

## Case study of retailer and supplier correspondence

### Introduction

1. This appendix provides a review of correspondence (predominantly email) between Asda and Tesco and their suppliers during the period 18 June to 22 July 2007.<sup>1</sup> The purpose of this review has been to assess the implications for suppliers of the ‘price war’ between these two grocery retailers that commenced on 15 June 2007, and more generally, to better understand the relationship between grocery retailers and their suppliers through our review.
2. The appendix is set out as follows. First, we provide background to the ‘price war’ over the summer of 2007, including the scope of the price cuts and its possible motivations and timing. Second, we note our observations about retailer–supplier relationships and some particular areas of concern arising from this review.

### The ‘price war’

3. On 15 June 2007 both Asda and Tesco announced price cuts across their product range. Asda said that it was cutting 10,000 prices across grocery and non-grocery products at the cost of £250 million. On the same day Tesco announced that it would be cutting prices on 3,000 products at a cost of £270 million. Both Asda and Tesco stated that these price reductions were motivated by tighter household budgets and a desire to assist households in cutting their weekly shopping costs.<sup>2</sup>

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<sup>1</sup>In July 2007 the CC received a copy of an email [redacted] sent from an Asda buyer to a supplier. This email explicitly referred to the price war in progress with Tesco and requested a retrospective discount. We discuss the background and scope of the section 109 notice that was subsequently issued in Annex 1.

<sup>2</sup>Asda was quoted in the press as stating that UK grocery retailers have been ‘too focused on the environmental concerns of some shoppers and had taken their eye off the ball of offering lower prices: “We have been too attentive on a small part of the population. There is a vocal minority for whom price is less important, but there is a huge set of people out there for whom price is still very important”’ (*The Guardian*, 16 June 2007).

4. On 4 July 2007, at a hearing with the CC, Asda told us that the price cuts were financed by [REDACTED].
5. At its hearing on 20 June 2007, Tesco told us that the price reductions that it announced [REDACTED].
6. We note the proximity of the price reductions announced by Asda and Tesco to the anticipated publication of our own provisional findings in this investigation. There are similarities in the timing of these price reductions and those announced in October 2000<sup>3</sup> prior to the publication of the CC's then investigation into grocery retailing.<sup>4</sup>
7. The extent and cost of the price cuts announced by Asda and Tesco can be calculated and interpreted differently. [REDACTED] Tesco's press release announcing the price cuts stated that—unlike some of its competitors' price claims—its reductions were genuine reductions and did not include the hundreds of promotions throughout Tesco stores.
8. Asda told us that it considered that the rate of annual (food) inflation was particularly marked in the fourth quarter of 2006 and had declined significantly, particularly in some categories like produce, since the start of 2007. As a result, it did not consider that there was an inconsistency between the price war that had been announced and the wider reports of food price inflation driven by commodity price increases.
9. The price war included a period of television and billboard advertising by Tesco comparing its own prices with those of Asda, Morrisons and Sainsbury's.

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<sup>3</sup>For example, Tesco on 2 October 2000 announced price cuts that it said would cover a wide range of products at a cost of £55 million. This was reported as 'restarting a price war with its rivals' (BBC, *Tesco restarts price war*, 2 October 2000, at <http://news.bbc.co.uk/1/hi/business/952427.stm>).

<sup>4</sup>CC, *Supermarkets: a report on the supply of groceries from multiple stores in the UK*, October 2000.

## Areas of concern arising from the email review

10. In carrying out this review we identified three areas that give rise to potential competition and supply chain concerns. These are:
- exchange of information on competitor pricing and promotion;
  - contribution to costs of promotion; and
  - wastage and product quality complaints

### *Exchange of information on competitor pricing and promotion*

11. The communications that we reviewed indicated that suppliers provide information on the retail price at which competing grocery retailers are selling goods as well as details of promotions.<sup>5</sup>
12. This information on pricing was provided in various ways. In some examples it was only an aspect of the primary communication, but in other cases it was systematically organized as part of an audit of comparable products or a periodic submission on prices.<sup>6</sup> In some instances the information seemed to be provided voluntarily,<sup>7</sup> and in others suppliers were directly asked to gather information, sometimes jointly.<sup>8</sup> For example, a weekly price check was apparently requested in one email.<sup>9</sup> There was also an example of a supplier using information from a third party market research company to provide a report to the retailer, although it was unclear whether this was requested or an exercise that would have been undertaken by the supplier in any event.<sup>10</sup> In some cases very specific information was requested, including one request for photos to be taken inside a rival supermarket.<sup>11</sup> On another occasion, for

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<sup>5</sup>For examples of suppliers providing information regarding the retail prices at competing grocery stores, see [§]. For examples of suppliers providing details of promotions at competing retailers, see [§].

<sup>6</sup>See, for example, [§], where a supplier provides a 'gap analysis' for Indian ready meals, setting out retail selling price, equivalent price per weight and detailed content and including a summary of 'recent promotional activity within Indian meals.' The supplier is subsequently asked to re-present some information to show the protein content of individual meals.

<sup>7</sup>See, for example, [§].

<sup>8</sup>See [§], in which a fish buyer asks a number of suppliers each to collect and provide information on prices at specific competitor stores. Also [§].

<sup>9</sup>[§]

<sup>10</sup>[§]

<sup>11</sup>[§]

a list of products to be bought and receipts provided.<sup>12</sup> We also saw an example of a detailed request for information on a competitor's promotional activity.<sup>13</sup>

13. It seems that grocery retailers rely on their suppliers for significant amounts of information regarding the activities of competing grocery retailers.<sup>14</sup> In some cases, though, the emails that we have reviewed show an explicit rejection by a retailer of an offer made by a supplier to provide information.<sup>15</sup>

14. We have also observed private information that would not otherwise be available to a grocery retailer being volunteered by a supplier to one of the grocery retailers including information on:

- a future promotion at a rival supermarket;<sup>16</sup>
- events at competing retailer depots;<sup>17</sup>
- competing retailer stock lines;<sup>18</sup>
- a rival supermarket's funding for a particular price reduction;<sup>19</sup>
- future retail changes at competing retailers;<sup>20</sup>
- the launch of increased product range at a rival supermarket;<sup>21</sup>
- a competitor's retail prices for the coming week;<sup>22</sup>
- a supplier's view of a competitor's future retail price changes;<sup>23</sup> and
- the amount of goods to be supplied to a competing retailer.<sup>24</sup>

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12 [REDACTED]  
13 [REDACTED]  
14 [REDACTED]  
15 [REDACTED]  
16 [REDACTED]  
17 [REDACTED]  
18 [REDACTED]  
19 [REDACTED]  
20 [REDACTED]  
21 [REDACTED]  
22 [REDACTED]  
23 [REDACTED]  
24 [REDACTED]

15. These communications raise issues of coordination between suppliers and grocery retailers and we discuss these in Section 7 of the main report.

### ***Contributions to promotional costs***

16. The SCOP contains provisions dealing with promotions in Clauses 11 to 14. These require (where the promotion involves the supplier directly or indirectly making payment) that the grocery retailer should give the supplier reasonable notice; that where goods for a promotion are over-ordered the supplier should be compensated or goods subsequently sold at a non-promotional price by the grocery retailer; and that the basis for calculating the cost of a promotion should be transparent. Clause 14 also indicates that the main financial burden of a promotion should fall upon the grocery retailer and the supplier should not be unreasonably required to predominantly fund a promotion.
17. Given the context of our review of communication, namely a price war between two major competitors, we looked for examples that might suggest who paid the costs of promotional activities. However, from the communication that we reviewed it was difficult to determine from the specific examples if suppliers were compelled or voluntarily contributed to promotional costs. In addition, it was difficult to ascertain the scale of the financial impact on the supplier.
18. From the examples we have seen, it appears that suppliers can come under intense pressure to agree to fund promotions, sometimes at very short notice. In some instances, this may be viewed as a negotiation tactic by a retailer to reduce the costs of wastage. In this way a grocery retailer might shift the burden of some of the cost of over-ordering back to the supplier by requesting support for a promotion. We observed some examples of suppliers providing 65 per cent of the funds for a

promotion<sup>25</sup> and strongly-worded requests from a retailer.<sup>26</sup> However, without further knowledge of the circumstances surrounding each promotion, it is difficult to determine if these were examples of activities that are intended to be discouraged by the SCOP. We observed only a few examples of a supplier being asked for an additional contribution for a promotion.<sup>27</sup>

### ***Wastage and product quality complaints***

19. The issue of wastage incurred in a grocery store is referred to at Clause 7 of the SCOP. We note that wastage is not defined in the SCOP and is capable of an interpretation that includes products that have deteriorated as well as those that have been ordered in excess of demand.
  
20. The SCOP indicates that a supplier should only be required to make a payment for wastage where it arises because of the supplier's negligence or default or there is an agreement in writing setting out the terms of such a payment. In our review of communication we observed some examples of where the grocery retailer has requested the supplier to meet the costs of wastage.<sup>28</sup> However, in these examples we are unable to ascertain if there was an existing agreement between the retailer and supplier.
  
21. We note that in the SCOP, wastage is referred to only in relation to the retailer's stores. On this basis, provided goods never leave the depot, it is possible that the provisions in the SCOP do not apply to wastage within a depot.
  
22. We also note that rather than accounting for customer product quality complaints individually, many retailers agree an aggregate charge with their suppliers. Asda, for

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<sup>25</sup> [REDACTED]  
<sup>26</sup> [REDACTED]  
<sup>27</sup> [REDACTED]  
<sup>28</sup> [REDACTED]

example, now charges a flat rate of £[REDACTED] for customer complaints it considers to be the fault of the supplier.<sup>29</sup>

### **Buyer power**

23. The communications that we reviewed give the impression that Asda and Tesco have a strong position when negotiating with their suppliers. We consider that this factor can have a role in the motivation for what might otherwise be unintuitive such as a supplier providing product at below cost or paying for promotions proposed by a retailer.<sup>30</sup> Given the relative size of the grocery retailers we expect this dynamic to an extent and we discuss the buyer power of retailers in Section 8 of the main report.

24. Among examples of negotiating tactics used by the grocery retailers that we observed were: demands for replies to emails to be received within hours;<sup>31</sup> pressure to supply information about other retailers;<sup>32</sup> attempts to reduce costs by leveraging off the prices charged for comparable products to other retailers;<sup>33</sup> threats to de-list or partially de-list a supplier;<sup>34</sup> and requirements for products to be supplied below cost in a situation where the grocery retailer had sufficient margin for both parties to profit.<sup>35</sup>

### **Breaches of the SCOP**

25. We note that our review did not intend to identify specific breaches of the SCOP but was instead to observe the buyer/supplier relationship more widely and in the specific circumstances of the 'price war'. The SCOP itself is never mentioned explicitly in the communications reviewed. However, we assume that most buyers are aware of the potential consequences of retaining communications that might evidence dubious

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<sup>29</sup>[REDACTED]  
<sup>30</sup>[REDACTED]  
<sup>31</sup>[REDACTED]  
<sup>32</sup>[REDACTED]  
<sup>33</sup>[REDACTED]  
<sup>34</sup>[REDACTED]  
<sup>35</sup>[REDACTED]

communication. In the communications that we reviewed there is evidence that buyers are aware of the liability of recorded communication that relates to possible infringements of competition law.<sup>36</sup> Further, there are examples of buyers acting quickly to end email communications with a supplier where communications might be misinterpreted.<sup>37</sup> In summary, our review has suggested that at least 20 of the 52 practices identified in the 2000 investigation continue to be practised. This analysis is presented in more detail in Annex 2.

### **General conclusions of the review**

26. In general, we observe that communications between buyers and suppliers evidence a healthy relationship between trading partners with a shared objective to do business together while maximizing their own profitability. We have not observed any systematic abuse of the supplier relationship. In some instances we observe buyer communications that might be described as ‘best practice’. For example, facilitative discussions over issues such as waste and product quality, responding positively to requests, courteous communications and appreciation for the suppliers’ business while being effective at representing the retailer’s position.<sup>38</sup>
27. In contrast, there are also instances of buyers communicating in terms that utilize a stronger negotiating position to their advantage including threats about the consequences of a supplier not complying with a buyer’s request for promotional investment.<sup>39</sup> The very nature of the transactional relationship between a buyer and a supplier, particularly in a competitive market, is such that it encourages assertive behaviour.

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<sup>36</sup>[REDACTED]

<sup>37</sup>[REDACTED]

<sup>38</sup>[REDACTED]

<sup>39</sup>Examples of more assertive communications include: [REDACTED].

28. We note that in the context of the amount of correspondence that we have reviewed our general observations are based on a proportionally small number of emails. While it might be argued that such a small number of communications are insignificant within the volume of material provided, the nature of the issues is potentially significant for competition.

### **Scope and limitations of the review of Asda and Tesco's email communications with their suppliers**

1. The CC required Tesco and Asda to produce copies of communications with their respective suppliers over a five-week period (18 June 2007 to 22 July 2007).<sup>1</sup> We undertook this review because general concerns had been expressed by suppliers on the supply chain practices of grocery retailers, and representations had been made to us by Asda, in particular, regarding its pricing negotiations with suppliers and the financing of the 'price war'.
2. The focus of the review was on those employees involved in commercial negotiations with suppliers. It did not include those employees whose contacts with suppliers were more concerned with, for example, logistics management, invoicing and payments, or technical support. Excluded from the scope of the email communications provided to the CC were genuinely personal emails (eg news of family births and holidays).
3. The total number of emails received in this review was 53,640 from Tesco and 126,475 from Asda. Each attachment to an email was counted as a separate email, so this figure overstates the number of actual communications with suppliers, which was 31,598 for Tesco and 74,165 for Asda.
4. Our review concentrated initially on four product categories. These were chosen because they seemed most likely to provide useful insights into the nature of the buyer/supplier relationship. These product categories were:
  - produce and produce joint sourcing;
  - chilled food;

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<sup>1</sup>We served notices on Tesco and Asda under section 109 on 3 August 2007. Following discussions with Asda and Tesco, the notices were reissued in amended form on 22 August 2007.

- bakery; and
  - meat, fish, poultry and eggs.
5. For selected buyers working within these product categories, all emails and attachments were examined. Email inboxes for buyers in other product categories, including groceries, were then sampled on a random basis. On this basis, the total number of emails scrutinized was 23,667 for Tesco and 62,609 for Asda: that is, some 44 and 49.5 per cent respectively of total emails provided to the CC. Asda and Tesco also provided a relatively small amount of hard copy material in compliance with their section 109 notices. This was similarly reviewed and fed into our analysis of the email traffic.

### **Limitations of our review**

6. There are some limitations to the review that we have undertaken. First, the material represents only a snapshot in time and shows only a slice of the email communication between the parties. For this reason, following any particular line of communication and ascertaining its conclusion can be difficult.<sup>2</sup> Second, the emails were generally only one form of communication between any particular buyer and supplier. Our review indicated that there was extensive telephone contact and written communication often confirmed earlier oral communications.<sup>3</sup> In many cases the email communication was additional to conversations which are not recorded.<sup>4</sup>
7. Despite the limitations set out, in some instances the absence of a response in the context of particular communications seemed unusual. For example, there was no response to a supplier requesting a price increase<sup>5</sup> nor to another email where a

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<sup>2</sup>For example: [REDACTED].

<sup>3</sup>For example: [REDACTED].

<sup>4</sup>In reply to our questions on supply chain practices on 3 August 2007, both organizations stated that conversations between buyers and suppliers are not recorded.

<sup>5</sup>[REDACTED]

supplier disputed the rejection by the retailer of produce supplied.<sup>6</sup> Some instances were also found of parties being asked to refrain from putting information into emails.<sup>7</sup>

8. Finally, we note that the scope of the review was limited to only two grocery retailers. However, given the broad similarities observed across the communications of both retailers, we consider them likely indications of communications between most major grocery retailers and their suppliers.

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<sup>6</sup> [REDACTED]  
<sup>7</sup> [REDACTED]

**Email correspondence supplied by Asda and Tesco**

