertake market research for producer groups. A characteristic of Traidcraft's trading practice was the provision of pre-order financing, so that it shares risk with the producer.

### Growth in the market

4. Traidcraft said that the UK market for fair trade products had about doubled every two years for the past few years. Sales of goods with a fair trade certification mark were running at about £200 million a year and there was likely to be growth of about 40 per cent in the current year. Certain products had reached a tipping point at which some retailers, in particular supermarkets, were starting to consider turning their entire offer in a category over to fair trade instead of taking just one product out of a range of dozens or hundreds of products.

### Scope of the investigation

5. Traidcraft believed that the scope of the CC's investigation should be widened to include producers and processors outside the UK. The grocery trade was so globalized that it was necessary to examine the whole supply chain. There were imbalances throughout, but particularly between retailers in the UK and producers in developing countries.

## **Relations with supermarkets**

6. Traidcraft told us that it currently sold to eight supermarket groups. In general, the larger ones were more challenging in terms of the demands they made of suppliers.
7. Traidcraft also made direct sales to customers by mail order and online. It also sold through independent retailers, but on a much smaller scale than through supermarkets. The importance of the supermarkets to Traidcraft lay in the opportunities they offered for volume sales (each kg sold under fair trade system which guaranteed producers a fair price brought substantial benefits to these target groups), and the scope for reaching a wider audience and gaining brand recognition.

## **Negotiations and agreements**

8. Traidcraft told us that it had never had a written agreement with a supermarket. It was aware from its contacts with other fair trade suppliers and other supermarket suppliers that written contracts were almost unheard of. The usual practice was for it to meet with a supermarket's buyer and get oral agreement that the supermarket would list a Traidcraft product. However, it could sometimes take many more months before the product was on sale in the stores, possibly because there was not a great incentive for supermarkets to buy from smaller suppliers that had virtually no negotiating power. (Traidcraft had observed that some supermarkets, for instance, could get products on to the shelf quite quickly if they so wished.) Traidcraft provided an example of the impact of a supermarket reneging on a commitment. This involved a major supermarket agreeing to list a food product and confirming this by email, on the strength of which Traidcraft ordered containers of the product from overseas. Then it later said that it no longer wanted the branded product and asked for own-label instead, which Traidcraft could not supply. The cost of storing the product and having it tested regularly until it could be sold fell on Traidcraft. Traidcraft felt that as a supplier, it was taking all the risk and as it did not have many reserves. Experiences of this kind limited its ability to work with new producers and bring new products to market. This was not an isolated incident: there had been similar ones with other supermarkets.

## **Effects of supermarkets' buyer power**

9. Traidcraft said that there was evidence, for example an impact study commissioned by the Ethical Trading Initiative (ETI) into the impact of ETI member companies' implementation of the ETI base labour standards code, to suggest that the buyer power of supermarkets was having an effect on the producers at the end of the supply chain. Their businesses were becoming more vulnerable, which was in part evidenced by permanent employment being replaced by short-term contract employment. There had been some efficiency gains from cutting costs in the supply chain but the pressure applied had now gone beyond efficiency to a trend where increasingly producers were accepting uneconomic deals (which did not contribute to sustainable development or international development).
10. Traidcraft told us about the 'race to the bottom' concept, which was essentially supermarkets pitching suppliers against each other, so that they competed in reducing prices and chasing each other to the bottom in terms of quality and standards. The impact of downward pressure on price could be seen, for example, in bananas, where in some cases workers were not provided with adequate health and safety measures, such as masks for crop sprayers, with disastrous results.

11. Traidcraft had heard of suppliers who had been asked to make a 'donation' to a supermarket that was in danger of missing a target set for the investment community. The threat that the supermarket would delist their products prevented the suppliers from refusing to pay, but the cost of the reduced 'donation' that was paid had to be passed on in turn to their suppliers in one way or another.

### **Errors by supermarkets**

12. Suppliers could find themselves penalized as a result of a supermarket's error. Traidcraft told us of an experience where, because of an error in a supermarket's system, a Traidcraft product was underpriced in the stores and sales increased dramatically. The supermarket consequently ordered much higher volumes, which Traidcraft was struggling to supply, before the supermarket realized the mistake and cut the volumes. However, Traidcraft was charged approx £1,000 because it had been unable to supply one of the large orders within 24 hours notice period. Traidcraft was then responsible for the storage costs of higher volumes it had organized.

### **Delivery requirements**

13. Traidcraft recognized that demanding delivery schedules, just-in-time ordering, packaging specifications and palletization were required by the major supermarkets as a means of competing with each other. However, these requirements often added costs to suppliers.
14. Asked whether costs were being passed down the international supply chain unfairly, Traidcraft said that this was certainly happening in some products. Disproportionate risk was being passed down to the producers, with lower prices being paid while demands increased and higher standards were imposed. Traidcraft drew our attention to European Retailers' Good Agricultural Practice (EurepGap), which related to traceability and consumer safety. Most of the retailers had agreed a particular standard (similar to EurepGap) which, when applied throughout the supply chain, had significantly and disproportionately increased farmers' costs, to their disadvantage. For example, only certain chemicals could be used, which were more expensive than those used previously, and farmers were required to have additional buildings for storage of chemicals (sometimes to a better standard than farmers' own homes!). The aspirations of the standard were fine—but the prescriptive implementation was inappropriate and disproportionate. Just-in-time buying by the supermarkets was also difficult for producers in developing countries. This was an area where supermarkets placed disproportionate risk on their suppliers. Some supermarkets finalize the delivery volume they want often when the product is in the air (placing the risk on the supplier, when it is the supermarkets that have the best knowledge of their till sales, and arguable should take a greater proportion of the forecasting risk.) The disproportionate risk placed on the suppliers was heightened when, for example, fresh produce suppliers with rapid farm-to-shelf times suffered cost penalties or loss of business if they could not deliver the final volume specified in full. Some supermarket buyers varied the percentage proportion of same product bought between different suppliers at short notice as a way of penalizing or rewarding suppliers. Overall this created a context where it was very difficult for suppliers to plan and invest in their businesses because they could not forecast the levels of output they would be expected to provide from day to day.

## Effects on UK consumers

15. Traidcraft said that a fast-growing minority of UK consumers wanted fair trade and the market for fair trade products was set to grow considerably. Any practices that limited the availability of supply of these goods meant that consumers were not being offered what they expected and were entitled to expect. Traidcraft was concerned about three categories of poor treatment of suppliers: disproportionate risk placed on the supplier; suppliers prevented from pursuing cost efficiencies (to service individual supermarkets); and the essentially unfair competition with own-label products. Disproportionate risk was experienced in many ways which resulted in a supplier being unable to plan, and this was demonstrated by the increasingly few products which had prices determined from 'bottom up' through the supply chain. For example, suppliers were expected to take the risk of final delivery volumes when best information was held by the supermarket, when supermarkets 'requested' unplanned promotions, or requested 'donations/contributions'. This poor treatment of suppliers affected the market in that they made small suppliers more vulnerable and likely to go out of business. Traidcraft said that it would prefer to sell more products to medium-sized outlets, but the convenience sector was difficult because the stores, having limited shelf space, would accept only major brands already established. This implied national advertising, which meant that a supplier also had to sell to supermarkets in order to justify expenditure on an advertising campaign. This placed suppliers who wanted to grow in a catch 22 situation. Suppliers would like to be able to scale up their volumes step by step, hence the importance of medium-size retail outlets. Instead current market dynamics resulted in a supplier having to make substantial investment and taking significant risk (no contract with specified volumes, price and timing) to make a step change in volume to supply a supermarket. Concurrently suppliers were expected to invest to 'promote' (advertise to run promotions) to result in sufficient product sales per shelf space to retain their listing. These market dynamics limited the growth of suppliers and range of potential products offered to UK consumers.
16. Traidcraft suggested that price competition between supermarkets, particularly with own-label products, was a double-edged sword as far as the fair trade suppliers were concerned. While it was good for fair trade farmers to be able to sell large volumes of commodities at minimum fair trade price, own-label fair trade goods put pressure on the prices of branded fair trade goods and supermarkets created a perception that the price of fair trade products should be lower. One example of this was coffee, which was a very competitive market. There had used to be an accepted price range for fair trade coffee but branded suppliers had had to lower prices in the face of competition from own label and as a result had suffered, and were not able to reduce their investment in promoting and developing new fair trade producers. Traidcraft suggested that the pressure on price caused some confusion among consumers about the balance between price, quality, and the fair trade model.
17. There was false competition between a supermarket own-label product and branded product, because the 'gatekeeper' had a biased interest. In some cases a branded product never got to perform on supermarket shelf because a supermarket buyer might allocate the shelf space to a near 'copy cat' own-label product which earned the supermarket additional margin over all than the branded product. The supermarket staff also set the retail price of both own-label and branded products, and can vary from the recommended retail price. This results in a practice in which the own-label product is always being priced below the comparable branded product.
18. In the fair trade sector, 100 per cent fair trade companies which have invested in building up the business capacity of producers, building market linkages, and improving quality of products were not seeing a return on their investment, since the

placing of supermarkets' own-label product priced below the branded product reduces the branded product's sales. Supermarket own-label products essentially piggy backed off the investment made by other companies, and were in essence subsidized by the market entrant.

## **Supermarkets Code of Practice**

19. Traidcraft told us that it was aware of suppliers which had been reluctant to use the Supermarkets Code of Practice (SCOP) because they felt vulnerable in their dealings with supermarkets and were afraid of losing sales. It was not easy for any supplier to raise a formal complaint with a supermarket, which was the first stage of the process. Part of the problem was the absence of written contracts, which meant that there was nothing formal to complain against and a supplier could be easily fobbed off. Traidcraft said that it knew of suppliers that had stood up to supermarkets and had then been delisted resulting in a large proportion of their sales being lost, which then in turn impacted on the viability of their business model.
20. It suggested that the CC could do something about the market share of the supermarkets, to reduce the power imbalance between them and their suppliers. It also suggested the introduction of an independent third party to monitor supermarkets' behaviour, both informally and formally, so that suppliers would not have to raise formal complaints with supermarkets as the first step. The informal monitoring could include interviews with suppliers and supermarkets about how different products were being sold and meetings with supermarkets to discuss, on an anonymous basis, points raised by suppliers. This might help to nip in the bud bad practices as they are being developed without the need for formal complaints.
21. Traidcraft also thought that a tighter, principled list of good practice needed to be drawn up. Examples of matters to be included were written contracts, practices which obviously placed a disproportionate inappropriate risk on suppliers, and no unilateral demands, (such as notifications by supermarkets to suppliers that their invoice costs would be reduced by percentage, or that payment terms were to be extended). It was possible that if the SCOP were tightened up, the supermarkets would negotiate harder on unit price but Traidcraft felt suppliers would prefer this to ad hoc charges that affected suppliers' ability to plan and develop their businesses.
22. Traidcraft commented that whichever organization was responsible for the SCOP needed to be rigorous in implementing penalties. There was a certain lack of confidence in the OFT. Penalties should cover not only the loss to the supplier but also the potential cost of any delisting. Furthermore, it was aware that the competition authority in South Korea required supermarkets that had been fined to pay for the cost of an advertisement in the national press explaining why the supermarket was fined and by how much: it would be a good idea to introduce a similar scheme in the UK. Traidcraft also suggested that whatever scheme or Code of Practice was applied to supermarkets could potentially also be applied further down the supply chain.